Monthly Commentary 3rd September 2020

August was a very strong month for world equities that rose more than 5% on aggregate. The US market, up 7% was the strongest, with the UK's FTSE being the laggard, up only 1%. Bonds gave back some of their recent gains, with the UK Gilt market falling more than 3%. Commodities were up almost 7%, with crude oil up 5.8%. Silver shone, up 15% while gold fell a bit. The USD index gave up 1.29%, with sterling up 2.3% vs the dollar.

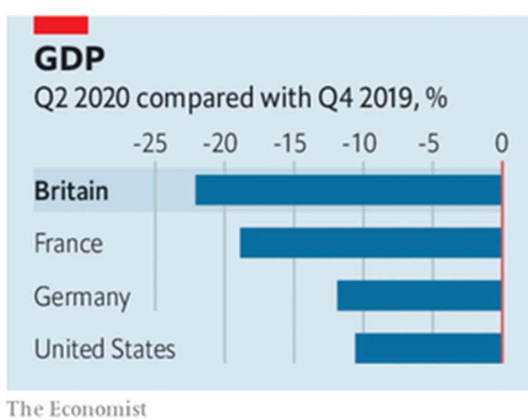
Is the market getting frothy?

US markets have risen to levels above their pre-Covid February highs. By most fundamental and technical measures they are extremely overvalued. Other markets, most notably the Dax and the Nikkei have also risen very strongly. The only major market that is still down about 20% YTD is the UK (more on the UK later).

The question we face as asset allocators is whether we should take some money off the table and wait for a correction before redeploying it. If history is a guide, we would probably not get it right for two reasons. First, we do not know how long this liquidity-driven rally can continue. I.e. what if we sell now and the market rises another 10-20%? Second, when do we get back in? What if we buy back after a 10% drop but markets fall 20% before they stabilize? So, if we have a 50% chance of getting both right, then the probability of success is 25%. Not great odds.

The UK economy

The chart below from the Economist shows the fall in output (GDP) for a few countries in the first half of 2020.



The UK has done particularly badly. The Economist suggests that it is because the government is not doing enough to prioritise growth for political reasons. Below is a snippet of what they wrote:

"Tory voters' preferences show up in policies that will hamper growth and in spending preferences that will not help it. Brexit, supported by 60% of pensioners but only 27% of under-25s, will damage the economy. Spending on health, which disproportionately benefits old people, has grown from 6% to 7% of gdp since 2010, when the Tories came to power, while spending on education, which matters not just to the young of today but also to the growth rates of tomorrow, has dropped from 6% to 4% over the period. The "triple lock", guaranteeing that state pensions will rise annually by whichever is the highest of earnings growth, inflation or 2.5%, will be especially generous this year and next: if the government sticks to that promise, pensioners will get a 2.5% increase this year while earnings decline by 1.5%, and a big rise next year too, when they are expected to rebound".

Perhaps the FTSE's performance in the first six months of the year is reflecting the above…