Sanlam Wealth

The noise, the numbers & the nuance

Weekly Market Update | 23 October 2020

Welcome to our weekly newsletter, where we summarise the key market developments over the last seven days

The noise

- Uncertainty looms surrounding the result of a proposed US stimulus bill. House Speaker Nancy Pelosi was in discussions with Treasury Secretary Steven Mnuchin yesterday to attempt to resolve blockages caused by Republican push-back concerning the size of the bill. Markets have slipped this week in response whilst the US dollar has weakened against most major currencies.

- In July, EU leaders agreed to set up a €750bn recovery fund to help the bloc alleviate the economic stresses caused by the Coronavirus; the agreement heralded the first time that the EU would undertake collective borrowing. This week has seen the first issuance of these bonds under its Support to Mitigate Unemployment Risks in an Emergency (SURE) programme. Demand for the bonds has been extremely strong, with orders totalling €233m; the implications for the dynamics of EU debt markets remains to be seen.

- In the UK, both Ireland and Wales have entered "fire break" lockdowns, closing non-essential retailers and requiring the populous to stay at home for two weeks. After failing to reach an agreement with local leaders in Manchester, Boris Johnson's government has enforced Tier 3 restrictions on the region. Manchester will not be receiving the £65m financial support it was lobbying for, led by Greater Manchester Mayor Andy Burnham.

The numbers

GBP Performance to 22/10/20	1 Week	YTD
Equity GBP Total Return (MSCI)		
UK (MSCI UK)	-0.6%	-22.7%
Europe (MSCI Europe)	-0.9%	-7.0%
US (MSCI USA)	-2.3%	11.3%
Japan (MSCI Japan)	-1.6%	1.1%
Emerging Markets (MSCI Emerging)	0.1%	5.2%
Fixed Income GBP Total Return		
UK Government (Barclays Sterling Gilts Index)	-1.7%	7.1%
Investment Grade Hedged (Barclays Global Aggregate Corporate Bond Index)	-0.4%	4.7%
High Yield Bonds Hedged (Barclays Global High Yield Index)	0.1%	-1.2%
Currency moves		
GBP vs USD	1.3%	-1.3%
GBP vs EUR	0.4%	-6.4%
GBP vs JPY	0.8%	-4.8%
Commodities GBP return		
Gold (in £)	-1.6%	27.2%
Oil (in $)	-2.8%	-27.1%

Source: Bloomberg, data as at 22/10/2020

The nuance

Against a backdrop of political uncertainty and still no signs of optimism in Covid-19 case numbers, investor confidence seems to have moderated for the first time in weeks. Market sentiment continues to swing around, allowing us to lean against short-term trends to make sensible incremental decisions.

Market weakness in September allowed us to make just these sort of adjustments, buying into good companies where short-term market sentiment had driven down prices. As valuations pulled back, the return potential for these high quality businesses improved, allowing us to allocate more capital to the positions. Some of this return potential was realised in October as portfolios were rewarded by subsequent market strength.

With the US election looming, a stimulus deal which seems unable to make ground and Covid-19 cases rising, uncertainty is rife and markets are unlikely to make anything other than moderate progress in the short-term. As such, we are once again leaning against the trend and using market strength to pare back positions which we judge to have run ahead of medium-term business prospects.

Portfolio activity

This week, we sold out of our position in Orsted, the Danish offshore wind farm operator. Despite our conviction that the business will grow its profits as a result of ongoing trends, Orsted's current valuation requires it to meet ambitious targets in order to provide meaningful long-term growth. Whilst its earnings have remained relatively flat over the last two years, its valuation relative to these earnings has more than doubled over the same period. The soaring valuation of the business reflects Orsted's significant growth potential over the next decade, partially as a result of investor confidence that globally coordinated efforts to provide stimulus to the green energy sector are imminent. Whilst we have faith in the business's prospects, we are exiting the name on a valuation basis.

We also sold out of the US IT software company Cognizant over the week having previously trimmed the position to a smaller weight. Cognizant is a good example of a smaller technology company which has proved a significant contributor to returns within the funds, outside of large cap names such as Facebook, Microsoft and Google. Similarly to Orsted, the price of Cognizant has continued to push higher even whilst its earnings have trended down slightly; we no longer see a catalyst for its valuation to move much higher.

Reflecting our outlook of muted government bond returns given historically low yields, we have begun the process of selling down our position in the bonds in order to reinvest the proceeds in a ladder of short-dated, investment grade corporate bonds. The decision will result in a pick-up in yield for the fixed income component of the funds, boosting the return potential from this asset class with negligible consequence to the risk of the overall portfolio.