Lacomp plc

Quarterly Newsletter - Winter 2018/19

Lacomp plc is an independent investment management company providing portfolio management services to private investors worldwide.

Traditionally at this time of year it is our practice to look at what has gone before. Quite frankly, 2018 was volatile and difficult!

A year ago, in January 2018, we expressed surprise that despite all the worrying news during 2017, events had failed to negatively affect the stock markets in any significant way. Indeed, markets had been uncharacteristically calm with minimal bouts of unsettling volatility.

Well, this has changed.

While in 2017 we had President Trump engage in some sabre-rattling with North Korea and introduce protectionist policies, 2018 saw the start of a trade war, particularly against China. In 2017, we worried about the continuing crisis in the Middle East, and that was far from resolved last year and is still ongoing now. In 2017, there were concerns about rising interest rates (led by the US) and that still applied last year. Talking of the US, the flurry of personnel changes at the White House and at cabinet level is unprecedented, and many people have either resigned or been fired in both years. In the UK, 2017 saw a disastrous Tory general election campaign, leaving Theresa May in need of being propped up by the DUP, and we were also fretting about the Brexit negotiations. Plus ça change!

In essence, you could say that there was nothing monumentally different between the two years, yet markets reacted very dissimilarly.

As we often have said, a major trigger in both up and down moves in markets is investor sentiment. We have just seen the longest bull market since World War II - it started on 9th March 2009. Given that interest rates were very low during the last ten years, savers increasingly looked at returns from equities in the form of dividends. Against the background of this positive market sentiment, traditionally cautious investors became less risk averse. Understandably, they were the first to run for the hills once the direction of the markets changed, and the net outflow registered by equity and bond funds in the last quarter of 2018 was large.

In America, Q4 last year saw equity performance plummet: the Dow Jones, S&P 500 and NASDAQ were down 11.8%, 14% and 17.5% respectively.

Given that the United States is the world's largest economy, it provides a useful proxy for world market trends and broadly reflects Lacomp's global approach to investing. A key feature of the US market is that it often shows a significant time shift so that the US enters both recession and subsequent recovery ahead of overseas economies. It therefore makes sense to look at the performance of the fifty components of the Dow Jones Industrial Average ('Dow') index.

In 2017, there were 10 daily moves of plus or minus 1% in the Dow whereas 2018 saw 69 such outcomes, equivalent to one in four trading days. The long-term average (since 1940) is one in five but, encouragingly, 'up' days generally exceed 'down' days.

Another way of comparing the two years is looking at the VIX index – often called the 'fear index'. It has a long-term average of 18.5 but can rise spectacularly in time of crisis. At the beginning of last year, it opened in similar fashion, but rose rapidly towards the end of March (VIX @ 24.9) as fears of inflation and faster than expected interest rate rises took hold.

Summer was relatively calm before fears of a slowing global economy pushed volatility up again (VIX @ 25.2 in October) where it remained at year end. A near 150% increase in volatility over the calendar year would seem to suggest disaster but a deeper look at market performance shows that the VIX was performing in typical fashion in comparison to historical averages and still remains well below its record highs.

Alongside the undeniable return of volatility, the Dow also generated a mixed bag of headlines – the fastest growth of 1000 points, the first 1000 point daily drop (on 5th February), the worst Christmas Eve on record (-2.91%), followed by the first ever daily rise of 1000 points on the 26th December. There were 15 new 'highs' in 2018 which is in stark contrast to 2017 when we saw an all-time record of 71 such closes, but 2018 was still ahead of the historical average.

Of greater concern to investors, the index fell by 13+% from the October peak, ending the year at a negative 5.6% which actually compares quite favourably to the UK (FTSE down 12.4% for the year) and to Europe (DJ Eurostoxx index down 14.3%). As you know, we at Lacomp have been greatly reducing your exposure to both the UK and Europe. Emerging markets also suffered, with added pressure from a rising dollar adding to fears of a global (read 'Chinese') slowdown. The US, in fact, appears the best of a very mundane bunch in 2018 when viewed on a simplistic 'calendar year' basis.

What are the prospects for 2019? The outlook remains clouded, with the continuing trade war, ongoing political unrest and the temporary US government shutdown, but there are always headwinds and these are typically either ignored or exaggerated in importance according to the prevailing general levels of sentiment.

There is anecdotal promise in the form of the 'January barometer' which would seem to suggest that a positive January has led to a positive yearly performance on 80% of occasions. Records also show that the second half-year has shown an average performance some 25% ahead of the first six months and only 20 of the 122 full year records show negative performance in both the first and second half.

At the time of writing, the Dow has posted a gain of 5.3% since the beginning of the year but this might be a reaction to the very poor Q4 of last year.

Bizarrely, 2018 was an exception to this pattern, rising by 5.8% in January but closing the year at negative 5.6%. Given that the global economy has undoubtedly stuttered in the face of the trade dispute between the world's two largest markets we anticipate that growth will be positive but not stellar. One thing is certain – there will be no shortage of 'news'. What matters is how the market reacts on each occasion.

Statistical data can be interpreted in all manner of ways to emphasise the positive or negative aspects but, from an investor standpoint, it has to be said that 2018 felt grim for most of the period from mid-summer onwards. Higher volatility is unsettling, particularly when contrasted with the heady days of 2017. Nevertheless, investors should take some comfort from history – just as good times do not last forever, neither do the darker days.

Finally, Brexit!

As things stand, we could be looking at about seven different outcomes, but nobody really knows which one it is likely to be. A myriad of Amendments has been tabled before next week's Commons vote. They either wish to see Brexit postponed, or a softer Brexit, or to give MPs a series of 'indicative votes', or a motion to ask the EU to postpone Brexit day, or to extend Article 50 until the end of 2019, or a bid to freeze the centuries-old rule that says the Government has the power to decide what MPs debate. You get the picture…

Jeremy Corbyn at long last has come off the fence, adding his voice in an effort to stall Article 50. It will be interesting to see how the traditional Labour voters in the North of England who voted heavily in favour of 'leave' react to this change of heart. Equally, it will be fascinating to see how MPs who have clearly gone against the majority of their constituents' Brexit views will fare in the next general election.

A majority of MPs want to avoid a 'no deal' Brexit at all costs, overlooking the fact that it is probably the one really strong card the UK can play in its negotiations with the EU. Yes, a 'no deal' scenario would be disruptive, but it would be equally disruptive on both sides of the Channel and the Irish Sea. It would focus minds on both sides and speed up finding solutions to smoothen the future relationship between the two parties.

Whatever will happen, our MPs have not covered themselves in glory, and the UK Parliament and political system have become a laughing stock elsewhere in the world. Mrs. May has been called stubborn and unimaginative, and some have gone further in stating that she is duplicitous – saying one thing and doing another. Some MPs have been viewed as self-serving and spineless. Nothing new there, I guess.

At the beginning of December, there was a comment in the press by Nick Timothy, Mrs. May's former political adviser. In closing, it is worth repeating:

"Brussels has screwed Britain, Remainers have screwed the Prime Minister, and the Prime Minister has screwed the Leavers. The result is the establishment has screwed the public."

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