Global Market View

November 2020

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🟢 Market expected to provide better than normal returns for that market

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🟡 Market expected to provide normal returns for that market

Negative View

🔴 Market expected to provide below normal returns, or negative returns

Ratings are not bound by a specific timeframe; they will change when fundamental conditions change

Don't sweat the small stuff - focus on China

What was the most important economic event in October? Not just in today's C-19 dominated world, but providing a clear direction for global economic development over the next decade or two – or longer?

Amongst the many pieces of global data (positive and negative) over the past month, the one that stood out as arguably the most important in the long term was the world's largest ever IPO of Ant Group (Ant), raising $34billion in Hong Kong and Shanghai. As readers will know, Ant is a Chinese FinTech business offering a digital payment platform with over 1 billion users, and the world's largest money market fund with over 588million users (WSJ). Earnings this year are expected to exceed $10billion.

To put this in context, an IPO values Ant at approximately $315billion, or $15billion more that J P Morgan & Co (at today's market price), the world's most highly valued bank, established in 1871.

The origins of Ant go back to 2004, and the creation of an electronic payment processing system for Alibaba's new trading platform. Ant was carved out of Alibaba into a separate entity in 2014 and today is the world's most highly valued financial services company – all achieved in less than 20 years. Some other important facts and figures surrounding the IPO:

- The IPO was planned for Shanghai and Hong Kong only – typically a US market (Nasdaq) would have been included in order to ensure success of such a large equity event. Chinese companies can now be independent of US capital markets.
- The issue was reported as 870 times oversubscribed (Bloomberg) and described as a 'frenzy'. Individual investors in Hong Kong were using up to 95% leverage to apply for the largest possible allocations.
- Jack Ma, the founder of Alibaba and Ant, was an English teacher in China when he founded Alibaba with $60,000. With an Ant IPO his estimated net worth would be $71billion (Bloomberg), and 18 other employees of Ant would become paper billionaires.

The shocking last-minute cancellation of the Ant Financial IPO sends some very important messages about investment in China:

- In spite of the huge gains China has made in its economic growth, financial regulation has lagged. Governance issues remain a real risk in Chinese companies, and this episode emphasises this fact. Whether the regulators changed the rules at the last minute, or Ant had failed to heed the draft guidelines is neither here nor there - the fact is China remains a relatively high risk investment environment from a governance perspective.
- The political overtones suggest that Ant was becoming too high profile and powerful. Jack Ma, the founder and Chairman, recently dared to criticise publicly the financial regulators in China and the established Chinese banking industry. As is clear, the CCP bears no criticism and Ant (and its shareholders) have paid the price. The message is very strong - the CCP is in control.

- The regulators used "financial stability" as the pretext for the actions on Ant. Stability in financial, social and political matters are the core to the CCP's future plans for China and their own survival, suggesting even greater levels of government control in the future to ensure stability.

It is unclear at this stage whether the IPO will be relaunched in the near term or further out in the future, with a very different valuation and risk profile. However, this event does not derail China's long-term goals. Indeed, President Xi re-iterated last week the goal to double the size of the economy by 2035. The Shanghai market actually rose in spite of the turmoil cause by the IPO cancellation. The long-term investment opportunity remains in place, but with higher governance and regulatory risk.

Why is this news so important?

Apart from the self-evident size of the IPO, this event highlights perhaps the most important long-term development for the world economy; that is, the coming of age of China as an economic (and political) powerhouse and empire builder. The much talked about "China Century" is now a reality, and one that the world and investors can no longer ignore. The sheer size and reach of China is now a defining factor in world economics – and politics.

More relevant facts and figures:

- China has grown at break-neck speed for over 30 years, taking GDP from $360billion in 1990 to $14.3trillion in 2019. Some argue that it is already the largest economy on the planet on a PPP basis. For eg, vehicle production of 27million units in 2019 is now more than double that of the US, and up from 2million in 2000. The combined market cap of Chinese stock exchanges (including Hong Kong) is now greater than $15trillion (vs $30trillion in the US).
- GDP per capita has grown from $730 in 1990 to $8,254 in 2019 – but it is still a long way short of $55,809 in the US. China plans to be "stronger, richer and the world's top innovator by 2035" with an annual GDP growth target of 5% until then.
- China has implemented the Belt and Road Initiative (BRI: https://www.beltroad-initiative.com/belt-and-road/) to create an economic and political empire through investment in, and control over, telecommunication systems and trade channels with its subscribers. Today 138 countries have signed up to BRI, which are estimated to cover more than 65% of the world's population and include developed countries such as Italy, Austria and New Zealand. The project is set to continue this development up to 2049, the 100th anniversary pf the People's Republic of China, and is written into the constitution.
- The Chinese currency, the Renminbi, (of which the yuan is a basic unit), is already a parallel trading currency to the USD within the BRI countries, to be expanded by a crypto version that will be run centrally by China and be backed by large gold reserves – and will bypass the USD.
- China is implementing a "dual circulation" economic strategy, which prioritises the importance of strengthening domestic demand and local technology development over closer integration with the outside world. China currently imports $300bn of semiconductors annually and aims to become self-sufficient by 2025.
- China's economic recovery from the pandemic has been a "success", showing positive GDP growth to date of 0.7%, and more than 3% expected for the year as a whole – the only major economic block expected to show growth for the year as a whole.

The lessons to be learnt

As the "old, democratic world" slides into ever greater debt, demographic headwinds and a C-19 (from China) driven economic torpor, China should continue to grow both domestically and on the back of its new empire, and without the shackles of domestic democratic interference. Control of communications and trading channels has been the backbone of economic empires since time began and is no different today. Companies based in and doing business with China will benefit from these economic developments, but at the cost of political acquiescence (see HSBC). Thus, global economic growth is likely to be increasingly dominated by China and its satellites, while the others will grow at (significantly) slower paces. Chinese equity markets are likely to reflect this in the longer term, while the mature economies' equity markets are likely to reflect their lagging growth prospects.

The choice for investors

Given the likely economic growth differential between China and the other established large economic blocks (the US, Europe, Japan) over the next decade or more, investors face a conundrum. With the prospect of stronger economic growth come important downsides from investing in China:

- A political system that does not appeal to most Western sensibilities and helped generated the C-19 disaster
- The most polluting large country in the world (79.9/100 on one measure vs 38.2/100 for the US)
- The lowest country ESG score (according to Robeco) after, India, Venezuela and Nigeria
- The third lowest corporate ESG scores according to Morningstar, with only Russia and Qatar lower

The trade-off seems clear – do investors accept the downsides, including the very real risk of poor corporate governance and the unattractive social and environmental conditions that come with investing in China, in order to take advantage of the potentially higher investment returns on offer. Or not.

In conclusion....

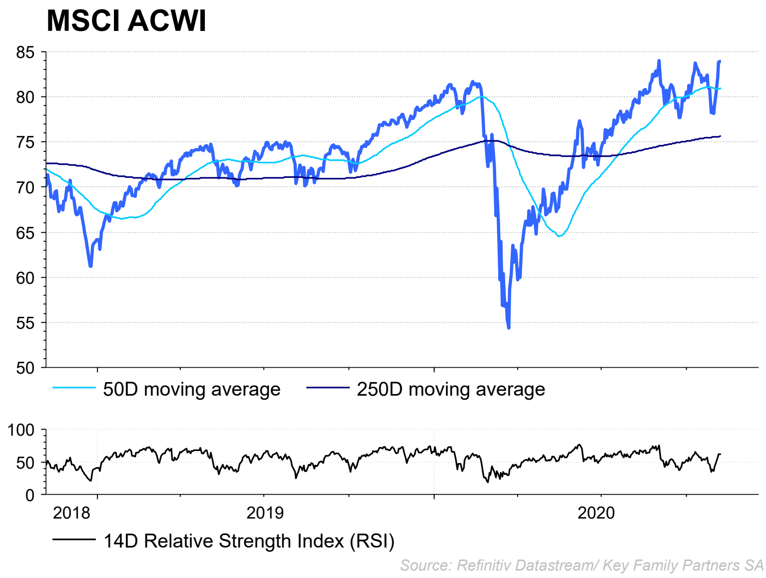
Investment in China cannot be avoided, in spite of political and ESG issues, if portfolio returns are to be acceptable over the next decade or more. But ESG considerations should apply to the selection of investments, with CAVEAT EMPTOR as a top consideration.

EQUITIES

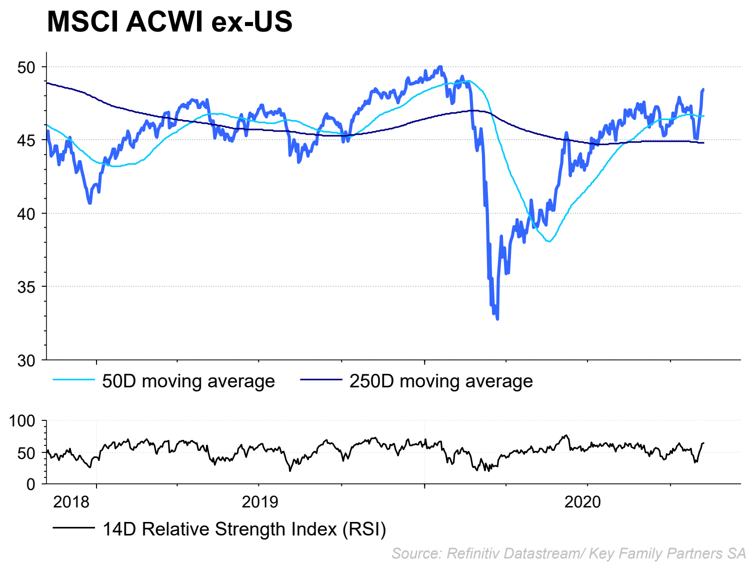
Equity markets sold off again, led by Europe where C-19 second wave lock downs may damage the growth recovery seen in Q3.

GLOBAL EQUITIES

	1 month	YTD	12 month
Global Equity	-2.5%	-2.5%	+2.3%
Global Eq. Ex US	-2.2%	-9.3%	-5.4%



We note that the election results and prospect of a US split Congress was interpreted in November by the markets as the best possible outcome, resulting in a surge in equities this month. This short-term rally takes valuations to even more extreme levels and will be covered in December's newsletter.



Global equities fell again in October, led by new concerns over lock down impacts and some moderate earnings numbers from tech stocks. However, GDP growth numbers for Q3 were stronger than expected worldwide, while PMI numbers for October were still generally positive, especially in China. Sentiment turned neutral/negative while in the short term, equity markets reached oversold levels.

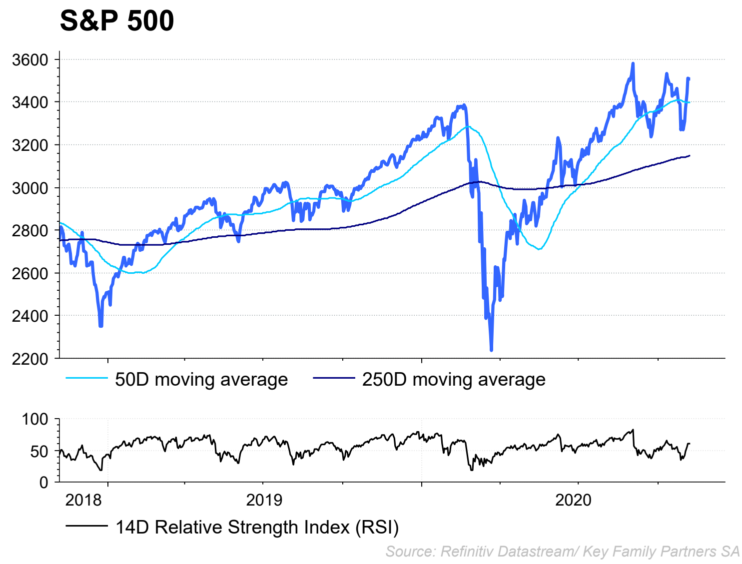
Valuations on adjusted 2020 expected earnings fell slightly to 21.8x from 22.9 and remain elevated on a 10-year view. The outlook remains NEUTRAL.

USA			
	1 month	YTD	12 month
US Equity	-2.8%	+1.2%	+6.6%

The S&P500 fell again in October with prices lower across the board. Q3 earnings, whilst beating estimates overall, were seen as somewhat disappointing – the market wanted even more. Sentiment moved to neutral overall and short-term oversold.

Valuation moved to 23.8x from 25.5x 2020 estimated earnings and remains elevated.

The outlook remains NEUTRAL.



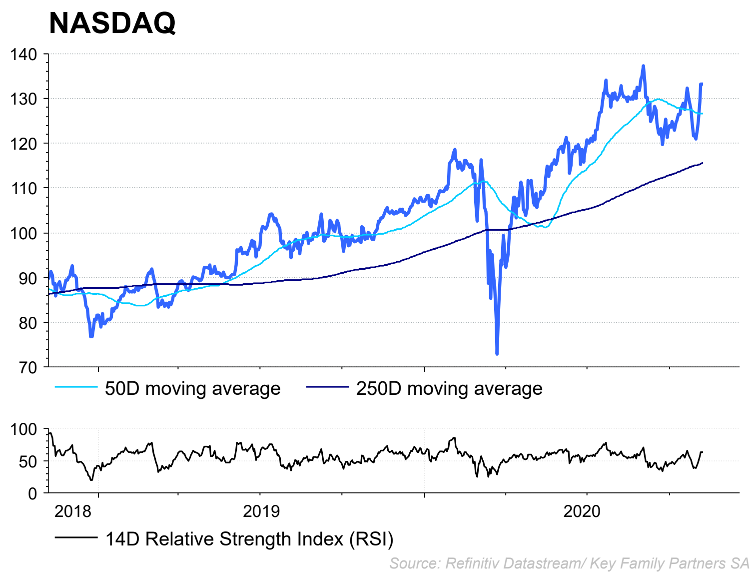
NASDAQ Comp			
	1 month	YTD	12 month
NASDAQ	-2.3%	+21.6%	+30.1%
FANG+ Index	-2.0%	+70.2%	+95.2%

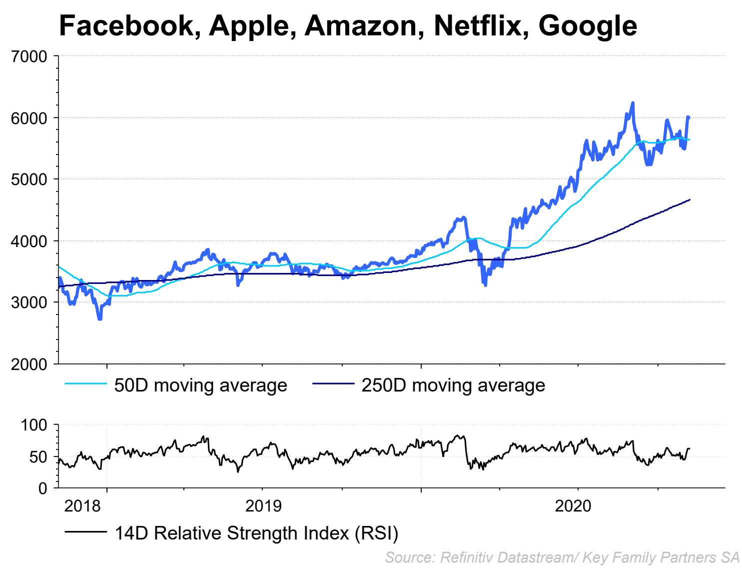
The NASDAQ and FANG+ indices both sold off again in October.

Tech earnings for Q3 were ahead of estimates, but not enough to excite the market. Plus, possible antitrust actions against the Fangs under a new Democratic government rattled investors and the market sold off.

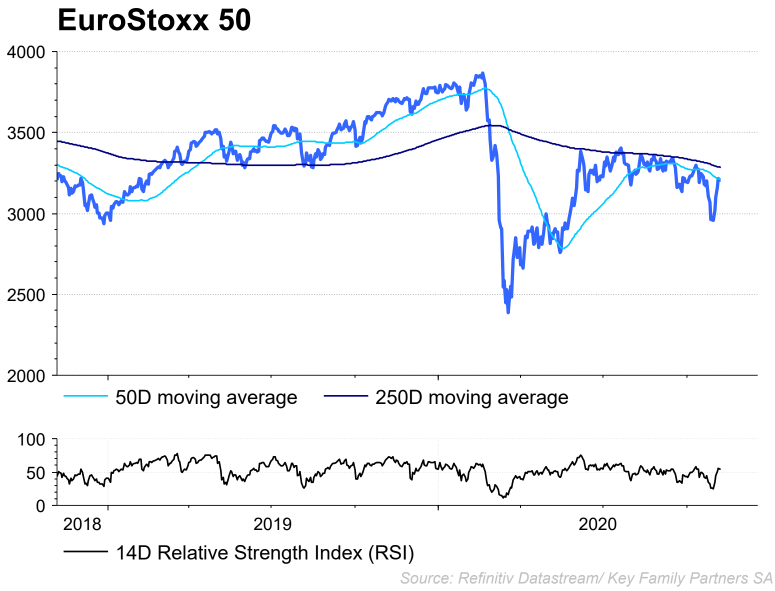
Sentiment turned more neutral for both markets.

Valuation of both indices fell, to 35.7x from 40.4x prospective 2020 earnings for NASDAQ and 41.3x from 43.3x for the FANG+ index, both remaining at elevated levels. The outlook remains NEUTRAL.





EUROZONE	1 month	YTD	12 month
EU Equity €	-7.4%	-21.0%	-18.4%
$	-7.9%	-17.9%	-14.7%



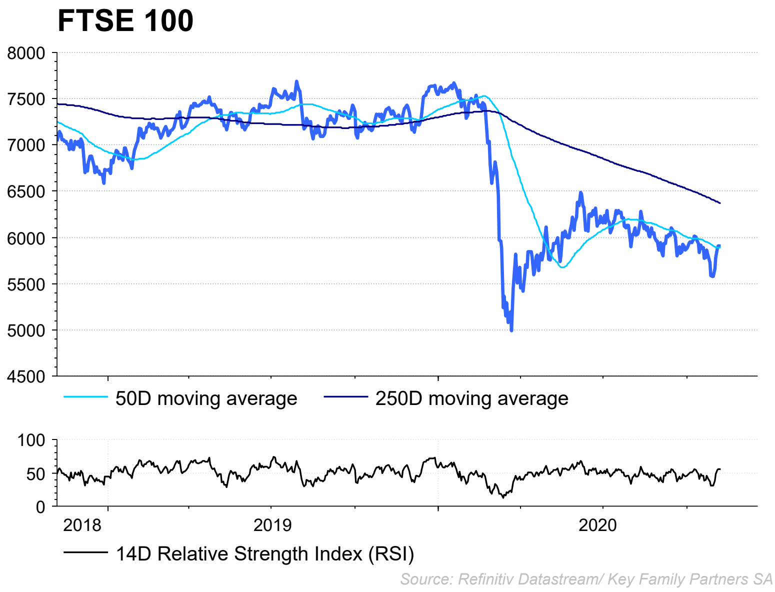
Euro equities sold off again at the end of October on evidence of accelerated C-19 lockdowns in many EZ countries, and in spite of continuing signs of economic recovery across the EZ. The new lockdowns have the potential to derail the recovery.

Valuations fell to 19.2x from 21.3x adjusted prospective 2020 earnings.

The market fell into oversold territory and the outlook moved to NEUTRAL.

The FTSE100 fell again on the month and remains by far the worst performing global market year to date in sterling and USD. This in spite of some encouraging numbers for Q3 and October for the economy.

UK	1 month	YTD	12 month
UK Equity £	-4.9%	-26.1%	-23.6%
$	-4.7%	-27.8%	-23.3%

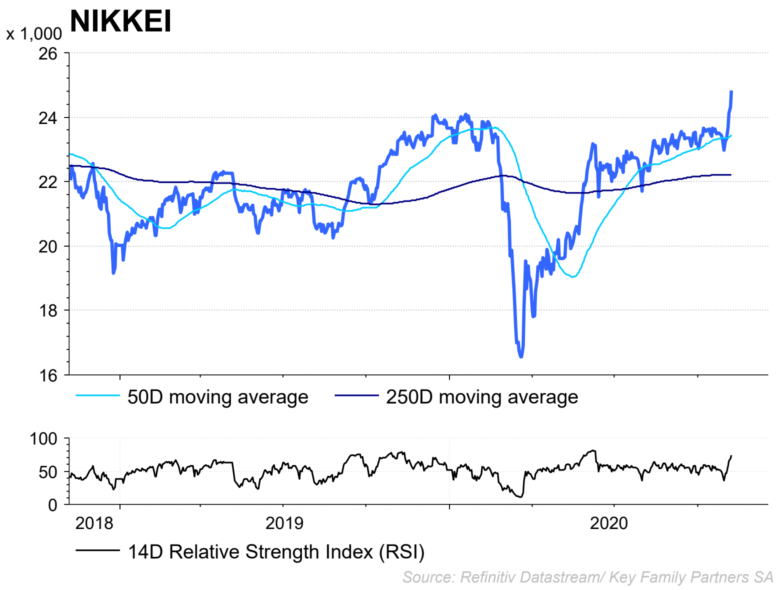


The FTSE100 fell again on the month and remains by far the worst performing global market year to date in sterling and USD. This in spite of some encouraging numbers for Q3 and October for the economy. New lockdown arrangements to control the spread of C-19 have damaged market sentiment even further. Short term the market was oversold. Valuation fell to 18.2x from 19.4x adjusted prospective 2020 earnings, at the top of the 10-year range.

The outlook remained NEGATIVE.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	-0.9%	-2.9%	+0.6%
$	-0.1%	+0.8%	+4.6%

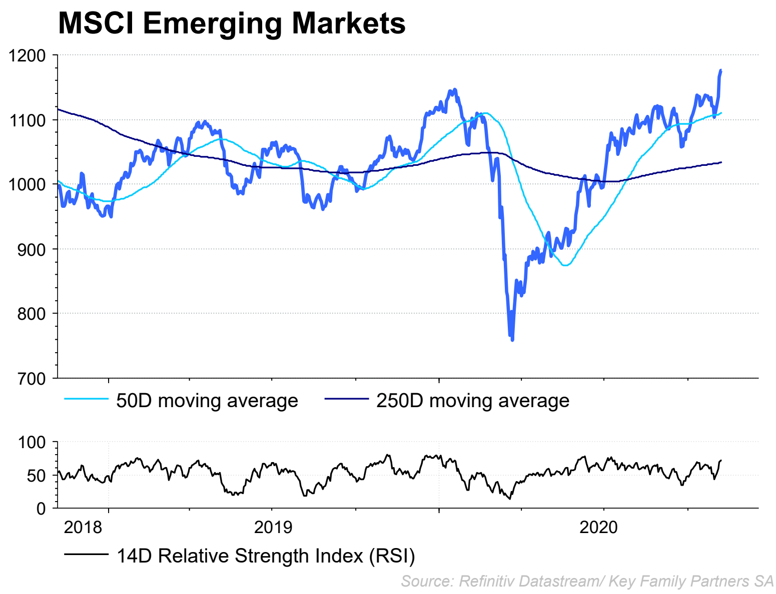


The Nikkei fell slightly for the month – the best performing of the DM markets on an absence of major news. Sentiment remained neutral/positive in the short and longer term.

Valuation fell to 22.8x from 23.2x adjusted 2020 earnings, making the market expensive on a historical basis. Overall the outlook remains NEUTRAL.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity £	+2.0%	-1.0%	+5.2%



EM equities had a strong month in October on the back of a continued strong recovery in China's economy. Chinese equities were up 3.9% for the month and 19.3% year to date (in USD).

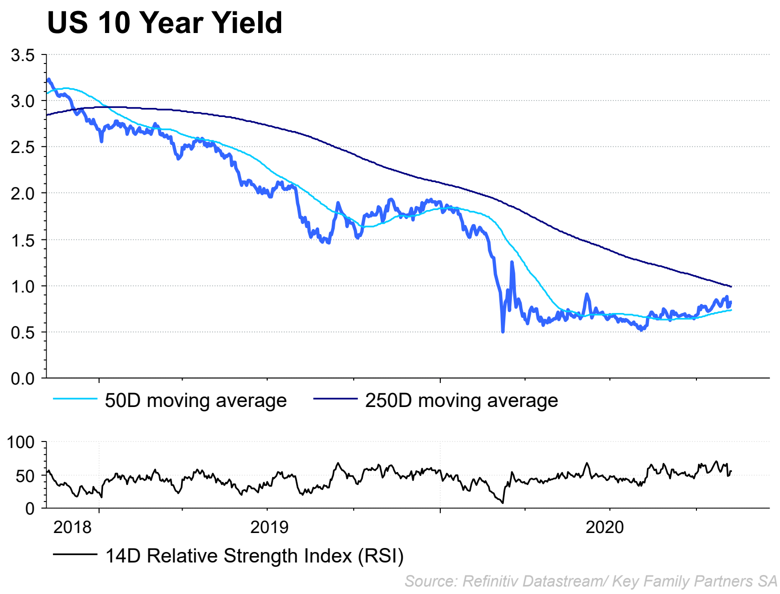
Valuations fell to 17.7x from 17.8x prospective earnings keeping EM equities in the top range of valuations over the past 10 years. Sentiment remains positive.

The outlook remains NEUTRAL with a positive bias.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	-0.80%	+7.88%	+7.19%



Yields on 10 year Treasuries rose to 0.87% from 0.68% and 10-year inflation break even rose to 1.70% from 1.64%.

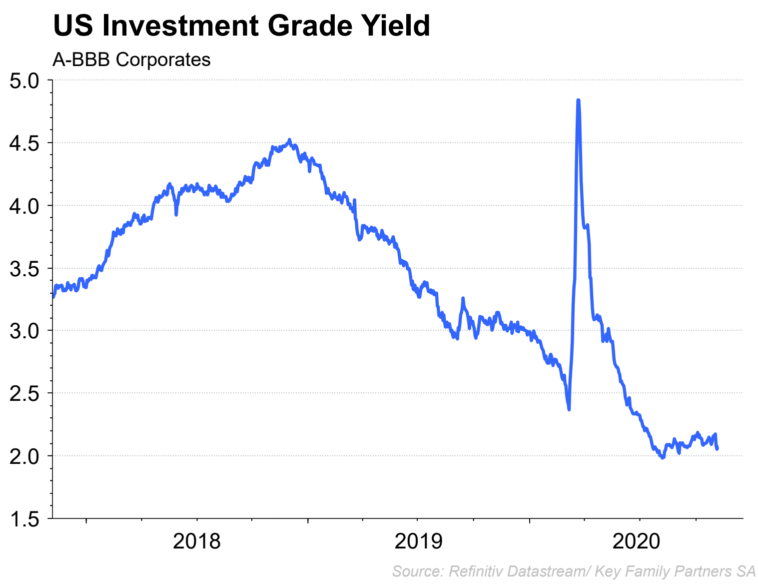
Yields on longer dated Treasuries are now clearly on a rising trend as inflation expectations tick up. Further disruption in supply chains from new lock down measures could fuel further price rises.

Longer term leading indicators for future inflation continue to rise (not shown).

The outlook remains NEGATIVE on a deteriorating inflation outlook.

Investment Grade

	1 month	YTD	12 month
US Inv Grade Total return	-0.20%	+6.45%	+7.24%



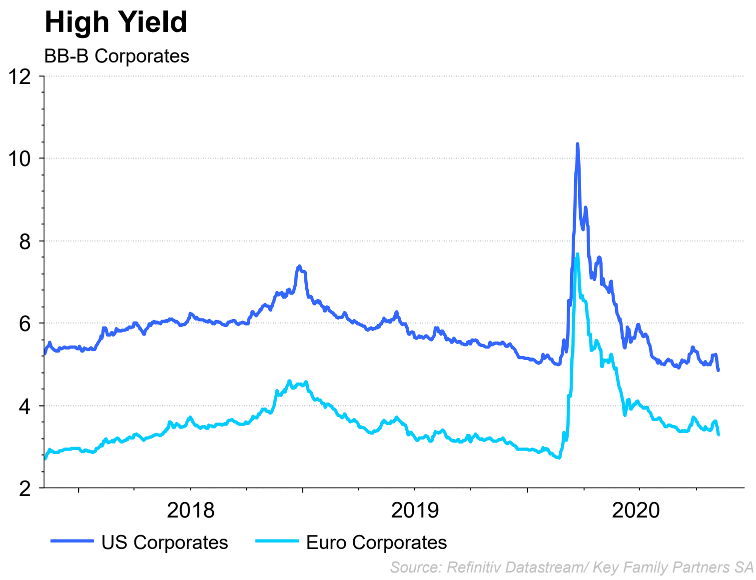
Yields on investment grade corporates increased slightly to 2.03% from 2.01% while spreads fell to 125bps from 135bps.

Risk of default (the spread) fell slightly over the month as the economy continued to recover, absorbing the rise in Treasury yields. Spreads can narrow further if the economy continues to recover as expected – C-19 willing.

The outlook remains NEUTRAL given the Fed support measures for the sector and the still attractive spread over Treasuries.

High Yield

	1 month	YTD	12 month
US High Yield Total return	+0.35%	+1.13%	+3.37%



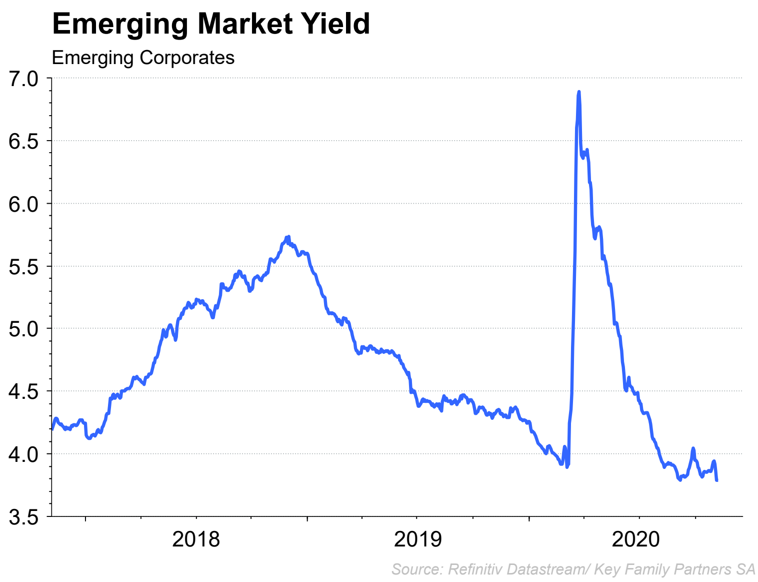
US HY bond yields were flat at 5.77%, while spreads fell to 508bps from 537bps.

Spreads and yields should stay flat as long as the economy continues on its recovery path – spreads can fall further thereby supporting the price of high yield bonds.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	-0.11%	+1.81%	+3.39%



Yields on EM USD debt were essentially flat over the month closing at 4.09%, from 4.07%. from 4.17%

Spreads fell further to 339 bps.

As economic growth recovers in EM, led by China, and US domestic rates stay lower for longer, EM USD debt should remain attractive to investors.

The outlook remains NEUTRAL with a positive outlook.

CURRENCY – USD vs DM, EM

USD vs DM currencies

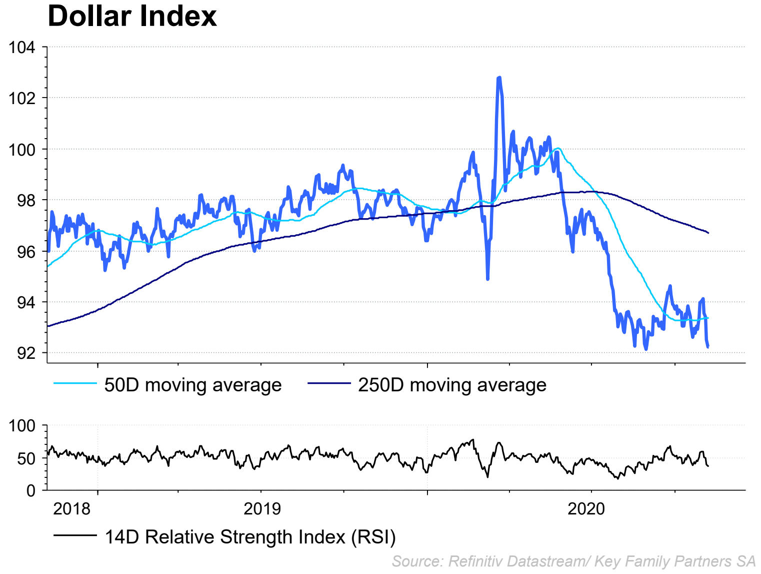
The USD finished the month flat against other DM currencies based on the DXY Index.

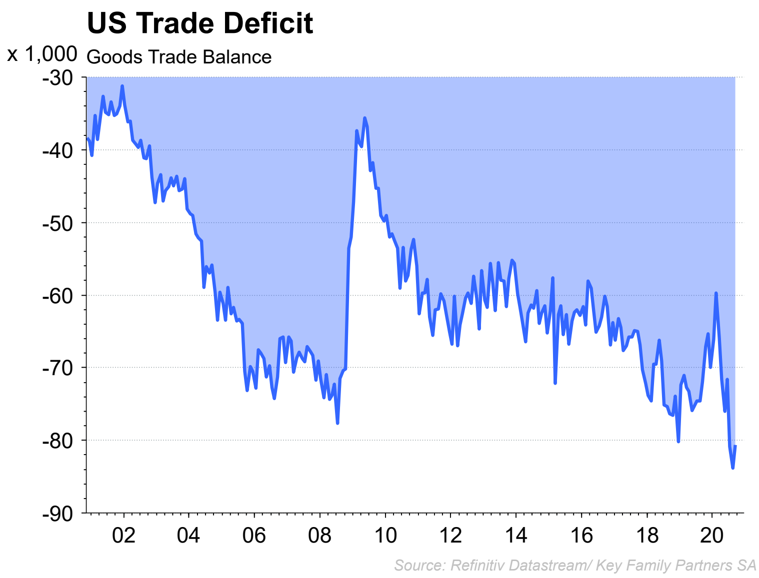
The principal component of DXY is the Euro, which paused its recovery against the USD in the month as new lockdown measures dented confidence in the Eurozone recovery.

At the same time the US trade deficit continues to balloon at an alarming rate in spite of all the tariffs imposed on imports to the US in recent years – which were meant to "re-shore" production into the US. So far this does not appear to be happening.

Longer-term sentiment remains negative towards the USD.

The outlook remains NEUTRAL short term, but with further downside risk longer term.





CURRENCY – USD vs DM, EM

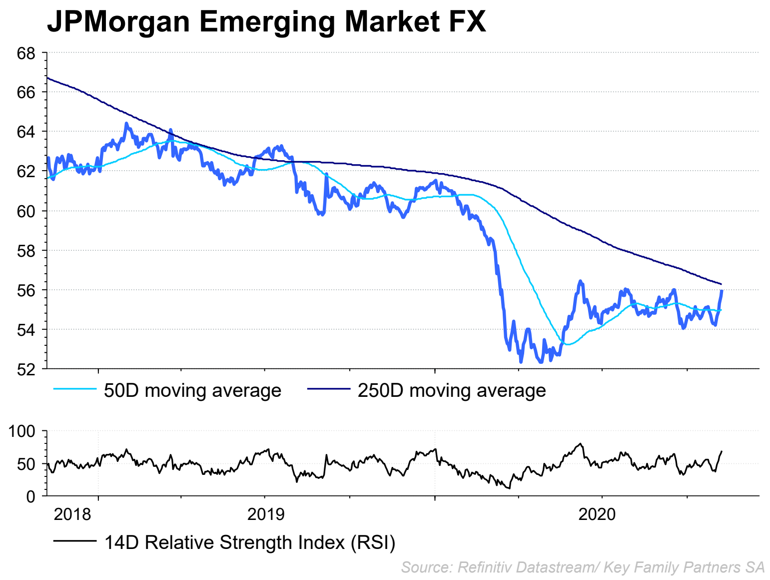
EM currencies vs USD

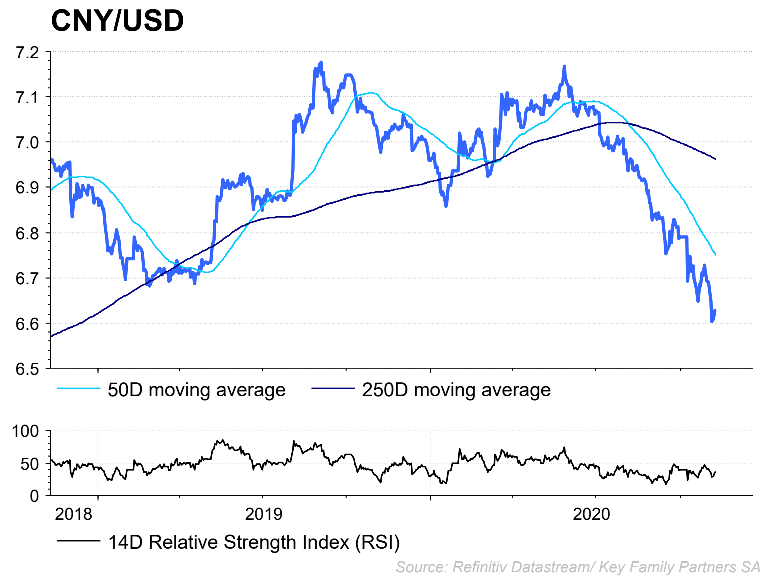
Overall EM currencies continued their recovery against the USD in the month, led by China again, but with the Mexican Peso also showing some strength.

Currency flow monitors show central bank reserves increasingly flowing from USD into CNY to take advantage of higher rates on government bonds, currently offering 3.19% on 10-year bonds.

The other main BRIC currencies, however, remained in decline vs the USD.

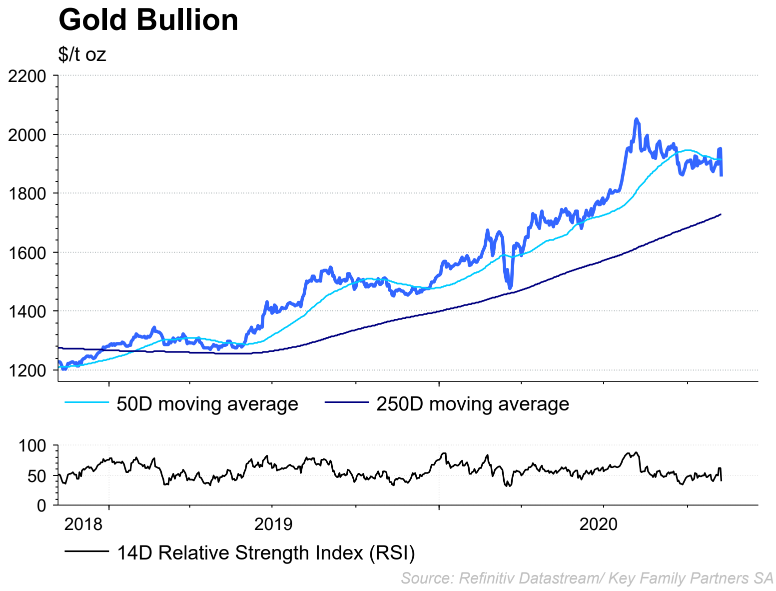
EM currencies outlook overall remains NEUTRAL with a positive longer term outlook.





GOLD

	1 month	YTD	12 month
Gold	-1.1%	+23.8%	+27.0%



Gold continued to trade sideways as the long end of US Treasury yields picked up and the yield curve steepened slightly. A pause after such a strong rally over the past 12 months is not unusual.

However, real yields (ie after inflation) on the USD remain deeply negative (-1.6% approx. on a 3-month outlook) which is the main factor for gold prices remaining supported. As inflation rises and the Fed keeps rates low, negative real rates may even widen.

The outlook remains POSITIVE.

COMMODITIES

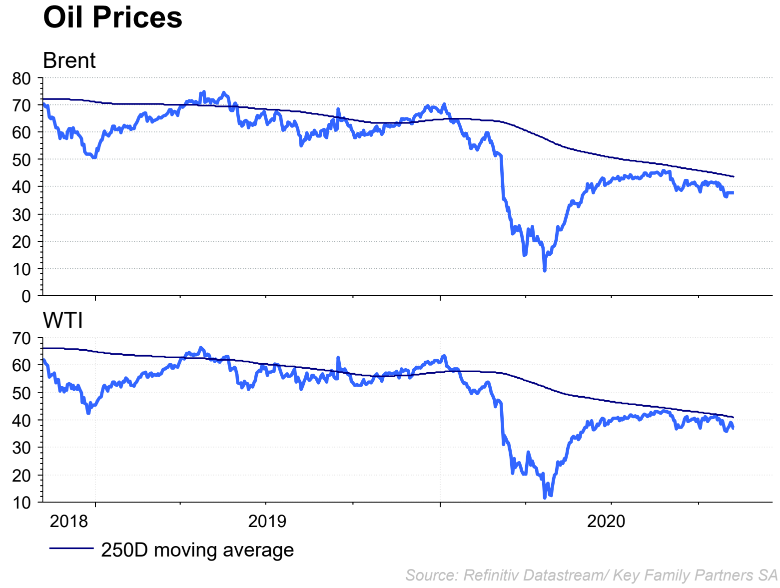
OIL

After a recovery early in the month, oil prices once again sold off on fears of demand reduction from the impact of renewed lockdowns – for eg, airlines reducing service levels even further.

The oil price will be very sensitive to the prospects for economic recovery from C-19, while supply stays fairly constant

Oil is again in oversold territory and could see a short-term recovery from here.

The outlook for oil remains NEUTRAL.

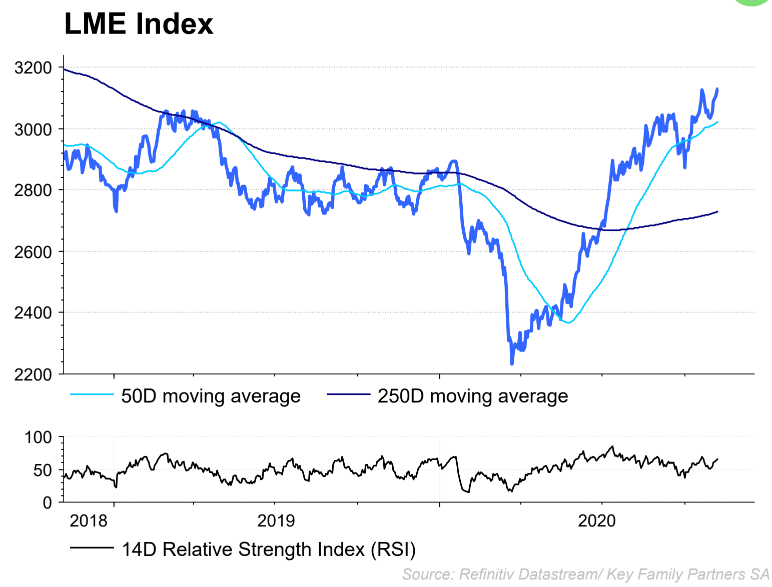


METALS

Metal prices as a whole rose again on evidence of demand from China – the world's largest consumer of metals of all types.

Copper remains the bell weather for global economic growth, and prices recovered during the month. Copper remains the main beneficiary of the electrification of everything while supply cannot easily be expanded without new mining projects.

The outlook remains POSITIVE.



ILLIQUID ASSETS

Real Estate	🔴	No change from previous month
Hedge Funds	🟡	No change from previous month
Private Equity	🟡	New opportunities for PE investors are likely as the economy slows and credit becomes scarcer. New investments going forward should attract better pricing than seen in the past 2 years.

Disclaimer

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