ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

MARKET COMMENTARY

January 2020

2020 Foresight

As 2019 drew to a close, nearly all global stock markets enjoyed a final flurry to round off an unusually strong year. The S&P-500 hit a new all-time high, returning over 30% for the year including dividends. Seven of the top ten performers came from the tech sector, with Apple up almost 90%. Continental Europe also had a great year, but based on a much more broad-based rally with consumer and industrial stocks faring particularly well. The UK benefitted from the so called 'Boris Bounce', following his huge election victory on December 12th and investors with a focus on domestic companies in the mid-cap category were well rewarded. Japan enjoyed a steady year of 20%+ gains and the wider Asian region moved in a similar direction as trade war tensions eased. Emerging markets generally joined in with the party, although Argentina and Chile were the notable laggards following major political unrest.

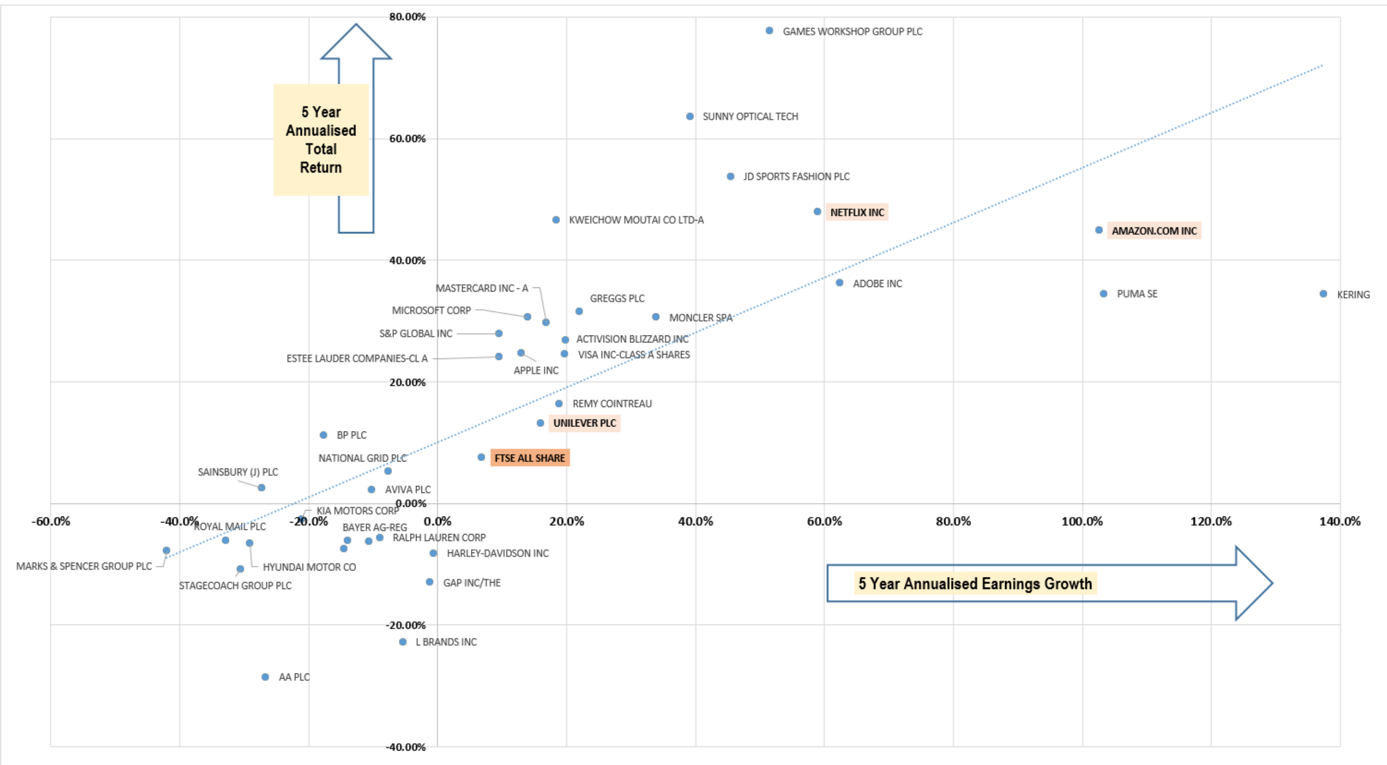
The main reason for the surge in equities arguably came from the US Federal Reserve's decision to cut interest rates three times, rather than raise them, through the course of 2019. At the end of 2018, consensus expectations were that the effective rate would move up from 2.25% to around 3% today; the fact they fell to 1.55% proved to be a huge policy U-turn. Longer dated bonds are the most sensitive to rate movements and, as expected, they generally benefitted the most. However some did better than others and one of the stories of the year was the behaviour of an Austrian government issue (the 'century bond') with a maturity date of 2117, that in August was showing an 80% return. This is a dramatic example of how changes in expectations can fuel incredible returns in the financial markets. It also illustrates the peculiar nature of the term structure across global bond markets following a prolonged period of quantitative easing.

Elsewhere, the oil price rallied by a third, in contrast to natural gas down 25%. Gold and precious metals had an excellent year with palladium up almost 60%. After sideways movement for many agricultural commodities for much of 2019, a powerful rally in the final quarter saw most close in positive territory with coffee leading the way, spiking 40% at one stage as Brazilian supplies dried up. As with every asset, price changes are always explained by demand and supply.

So which stock markets across the world look good for 2020? Or rephrased, which country will see its shares see the greatest demand and in so doing push the prices up most? This seems like an over-simplistic way of wording the question, but large swathes of the finance industry like to complicate matters in order to try and justify their fee. Make no mistake there is no secret recipe, no holy grail, but when a question is framed in basic terms, the mysteries of the stock market start to fade and explanations become easier to understand.

The short answer is that we find it very difficult to predict which region is the most favourable, but the broader trends seen over the last five years or so look set to continue. Consequently, we think that the market will continue to reward those companies that grow their earnings consistently, irrespective of the economic cycle. The chart below illustrates this point very clearly.

EARNINGS GROWTH VS TOTAL RETURN ACROSS THE WORLD: 2014 - 2019



Source: Bloomberg®, Albert E Sharp

Noticeably, many of the best performers (top right quadrant) come from the technology sector and the laggards are more exposed to the economic cycle (bottom left quadrant). In the case of Amazon or Netflix, it is unsurprising that investors clamour for exposure to the explosive growth rate in earnings. Maybe it is more instructive to understand what Unilever has done to achieve a much better share price performance than the wider FTSE All Share index. The chart shows that over the last five years, the share price has grown at 13% annually, with earnings growing at 16%, compared to the broad FTSE All Share Index, with an 8% annual return on earnings growth of 7%. Annualising the returns visually dampens the impact of the difference of returns in the chart, because over 5 years, the index is up 44% and Unilever is up more than twice as much, at 94%.

Clearly, superior earnings growth is a key reason but there is more to it than that. We would argue that it is the consistency and visibility of the earnings stream that have proven so attractive. Will a war with Iran reduce demand for Dove soap or would a Corbyn government have threatened sales of Domestos? Probably not, and this perceived resilience to external shocks or wider issues such as the health of the global economy provides a peace of mind that investors cherish.

What happens if all of a sudden, economic growth picks up? Corporate investment increases and consumers start buying new cars and moving house for example? In this instance, companies that are exposed to the economic cycle will see their prospects improve, and possibly quite dramatically. Typically, companies that sell furniture, business travel and electronic goods do well – but will Unilever suddenly start selling more Bovril? Probably not.

UK Equities

So, starting with the UK, what are the chances of a cyclical upswing? Now that Brexit uncertainty is supposedly receding there is a good case to be made for a pick-up in consumer confidence, especially if we see a return of international investors to both the public and private markets. That said, with interest rates unlikely to move much and giveaway budgets a thing of the past, we can't see that the central bank or government will do much to provide a stimulus. That said, if the US-China trade relations improve, this would be good news. However the fact remains that global manufacturing is in a downturn, the IMF still describes GDP growth as 'sluggish' and any improvements through 2020 seem unlikely to be material.

In which case, we find it very difficult to make a case to suddenly start building exposure to cheap UK cyclical stocks, in the hope that they will take off when the economy heats back up. The great news is that there are still plenty of fantastic companies in the UK, that should fare well over the long term, regardless of the economic climate. Valuations remain reasonable; Unilever is trading on almost exactly the same valuation today as it was five years ago, for example. However - do not misunderstand, Unilever is not the silver bullet here. What we would say is that investors stick to a plan: focus on quality, avoid speculating on companies with 'giveaway' valuations and show patience, remembering not to overlook the small and mid-caps.

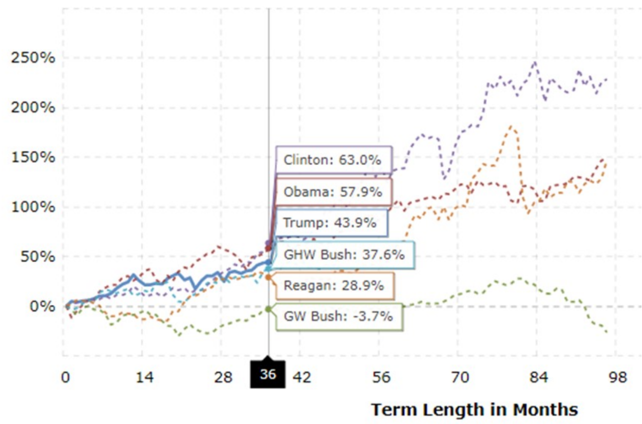
Stick to a plan: focus on quality, avoid speculating on companies with 'giveaway' valuations and show patience

US Equities

We could say much the same for the US but here it is difficult not to pass comment on the upcoming presidential election. No matter how much analysis one does on the non-farm payroll data or the composition of the budget deficit, what seems certain is that Trump will do everything in his power to make sure the vote coincides with the stock market hitting an all-time high. Right now after 36 months there is still ground to be made up and if he wants to be ahead of his recent rivals in November, the S&P-500 needs to move up by just over 20% in the next 10 months or so.

Trump will do everything in his power to make sure the vote coincides with the stock market hitting an all-time high

The S&P-500 Race: The Last Six Presidents



Source: Macrotrends.com

This supports the case for tech. Given that Facebook, Apple, Google, Microsoft and Amazon represent a fifth of the S&P-500 index, Trump seems very unlikely to push for anti-trust lawsuits or windfall taxes given the negative impact on share prices. In terms of guessing the outcome of the election – and guesswork is exactly what it is right now – the fact that three quarters of all incumbents win a second term provides us with a base case that Trump will be in power this time next year. In the absence of rising rates, this has to be good for share prices.

Continental Europe Equities

With global growth still sluggish and Continental Europe one of the key reasons, as illustrated by France and Germany currently on the verge of recession, it is maybe something of a surprise that their equities fared so well last year.

The reason quite simply is that the best-performers could be better categorised as 'global' than 'European' with most of their sales derived outside their home markets. Even if one makes the case that the departure of the UK triggers the downfall of the EU, it doesn't prevent Adidas from selling millions of running shoes to China. One should be very careful in making a link between the economic health of a region with the prospects for its stock market. We see plenty of rich pools of opportunity for fund managers to produce excellent returns over the next few years, so long as they know where to fish. That said, the Euro Stoxx 50 is still below its 1999 peak in price terms, underlining our ongoing belief that an active approach here is preferable to a passive one.

Be very cautious about making a link between the economic health of a region with the prospects for its stock market

Japan Equities

Japan gets the biggest pushback from clients, in our experience. Headlines regarding the ageing population, stubbornly low inflation and growing poverty make the outlook appear very bleak at times. However, media headlines should never be the basis of an investment decision. One of the features that we like in Japan is the number of under-researched companies following the collapse of the stockbroking industry several years ago. This gives resourceful fund managers a major opporuntity and highlights the market inefficiencies that exist here. The Nikkei-225 has outperformed the FTSE All Share over the last five years and some of the more successful funds are close to trebling in value. With valuations remaining markedly below the long-term average right now, avoid Japan at your peril.

Media headlines should never be the basis of an investment decision

Asia and Emerging Markets Equities

Over the next few years it looks likely that the Asia ex-Japan category will see China fully split out, following a slew of mainland companies entering global indexes. Nevertheless it is difficult to discuss Asia without mentioning China and we find the dynamics irresistible from an investment perspective. According to the Brookings Institute, 88% of the next billion people to enter the middle classes will be from Asia. Furthermore, by 2030 Asia will represent two thirds of the global middle class, up from one third today. Growing at 6% in India and China compared to 0.5% in the US and Europe, the Asian middle class will spend an additional $20 trillion per annum by 2030. Countless companies in the consumer sector have already benefitted from this (including Unilever) but expect to see new home-grown brands gain popularity and blossom over the next few years. Consequently, despite worries over the banking system, corporate governance, and human rights, the universe of great companies in Asia is enormous.

Exactly the same line of thought applies to the wider emerging markets. Local political and currency risks are always a worry but can be dealt with through international diversification.

In summary, we remain optimistic on global equites, seeing the glass as half full. A repeat of 2019-sized returns would be surprising but we think that the chances of the bull market continuing its shallow ascent are favourable. The main threat to this view would come from a change in outlook regarding the direction of US interest rates.

We remain optimistic on global equities, seeing the glass as half full

Fixed-Income

Remembering that the price of bonds is inversely related to interest rates, we find it difficult to take a generally positive stance on the asset class given the very clear comments from the US Federal Reserve there is likely to be no change in 2020. The US is only one part of the picture, but their rate positioning impacts nearly every sub-category in the fixed-income universe, especially government debt. So with interest rates in most of the developed world below 2%, and in many cases negative after inflation, it is hard to see value, unless one is expecting the global economy to take a sudden lunge lower.

However, as we previously remarked, prices change because of demand and supply and the Austrian 'century bond' was a great example of how strange things can happen. Government bonds with a 100-year maturity are rare and the short supply made them become very attractive when rates were unexpectedly cut. The supply structure is a crucial factor in fixed-income analysis. As one looks more closely, opportunities start to appear, and this is why we think active management is so very important here. Comparing corporate debt, emerging market local currency issues or even mortgage-backed securities requires expertise and we are happy to outsource this task, especially to specialists who can access areas that we cannot. Bonds still play a crucial part in a portfolios, but a duty of care is required.

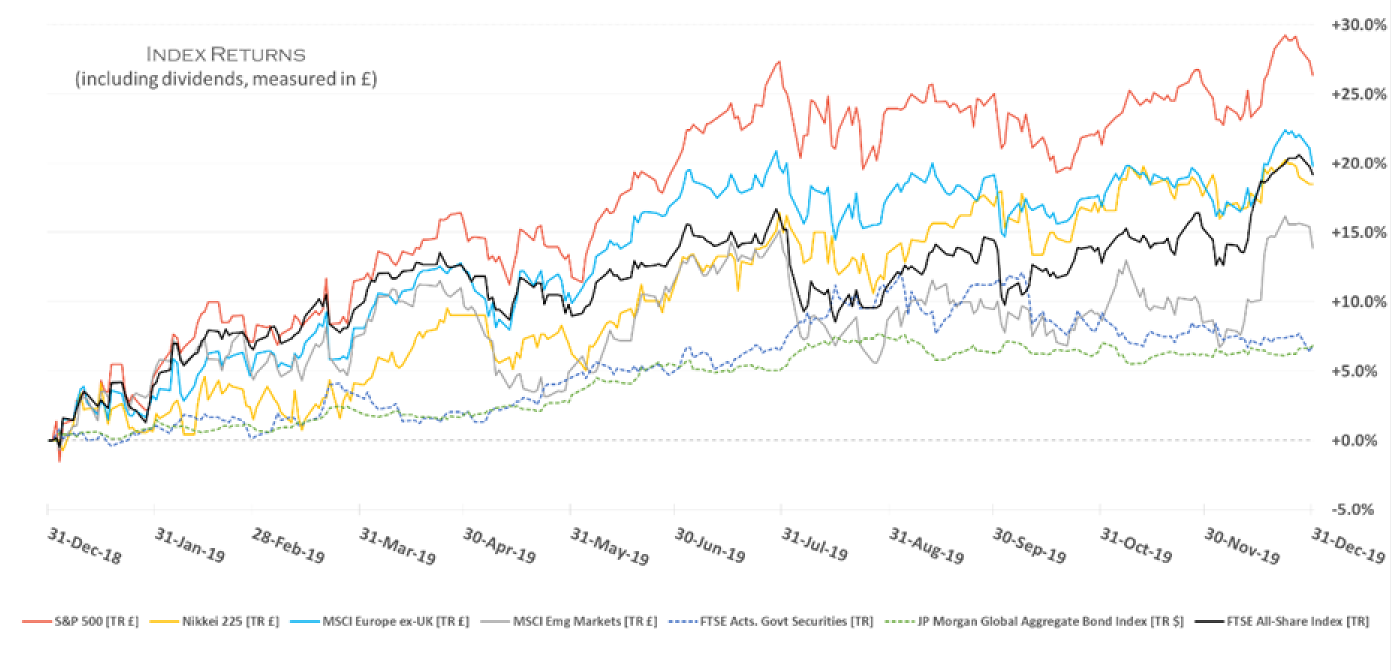
Property

The UK property sector had a mixed year with some open-end funds struggling to deal with redemptions seemingly due to Brexit uncertainties, whilst some investment trusts benefitted from discounts narrowing. The mood is still somewhat gloomy, but with yields topping 4% and alternative rates so low, money could return here quickly if conditions normalise.

In conclusion, the message is to stay diversified, focus on quality and do not get tempted into speculation. This strategy has worked well over the last few years and with the global economy expected to chug along we see no see no reason to change. If it ain't broke, don't fix it.

INDEX RETURNS

Index	Region/Asset Class	31 Dec 2019	1 Month Change	1 Year Change	2 Year Change
UK 100	UK	7,542.4	+2.7%	+12.1%	-1.9%
UK Mid Cap	UK	585.8	+4.2%	+21.8%	+2.3%
UK Small Cap	UK	5,950.5	+5.9%	+14.9%	+0.7%
Dow Jones Ind Avg	USA	28,538.4	+1.7%	+22.3%	+15.5%
S&P 500 Index	USA	3,230.8	+2.9%	+28.9%	+20.8%
NASDAQ Comp.	USA	8,972.6	+3.5%	+35.2%	+30.0%
Nikkei 225	Japan	23,656.6	+1.6%	+18.2%	+3.9%
Euro Stoxx 50	Europe	3,745.2	+1.1%	+24.8%	+6.9%
CAC 40 Index	France	5,978.1	+1.2%	+26.4%	+12.5%
DAX Index	Germany	13,249.0	+0.1%	+25.5%	+2.6%
Milan Index	Italy	23,506.4	+1.1%	+28.3%	+7.6%
MSCI Emg Mkts (£)	Emg Mkts	594.9	+4.9%	+13.9%	+3.3%
IBOVESPA Index	Brazil	115,645.3	+6.8%	+31.6%	+51.4%
IMOEX Index	Russia	3,045.9	+3.8%	+28.6%	+44.4%
S&P BSE SENSEX	India	41,253.7	+1.1%	+14.4%	+21.1%
Shanghai SE Comp.	China	3,050.1	+6.2%	+22.3%	-7.8%
Hang Seng	Hong Kong	28,189.8	+7.0%	+9.1%	-5.8%
UK All Property	UK Property	132.8	-0.3%	-1.0%	-2.4%
UK Conv Gilts	UK Gilts	3,858.8	-1.3%	+6.9%	+7.5%
UK Index linked Gilts	UK IL Gilts	5,209.6	-1.7%	+6.4%	+6.1%
JPM Glob Agg. Bond ($)	Global Bonds	511.7	+0.6%	+6.8%	+5.6%
iBoxx Non-Gilt	UK Corp Bonds	366.4	-0.1%	+9.3%	+7.6%
WTI Crude ($/barrel)	Oil	61.1	+10.7%	+34.5%	+1.1%
LMEX	Base Metals	2,843.3	+3.4%	+1.5%	-16.8%
Gold Spot ($/oz)	Commodities	1,517.27	+3.6%	+18.3%	+16.5%
S&P Agri & Livestock	Agriculture	691.89	+3.5%	-2.1%	-8.2%
£1 = US$	Currencies	1.33	+2.6%	+3.9%	-1.9%
£1 = €	Currencies	1.18	+0.7%	+6.3%	+5.0%
£1 = Yen	Currencies	144.07	+1.8%	+3.0%	-5.4%



ALBERT E SHARP
INVESTMENT MANAGEMENT & STOCKBROKING

WWW.ALBERTESHARP.COM

7 Elm Court
Arden Street
Stratford Upon Avon
Warwickshire
CV37 7LN
☎ 01789 404000

The views expressed in this report are not intended as an offer or solicitation for the purchase or sale of any investment or financial instrument. The views reflect the views of Albert E Sharp at the date of this document and, whilst the opinions stated are honestly held, they are not guarantees and should not be relied upon and may be subject to change without notice. Investments entail risks. Past performance is not necessarily a guide to future performance. There is no guarantee that you will recover the amount of your original investment. The information contained in this document does not constitute investment advice and should not be used as the basis of any investment decision. Any references to specific securities or indices are included for the purposes of illustration only and should not be construed as a recommendation to either buy or sell these securities, or invest in a particular sector. If you are in any doubt, please speak to us or your financial adviser as appropriate.

Issued by Albert E Sharp, a trading name of Albert E Sharp LLP which is authorised and regulated by the Financial Conduct Authority (488822). © Albert E Sharp LLP 2020. Registered in England & Wales with the partnership number OC339858.