Investments

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Quarter Three Commentary

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INTRODUCTION

Brexit aside, the big story through the summer was the continuing – and escalating – trade war between the US and China, with neither Donald Trump nor Xi Jinping looking like they will back down any time soon.

The US has now placed tariffs on a wide range of Chinese imports, with the latest list including electronic products and consumer goods such as handbags. Beijing has not been slow to retaliate, especially targeting agricultural imports – a move likely to hit Trump's Republican base as the US mid-term elections approach.

In Europe, Greece finally emerged from its bailout programme, just as Argentina gave every indication of becoming the 'new Greece' as it went cap-in-hand to the International Monetary Fund.

Back in the UK, the warm weather and the World Cup gave a boost to the retail sector, but even that was not enough to stem the tide of gloom from the national high street.

In company news, Apple won the race to become the first company valued at a trillion dollars (approximately £770bn) and has subsequently been joined in that exclusive club by Amazon.

What of world stock markets in the quarter? It was a mixed performance: the FTSE-100 drifted downwards and Greece was significantly down despite the bailout, while other markets recorded some good gains and the US stock market continued to show its love for President Trump. Let's dive into all the detail...

UNITED KINGDOM

The quarter opened with real optimism around England's chances of reaching the World Cup final, with the Centre for Retail Research (CRR) estimating that it would have been worth £2.7bn to the economy.

We know now that it did not happen, but England's progress to the semi-finals still gave the economy a significant shot in the arm, with Professor Joshua Barnfield, the CRR director, estimating that every goal England scored would be "worth £165.3m to England's retailers and an extra £33.2m to pubs, hotels and restaurants."

Sadly, the third quarter of the year once more told an unremitting tale of gloom for our high streets, despite the Bank of England talking of "greater confidence" and "increased consumer spending." The quarter started with both Poundworld and Mothercare announcing plans to close stores, saw House of Fraser go into administration (to be bought by Sports Direct boss Mike Ashley) and ended with Debenhams pondering the closure of 80 stores and profits at John Lewis crashing by 99%.

There were two encouraging signs as the Coca Cola Company bought Costa Coffee and Tesco announced a major investment in its cut-price retailer, Jack's, as it went into battle against the discount chains Aldi and Lidl, but the future continues to look bleak for UK retail. Do not be surprised if Philip Hammond announces further measures to try and 'level the playing field' in his Budget (which will be on 29th October) but he is almost certainly fighting a losing battle.

The long-awaited rise in UK interest rates duly arrived in August. The move – from a base rate of 0.5% to 0.75% - had been long expected, with the economy strengthening, consumer spending gradually rising and the Bank of England seeking to get inflation closer to its target rate of 2%.

As far as the numbers went, the Office for National Statistics reported that UK GDP rose by 0.4% in the second quarter of the year and the growth rate for the last three months of 2017 was revised upwards from 0.4% to 0.5%. Unemployment continued to fall and by September was down to 1.36m to give the UK an unemployment rate of 4% - the lowest for more than 40 years. However, inflation did edge back up to 2.7%, the highest level for six months.

On the stock market, the FTSE-100 index of leading shares drifted down through the quarter. Having ended June at 7,637, it closed September at 7,510 for a fall of 2%. The pound was 1% lower against the dollar over the quarter, ending at $1.3031.

UNITED KINGDOM

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BREXIT

Three months on from our last report, there is a feeling of déjà vu where Brexit is concerned. We are now less than six months away from the date on which the UK will – in theory – leave the EU. Theresa May has presented her 'Chequers' plan for Brexit, only to see it dismissed out of hand by Tory MPs from all sides of the party, with the EU's chief negotiator Michel Barnier dismissing it as unworkable.

The Prime Minister then went off to Salzburg to meet the other European leaders and according to your viewpoint was either 'ambushed' or got exactly what the UK's negotiating position deserved.

The sum of all that sound and fury is, so far, nothing. Theresa May further set out her position in a set-piece speech at the Conservative Party Conference and no doubt the negotiations will begin again. Whatever deal she brings back to the Commons seems highly unlikely to satisfy the ardent Brexiteers (who now favour a 'Canada style' deal with the EU, which we discuss below) or the pro-EU wing of her party. The Labour Party seem committed to vote against everything in the hope of securing an early General Election.

Despite the dire warnings from industry, a 'no deal' Brexit is looking increasingly likely – as is the possibility of Article 50 being extended. Do not be surprised if it is pushed back beyond 29th March next year to allow time for a compromise deal to be hammered out.

What is a canada style trade deal?

The EU has negotiated 35 trade deals for member states, with another 22 pending. Perhaps its most ambitious is with Canada, a deal known as the Comprehensive Economic and Trade Agreement, or CETA for short.

It is this 'Canada style' deal – or 'Canada plus' – that many Brexit supporters are now putting forward as the model the UK should aim for, as opposed to the supposedly much less ambitious Chequers proposals championed by the Prime Minister.

What are the main points of CETA?

It is very difficult to distil an EU trade agreement into 400 words, but let's try:

- CETA means that 98% of tariffs on goods traded between the EU and Canada have become duty free. Most were removed when the agreement came into force: all will be removed within seven years.
- So in general terms, Canadian importers do not have to pay tariffs on goods they receive from the EU and vice-versa.
- The EU and Canada will open up public contracts to each other's companies – so Canadian companies can pitch to build French railways and UK companies could pitch to build a school in Ontario.
- CETA also protects 'geographical indications' – so you can still only make Parma ham in Italy and Canada couldn't import something called, say, Camembert from a company in China.

UNITED KINGDOM

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- The agreement also protects intellectual property – protecting artists, musicians and writers – and the EU and Canada will also co-operate on standards, so that a product made in the EU will go through the necessary safety checks for the Canadian market and not need to have them repeated in Canada.
- Finally, CETA also allows professional qualifications to be recognised in both the EU and Canada, making it easier for those with such qualifications to work in both places.

What CETA does not do

- CETA is not a customs union or a single market, so both Canada and the EU are free to do trade deals with other countries – witness the new trade deal that Canada has just agreed with the United States.
- While it does not remove border controls, it does encourage the use of advanced electronic checking to speed up border clearances.
- It does not, however, make special concessions for financial services, over and above those covered in the World Trade Organisation rules, which both Canada and the EU are signed up to.
- ...And tariffs still remain on poultry, meat and eggs, with some semi-agricultural products still operating on a quota system.

In general, CETA looks to have been a success and the EU and Canada have been trading under the terms of the agreement for a year, while individual member countries in the EU continue to ratify it.

Could CETA work as a model for Brexit? Sadly, that is where the debate begins...

EUROPE

The ‘big’ stories in Europe have come away from the major centres of France and Germany.

As we noted in the introduction, the Greek bailout finally ended. On the surface this is good news: Greece is no longer borrowing from the EU, and the government is finally running a surplus. Dig a little deeper though and the outlook may be much less optimistic: Greece has been left with severe debts which will take generations to repay. A fifth of the population – and a quarter of Greek children – live in severe material deprivation. The unemployment rate remains at around 20% with youth unemployment twice that: half a million Greeks have left the country and the financial crisis has wiped out a fifth of the economy. As the saying goes, only death and taxes are certain, but we can be fairly sure that sooner or later the headlines will be saying ‘Greek Crisis’ again.

Italy, one of the other teetering European economies, set itself on a collision course with the EU by announcing a massive €80bn investment in the nation’s infrastructure. The populist government seized on the collapse of the Genoa bridge in August to announce the plan, hoping that the financial stimulus can boost Italy’s flagging economy. It is a high risk gamble, but something had to be done: Italy’s economy has been virtually stagnant for two decades.

In September, Sweden held a general election where both main parties saw a sharp decline in their votes as the nationalist, anti-immigration Swedish Democrats won nearly 18% of the vote. The country’s Prime Minister, Stefan Lofven, was ousted after losing a no-confidence motion and the country now faces a period of uncertainty as the politicians try to form a workable coalition.

While all this is going on, the remorseless German engine continues to drive Europe: figures for July confirmed a trade surplus of €16.4bn (£14.5bn) with unemployment down to 3.4% and inflation holding steady at 2.3%. Chancellor Philip Hammond will no doubt claim a higher growth rate for the UK when he delivers his Budget speech, but what he would give for that inevitable trade surplus every month…

The German stock market, though, was largely unchanged through the quarter, drifting down just 59 points from a starting level of 12,306 to end September at 12,247. The French market, by contrast, enjoyed a good third quarter, rising 3% to 5,493. But the end of the bailout did little for the Greek market, which was down 9% over the three months to 692.

UNITED STATES

As we mentioned in the introduction, August saw Apple win the race to become the first trillion dollar company. Better than expected figures, confirming strong sales growth for the more expensive iPhone models, sent the shares to a new high of $207 (£159), enough to see Apple beat Microsoft, Amazon and Alphabet (the parent company of Google) to the trillion dollar valuation (we take a look at Apple's journey in the special section below).

By September, the club wasn't quite so exclusive as Amazon also passed the trillion dollar milestone, and no doubt Alphabet and Microsoft will be along shortly. It may be some time before Facebook joins the party though, as it continues to struggle with data breach issues.

In the wider US economy, the jobs figures for June and August both showed more than 200,000 jobs being added, although July's figures were slightly disappointing. Second quarter figures showed the US economy growing at an annualised rate of 4.2%.

With figures released in September showing that wage growth had risen by its fastest pace for nine years to reach an annualised rate of 2.9%, it was inevitable that the Federal Reserve would take action and they opted to raise interest rates by a further 0.25% taking them to a range of 2% to 2.25%. This was the eighth rate increase since 2015 – with another one expected later this year – as the Fed maintains its policy of gradual rate rises.

And what of the President? The United States Salesman-in-Chief had a busy quarter, tying up new trade deals with South Korea, Mexico and Canada. Speaking at the White House, he described the United States-Mexico-Canada Agreement (USMCA) as "the most important deal" the country had ever struck which would bring "thousands of jobs" back to the US.

Everyone has their opinion on Donald Trump. What you cannot deny is that the US stock market loves him. When he was inaugurated in January 2017, the Dow Jones index was below 20,000. It closed September at 26,458 after rising 9% in the third quarter of the year.

Apple's Journey to a Trillion Dollars

Apple was founded on 1st April 1976 – so the journey to a trillion dollars has taken just over 42 years. The founders were Steve Jobs, Steve Wozniak – we've all heard of those two – and Ronald Wayne, who had a 10% stake in the company in return for lending his electronics industry experience and administrative oversight.

In what is almost certainly the biggest investment blunder in history, Mr Wayne sold his stake in Apple back to Jobs and Wozniak for $800 (£615) and later accepted a further $1,500 (£1,150) to relinquish any further claim on the company. Had he held his 10% stake today, Mr Wayne would be worth over $100bn (£77bn), making him the second richest person on the planet.

The company was founded in the garage of Steve Jobs' childhood home in Los Altos, California, and the first product was an assembled circuit board which lacked some fairly basic features – a keyboard, a monitor and a case.

UNITED STATES

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The company went public in 1980, instantly creating 300 millionaires and it is tempting to think that the history of Apple since then is one of seamless success: the Mac, the iPod, the iPhone, the iPad, the Apple Watch, more than 2m apps available in the app store and who knows what in the future. In fact, the exact opposite is true.

The company has had some spectacular failures, such as the Apple Pippin, the Newton and the Macintosh Portable. Then there was the Apple Lisa, on sale in 1983 for $9,995 – the equivalent of just under £20,000 today.

In the early 90s, the company was in more or less continuous decline, only returning to profitability at the end of the decade and, as anyone who has seen the Steve Jobs biopic will know, there were a few personality clashes along the way...

However, the company never stopped innovating, saw Tim Cook take over as CEO following the death of Steve Jobs in 2011 and now has 123,000 employees around the world and operating revenues (in 2017) of $230bn (£177bn).

It doesn't sell the most mobile phones – it is second behind Samsung and may one day be overtaken by Chinese company Huawei – but it has enjoyed spectacular success with its more expensive phones, and it was an increase in demand for these that sent the share price up to the level required to value the company at a trillion dollars. Significantly, Apple achieved that trillion dollar valuation with the shares selling at 15 times expected profits – that compares to 82 times expected profits for the Amazon share rise which made founder Jeff Bezos the richest man in the world.

FAR EAST

We have covered the US/China trade war in the introduction, so let us start with some good news for the region.

This came in September when South Korean President Moon Jae-in made a historic visit to the North to meet Kim Jong-un. The meeting moved the de-nuclearisation of the Korean peninsula significantly closer as Kim promised to close one of his country's main missile testing and launch sites.

At the other end of the good news/bad news scale, Typhoon Mangkhut struck the Far East in September, killing dozens of people in the Philippines, before moving on to batter Hong Kong and Southern China. The bill for the clean-up is already estimated at $120bn (£92bn) and is likely to rise further.

The impact of the trade war can clearly be seen in China's Shanghai Composite index, which is down 14% on a year-to-date basis. The government had taken some steps to protect its economy against the possibility of a long trade war after a slight slowdown in 2nd quarter growth, introducing some tax cuts and taking steps to issue special bonds for local government infrastructure projects.

Mind you, in China 'slight slowdown' is a relative term. Second quarter growth was in line with the official target of 6.7% - but slightly behind the 6.8% recorded in the first quarter of the year.

There was similar good news on the other side of the Sea of Japan, with figures for the second quarter showing the Japanese economy returning to growth, as it increased at an annualised rate of 1.9%. Car giant Toyota added to the good news as it posted a 7.2% rise in quarterly net profits, beating expectations and surprising analysts.

The good news from Japan was reflected in the Nikkei Dow index, which led the way in the third quarter with a rise of 8% to 24,142. The South Korean market was up by just 1% to 2,343 but both the Chinese and Hong Kong markets were down, China by 1% in the quarter to 2,821 and Hong Kong by 4% to 27,789.

EMERGING MARKETS

July brought us the 10th annual summit of BRICS – the meeting of the heads of state of the major developing economies: Brazil, Russia, India, China and South Africa. The meeting – held in Johannesburg – committed itself to the importance of an 'open world economy' with all countries benefiting from globalisation. The BRICS countries backed an 'open and inclusive' multilateral trading system under World Trade Organisation rules – but they did warn that multilateral trading faced "unprecedented challenges." Perhaps a reference to a certain incumbent of the White House...

For one of the members – India – the third quarter of the year brought plenty of good news. Due to a fall in September, the stock market only rose by 2% overall to 36,227 but economists at HSBC have forecast that India will overtake the UK, Germany, France and Japan to become the third largest economy in the world.

The forecasters are expecting growth of 6% in India, with China's growth slowing to 5% per annum. India will, however, lag a long way behind the world's two biggest economies, with HSBC forecasting that by 2030, China's GDP will be £26tn, ahead of the US on £25.2tn and India on £5.9tn.

Figures are not yet in for the third quarter, but with India's economy expanding by 7.7% in the first quarter of the year and by 8.2% in the second quarter, there is plenty of evidence to support HSBC's claims.

If India was on the up, two countries in Latin America were very much going in the opposite direction. Venezuela is in crisis: the country with the highest oil reserves in the world has been brought to its knees by the current government and is now seeing the largest exodus of people in South American history.

Meanwhile, Argentina has had to go to the International Monetary Fund with the begging bowl, interest rates have increased to 60% as the Government attempts to prop up the peso and the bailout programme has already been increased from the $50bn originally requested to $57bn (£43bn).

EMERGING MARKETS

Continued

The stock markets in the other two major Emerging Markets on which we report, Russia and Brazil, both enjoyed strong performances in the third quarter of the year. The Russian market was up 8% to close September at 2,475 while the Brazilian index went one point better. It was up 9% to end the quarter at 79,342.

And that is it for another quarter. We will be back with this report in the first week of January, by which time we will be less than three months away from the theoretical date for Brexit. It seems inconceivable that we will be reporting 'no progress' but anything currently seems possible. Rest assured that whatever happens – with Brexit or with any other topic – we are always here to answer your questions. We are never more than a phone call or an email away.

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