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Topical commentary

The October jinx

Although a long time ago, the great 1987 crash, which started on “Black Monday”, the 19th October, has left a legacy in the psychology of markets which has not quite evaporated away.

Quite possibly, part of the reason is that October already had some “previous” on its record, most notably the 1929 Wall Street Crash, which began on October 24th

With the anniversaries of these monumental events falling in the same month, it’s easy to see why speculators can be on high alert when normal folk are out enjoying the autumn leaves or getting some early Christmas planning in place.

Perhaps this history explains some of the sell off this October, but we doubt it.

In both 1929 and 1987, the crashes followed quite meteoric rises. In 1929 the Dow Jones Industrial Average had gained 400% in just 5 years. In 1987, both the US and UK markets were up about 40% in the previous 9 months.

In both events, the markets collapsed under the weight of their spectacular past overenthusiasm.

In contrast, in October 2018, we have seen a really quite subdued event, with falls generally of up to 3% a day, rather than the falls of 20% plus seen in the past.

Also in contrast, the most markets had not presaged the sell off with a spectacular rise, but with a year or two of really quite subdued performance.

The US markets are a bit of an outlier to this generalisation, since they have risen strongly over the last year, driven forward by Trump’s pro market policies and perhaps a small dose of the “irrational exuberance” Alan Greenspan famously referred to during the “dot com bubble.”

However, a rise over the year of about 19%, and about 110% over five years, is hardly the stuff of legends, and not remotely outside normal market behaviour.

All of which suggests that the recent sell off is also unlikely to go beyond normal market behaviour.

Indeed, the only thing that makes it feel special is the fact that, most unusually, we have had many years with hardly any significant market falls at all, whereas, in history, noteworthy falls have been commonplace, and have been closer to a yearly event than a ten yearly event.

While it is good to put this recent sell off in perspective, and note that it has been quite modest so far, that doesn't mean it is isn't important to analyse its causes and see if that can inform us on its likely future trajectory.

Obvious candidates for the cause are Brexit and the Trade War, but, while both create plenty of uncertainty, one is really mostly about the UK, rather than the global markets, and the other something the US market has tended to take as a positive.

In fact, the underlying reasons for the falls may be more to do with the factors set out below:

- US shares had moved to rather high, and in the case of the FANGS (Facebook, Amazon, Netflix and Google) quite eye watering, valuations.

- Interest rate rises in the US have risen to over 3%, bringing dividend yields well below deposit interest, creating less motivation to take stock market risks.

- The mid-term elections in November are threatening the durability of the tenure of Donald Trump, which itself might mean less supportive policies (for the USA, although perhaps less damaging to other areas if the trade war was rolled back).

- This period of global economic expansion is about to become the longest on record, implying a slowdown may be getting closer.

- Janet Yellen has just stepped down as the chair of the Federal Reserve, to be replaced by Jerome Powell, thereby adding some uncertainty to an already heady mix of things for the speculators to worry about.

All of these factors have been known for a while, making the speed of the change in sentiment a little surprising, as it is usually the unpredicted that sets off a panic amongst the speculators, rather than things everyone already knew about.

However, the biggest surprise is the extent to which other markets have followed the US. They did not follow it upwards much over the last year or more, as we have mentioned in our recent reports, so a quite significant valuation gap had developed.

Given this gap, logic would have this sell off applying mostly to the US, but at times like this, when speculation usurps sensible investing, logic usually leaves the room. It certainly seems to have done so this time, and we have seen indiscriminate selling by speculators all round the world.

Given our past concern that US equities were potentially overvalued, at least compared with the rest of the world, and that rising interest rates would cause bond prices to fall, we have been significantly underweight both these areas for quite some time.

This has not helped us over the last few months since the US markets has forged ahead, leaving nearly all others behind and increasing further the already stretched valuation gap.

While the indiscriminate nature of the selloff in October has meant our positioning has not, so far, helped us during this fall, we do feel that, once the speculative activity stops and reason and balance returns to the markets, our approach should pay off well.

There are, of course, other factors, such as the trade war, which may turn out to justify the recent market falls more than they seem to at the moment, and perhaps we will see more of a global slowdown than has, until now, seemed likely.

However, it does not seem probable that we will have a slowdown on a scale that substantially damages corporate profits or causes a general and widespread fall in share dividends. In the absence of that, this recent global market fall seems likely to be just the latest in a very long history of short term tumbles and not likely to have any real impact on the medium to long term results from an investment portfolio.

In the past, where there has been a sudden and significant stock market fall, this has always been followed, in time, by a recovery. We can see no reason why it will be any different this time.

Predicting the bottom of a market fall, either in level or time frame, and predicting the speed and gradient of a recovery, are impossible with any confidence. However, sensible investing does not need to look into the tea leaves like this, since what matters is the eventual outcome, and not the exact timing of the arrival at any point along the way.

Investors who have held portfolios for more than 10 years will be very familiar with falls on this recent scale, and, indeed, much larger falls, but we do realise that those who have held their portfolios for only the last few years have experienced unusually calm conditions, so may be more unnerved by the selloff than we think they need be.

Time will tell how long the difficult patch lasts and how long it takes for a full recovery to take place, but we suspect history to show that this was a very good buying opportunity, rather than a good time to consider selling equity investments.

In the meantime, a bit of market volatility is probably a healthy thing, especially if it dampens the enthusiasm of the short term speculators and reminds everyone of what sensible investors always knew: stock market investing is for the medium to long term.

Those using stock markets for short term speculation are basically gambling, while those using them for medium to long term capital allocation are investing.

For anyone happy to be patient in difficult times and ride through the short term turbulence created by the speculators, stock market investing seems highly likely to provide excellent rewards, just as it has for generations before us.

Kevin Bland

The Atkins Bland Jargon Buster: Alpha

Quite often when talking about investments the word alpha is bandied about and you could be forgiven for wondering what on earth it means. However, this short synopsis should help to alleviate this conundrum.

Alpha is a commonly quoted measure of investment performance and is defined as the excess return on an investment relative to a benchmark index. But what does this mean in real terms?

If you were to invest in a UK large cap share and it returned 20% over a defined period while the FTSE 100 index returned 10%, the alpha for this investment would be 10%. In a similar vein, an alpha of -5 would indicate that the share had returned 5%.

That said, alpha is not just a measure of investment performance, it is also often used as a measure of risk. A negative alpha would suggest that the fund manager has failed to reward investors for the amount of risk taken. Conversely, a positive alpha would suggest that the fund manager has provided value for investors through careful stock picking.

It is very important when assessing the alpha of your investment that a suitable index is used. There is little merit in comparing the alpha of a UK small cap stock with the FTSE 100 as they have different price influences that will cause natural price diversion.

Important notes

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader.

This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied.

The value of investments will fall as well as rise, as can any income produced.

Inflation can reduce the real value of capital and the income it generates

Past investment performance is not a reliable guide to the future

Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy.

The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective.

Errors and omission excepted

Prepared by Atkins Bland - October 2018

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