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Smart[im]: Weekly Market Review

09 February 2018
Smart Investment Management

The week to date as at 12 p.m. Friday (GMT).

Markets and key events

Market sell-off continues

The sell-off in bond yields accelerated last Friday after US wage data climbed at its fastest pace since the last recession, with average hourly earnings rising 2.9% year-on-year, suggesting that the tightness in the labour market is finally pushing through to wages. Friday's sell off in equity and bond markets followed through into this week, with both the United States Standard & Poor's 500 Index and the Dow Jones Industrial Average both experiencing their worst days since August 2011. Despite signs of investors 'buying the dip' on Tuesday, the selling resumed later in the week, not helped by William Dudley, President of the New York Federal Reserve quoted as saying that the wild swings in US stock markets would not alter the outlook on the US economy or the direction of interest rates.

Few places to hide

As of 12pm London time, the S&P 500 had fallen 6.6% over the week, but down just over 10% from its recent peak, meeting the definition of a 'technical correction'. However, despite the sell-off in markets around the globe, traditional safe haven assets have not provided much protection over the week, with gold having fallen 1.5%, 10-year government bonds trading at or close to their recent lows, and currencies such as the US Dollar, Swiss Franc and Japanese Yen remaining as bystanders to the gyrations in markets over the week.

Vix index spikes above 50

It has been a similar story outside of the US in a week when the CBOE (Chicago Board Options Exchange) Vix index, a measure of market volatility, rose briefly above 50, substantially higher than its long-term average of 20. The EuroStoxx 50 index fell 5.9% over the week, but is down 9.7% from its recent high and similarly, the UK's FTSE 100 index fell 4.6% over the week, but down 8.7% for this year. The Japanese Topix index fell 7.1%, down 9.4% from its 2018 high, and the Chinese Shanghai Stock Exchange slid 9.6% over the week or 12% from its recent high. The Australian S&P/ASX 200 has been a relatively safe place to hide, with the index down 4.6% over the week, down 4.9% from its high for the year.

Oil price not spared the pain

The oil price was not spared from the turmoil, as Brent crude fell 6.4%, now trading at $64.2, down 9% from its 2018 peak price of just under $71.

Changes to the portfolios

We have made no changes to the portfolios this week, however, the volatility overlay in the Smartfunds Cautious, Balanced and Growth funds have progressively reduced market exposure throughout the week, providing an element of protection should further falls arise.

Issues under discussion

Taper tantrum 2

The sell-off in markets has been triggered by what is arguably a totally rational repricing of the bond market against increasing inflation expectations, with many commentators labelling this as the "taper tantrum 2". The sell-off in equity markets has felt all the more brutal as it has come after an extended period of exceptionally low volatility, with the S&P 500 index having only fallen by 1% or more, four times during 2017 versus a long-term average of 30 days. Indeed, when dividends are included, the S&P 500 did not suffer one negative month for the whole of last year.

Whilst falling stock markets are rarely welcome, the S&P 500 is only back to levels it was trading at the end of November last year, in a year when the index returned an exceptional total return of 21.7%. It is not a dissimilar picture elsewhere. This time, the world economy is growing strongly, with the risk of recession currently very low. Although equities are fully valued by historic standards, even after the sell-off, on a relative basis versus other assets such as fixed income, they still look reasonably priced, whilst benefitting from rising earnings.

We acknowledge the risks, and this year we have further diversified the portfolios by removing the currency hedges against the US dollar and the Japanese Yen, both of which have historically exhibited safe haven status in times of sustained market falls. Additionally, we continue to hold a reasonable level of cash and absolute return holdings across all of the portfolios. Despite a correction of 10% or more being experienced in some markets, at this juncture we are not tempted in, preferring to sit on the side-lines until a better opportunity arises.