What a difference a year makes

Deon Gouws - CIO, Credo Wealth - 10 January 2020

It was exactly 52 weeks ago that we sent out a piece to clients under the heading "Living in interesting times".

This followed one of the most turbulent quarters in markets since the global financial crisis, with the S&P 500 reaching an all-time high in September 2018 before promptly shedding nearly 20% in the ensuing 3-month period.

As a result, many investors were fearing an extended bear market a year ago, especially given that a number of strategists had been calling a "top" based on elevated valuation levels for some time before that.

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Our response to this was similar to the messages which we've been sending out to clients whenever financial markets appear to take a breather:

it has always paid to remain invested for the longer term, so why change now?

A year later, we are therefore pleased to report that this strategy of staying the course (or adding to positions, for those who may have had additional cash to deploy) has once again paid off, with the S&P 500 adding some 30% over the ensuing twelve months and equities reaching numerous consecutive all-time highs throughout the last few months of 2019.

In fact, the last calendar year ended up being one of the strongest on record: **in the past decade, only 2013's S&P 500 returns were stronger than 2019** (and only about 1% at that). What makes this even more notable is that, with the benefit of hindsight, 2013 came relatively hot on the heels of the global financial crisis, which meant that equities still had some "catching up" to do at that time, given how cheap markets had become between the end of 2007 and the first quarter of 2009.

January 2020 started in similar vein: on the first trading day of the year, global equity markets closed at yet another record level. Whilst investment morale could hardly have been worse twelve months before, a much more positive outlook has certainly evolved since then, based on increased optimism that the much vaunted trade war between the US and the rest of the world (most notably China) appeared to move ever closer to resolution, as well as the fact that a global recession no longer appeared likely (in spite of some yield curve inversion and lots of worries in this regard a short few months before). At the same time, the US consumer was of course also benefiting from a significant wealth effect thanks to good employment statistics, record house prices and all-round strong markets (even though it has to be noted that the industrial sector has been somewhat more sluggish of late).

Against this background, confidence levels were now at an all-time high and there was a growing consensus that 2020 was going to be another positive year for equities. In a recent poll for the Wells Fargo Investment Institute, only one out of eight Wall Street strategists featured had a negative outlook for equities, for example.

And then everything appeared to change, practically overnight, with the news that Iran's top security and intelligence commander was killed early on the 3rd of January in a drone strike which was authorized by Donald Trump. Suddenly, confidence evaporated from the market and all bets were off: equity futures turned negative and gold as well as oil prices spiked. Many people feared the worst; some still do.

It is at times like this that some investment strategists will argue for a "risk-off" approach, with lesser allocations to equities, for example. **But why tinker with your portfolio in the first place?**

Not to be flippant about the continued threat of strikes in the Middle East or the grave possibility of World War III (a term/topic which has of course been trending on Twitter), but we would argue that one probably has much more to fear from war itself than any perceived risk based on investment exposure? And if – cross fingers

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– the worst case scenario does not play out on the war front, risk assets are likely to bounce back soon enough, and those that have "lightened" their holdings will just suffer opportunity cost once more.

In addition, bear in mind that we have been living with essentially this kind of geo-political risk for a few decades now, with multiple terrorist attacks around the world, for example. In spite of this, the global economy has kept on growing, free markets have survived, innovation continues apace, and a large number of companies have been and are thriving as a result. All of this has contributed to unprecedented stock market gains over the period.

As it happens, a week after the initial rumours of war, financial markets appear to have stabilized and global equities are trading at all-time highs once again. **Only time will of course tell how the situation plays out.**

At Credo, one of the points that we emphasize as part of our investment philosophy is that we aim to identify matters of strategic importance and focus on methodologies that have proven to be robust through a variety of market cycles, rather than fixating on short-term news-flow and forecasts. Important as it may be for a whole host of reasons, I would suggest that even the killing of a military leader in the Middle East and the tensions resulting from that, ultimately boil down to an example of such short-term news flow which we tend not to focus on, therefore.

Consequently, we remain fully invested on behalf of clients in well-diversified portfolios of quality assets acquired at reasonable prices.

This is of course also what we did last year, for example, when there was a huge amount of political uncertainty in the UK related to the Brexit process, ultimately leading to another general election in the first half of December. Some investors responded to this by reducing UK equity exposure, given inter alia the perceived risks related to the possibility of a new Labour government and a strongly socialist Prime Minister taking over.

Once again, the "do nothing" strategy has paid off: the FTSE All Share Index which traded around the 4,000 level in the week or so before the election, promptly added some 5% when the Tories achieved a resounding majority, and has increased by approximately another 5% to trade around the 4,200 level at the time of writing.

Does all of this mean that we have a bullish outlook for the year ahead? Not in particular; in fact, it would be remiss of us not to point out that markets are clearly not cheap compared to historic norms and hence we're always at pains to manage expectations accordingly. But by the same token we're not bearish either – we simply do not believe that any such ex ante view adds any value to a client's portfolio positioning.

If we thought we were living in interesting times a year ago, the world is probably an even more interesting place today. Which means that the investment environment has probably become even more challenging – but only for those who tend to focus on the tumultuous news-flow, or try to base their strategy on forecasting a range of outcomes. This is clearly a minefield if ever there was one... and definitely one which we will continue to avoid at Credo. ■