THE DRIVE YOU DEMAND

NAVIGATING CROSS-CURRENTS IN GLOBAL EQUITIES

Spotlight

November 2019 | Global Investment Committee

Union Bancaire Privée

Key points

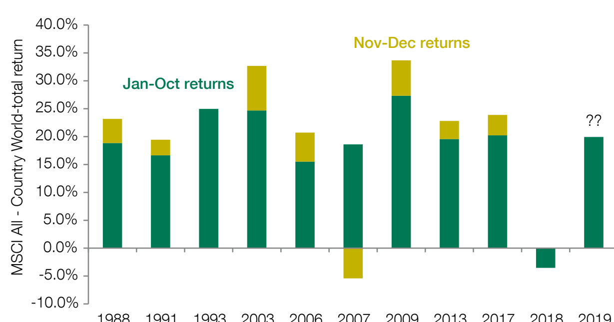
- *Though investor anxiety given the strong rally YTD in global equities is understandable, historically, strong January-October returns have been followed by gains averaging 4.8% in November-December.*
- *Central bank bond buying and an easing in trade tensions provides additional support for global equities. However, earnings clarity is key to sustaining attractive total returns in 2020.*
- *A weak US dollar may provide an earnings catalyst for US corporates moving through 2020. However, it should also signal a leadership shift away from US equities to non-US equities looking ahead.*
- *UK equities may be given an earnings catalyst post-election as fiscal policy should ease as Brexit clarity emerges in 2020 providing opportunities in both Sterling and domestic UK equities.*
- *While risks have eased recently, caution is still warranted given the as yet unresolved money market issues in the US and the uncertain prospects around fiscal stimulus in the European Union in particular.*

Strong YTD returns tend to lead to continued strength

With global equities having risen nearly 7% in September-October bringing total returns to over 20% through early-November, investors are understandably anxious especially with memories of the market declines of 4Q2018 still fresh.

However, looking at the historical picture, rallies of more than 15% through the first ten months of the year in global equities are not entirely rare with 2019 representing the tenth year of the 32 years since 1998 that global stocks have delivered such outsized returns.

Chart 1. Historically, strong returns from January-October mean strong November-December returns

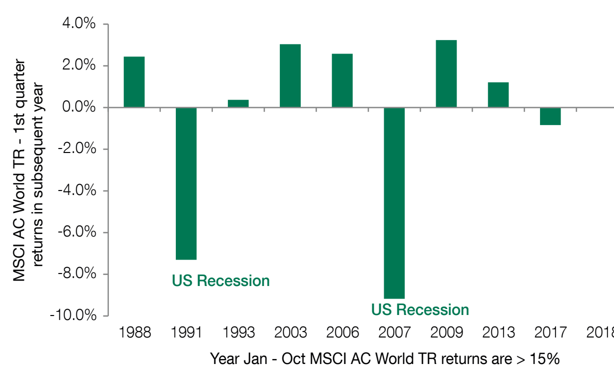


Sources: MSCI, Bloomberg Finance L.P. and UBP

Interestingly, of those previous nine years, in just one year – 2007 – have the November to December returns meaningfully retraced the January to October gains, with global equities falling by 5.4% as the Global Financial Crisis of 2008-09 began to accelerate. In 1993, November-December returns flattened out to a 0.1% decline. However, apart from those two episodes, in seven of the nine times that markets have rallied 15% or more in the first ten months of the year, they have then gone on to average further gains of 4.8% in the final two months of the year (Chart 1).

Indeed, looking forward to the first three months of the subsequent year, markets tend to continue their rally absent a recession in the United States. Following the 1991 and 2007 rallies, markets fell 8-10% in the first quarter of 1992 and 2008 as recession took hold in the American economy.

Chart 2. Market strength continues into the subsequent year as long as a US recession is avoided



Sources: MSCI, Bloomberg Finance L.P. and UBP

However, of the remaining episodes, markets have seen positive returns in six of these at an average of 2.1%. Even in the episode producing a negative return, investors still saw only a modest 0.8% drawdown in early-2018 (Chart 2).

Admittedly, the 2019 rally in global equities has relied more heavily on rising price-earnings (P/E) multiples rather than improving earnings expectations to drive the year-to-date returns. While further P/E re-ratings have indeed followed in previous November-December periods, at 18.5x forward earnings at end-October, MSCI AC World multiples are the highest amongst our sample with the exception of 2017.

It is worth remembering that in 2017 markets continued to deliver an additional 3.7% return through to year-end. Investors then saw more modest returns in early-2018, falling by 0.8% in the first quarter and setting the stage for a -8.9% total return for global equities in 2018.

Central banks / trade negotiators provide further support

With history supporting further gains in equities, October central bank action likewise becomes a tailwind for equity investors looking ahead.

In response to instability in US money markets, the US Federal Reserve announced that it would expand its balance sheet (by buying short-term Treasury bills) at a pace of US$60 billion per month through to June 2020. Combined with the extra support it

provided in September and October and added to the European Central Bank's announcement of a €20 billion per month bond buying programme and the pace is set to average nearly US$90 billion per month, faster than seen in its three previous quantitative easing programmes (Table 1).

Table 1. Central bank balance sheet expansion has been positive for equities in the post-crisis period

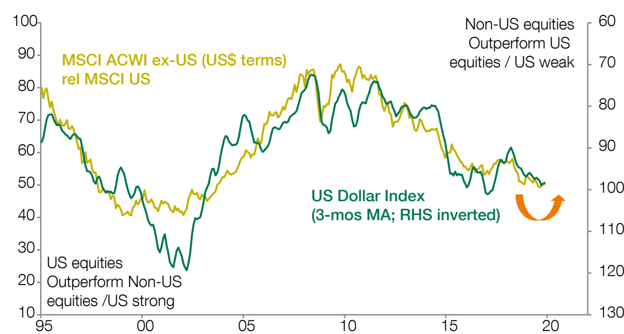
Bond Buying Period	Ave per month (US$ bn)	Chg in MSCI World P/E (x)	Chg in MSCI World EPS (%)	Chg in MSCI World (%)
June 08–June 10	57.5	(0.4)	(23.0)	(25.7)
Nov 10–June 11	64.9	(0.5)	15.8	11.5
Sep 12–Oct 14	64.7	2.8	7.4	30.2
Jan 15–Dec 18*	60.1	(2.0)	27.8	12.3

Sources: Bloomberg Finance L.P. and UBP
* European Central bank QE programme
** including Fed balance sheet expansion in Sep 2019 to address repo market instability and ECB bond buying programme

However, it is important to note that in the four previous episodes of central bank bond buying, earnings growth has been the key return driver for global equities. With 2020 earnings expectations likely looking overly optimistic and with equity valuations at their highest levels at the start of the central bank bond purchases, an earnings catalyst will be key to the equity total return picture moving into 2020.

Central bank support has come alongside what appears to be a growing likelihood of a 'stage 1' trade agreement between the United States and China. Should that agreement result in a removal of some tariffs imposed in September, the global economy may see a modest fillip in an otherwise slowing growth trajectory, providing additional macro support to earnings looking into 2020.

Chart 3. A US dollar peak may signal a leadership shift towards non-US equities



Sources: MSCI, Bloomberg FinanceL.P. and UBP

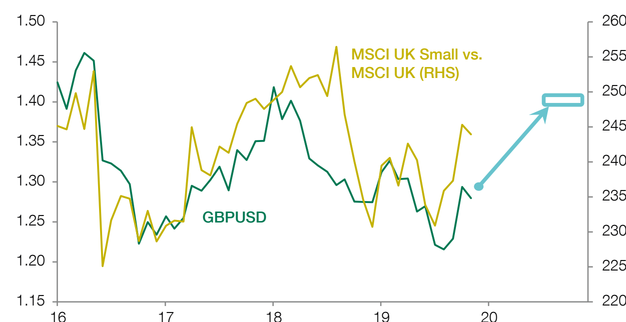
A weak USD may signal a shift to non-US equities

As Peter Kinsella, UBP's global FX strategist highlights, the US dollar bull market has likely run its course as we enter 2020 (please see UBP Investment Outlook 2020 - The Global Economy at the Crossroads). Indeed, since 1995, long-cycle inflections in the US dollar exchange range have coincided with long-cycle under/outperformance of US equities relative to non-US equities (Chart 3).

Indeed, with the UK general election scheduled for December 12th set to bring clarity to the Brexit process, investors may see this US dollar weakening story play out in real time in the months ahead.

After years of painful political deadlock, hope is growing that a clear majority can be found to break the parliamentary deadlock that has dominated the Brexit debate since 2016. Indeed, if Boris Johnson wins the election, this should unleash an array of targeted fiscal measures in support of the UK economy. In this scenario, we expect a further strengthening in the British pound and a continued rally in domestically-oriented UK equities including the property sector which has lagged since the 2016 referendum.

Chart 4. Post-election clarity favours Sterling and domestic UK equities



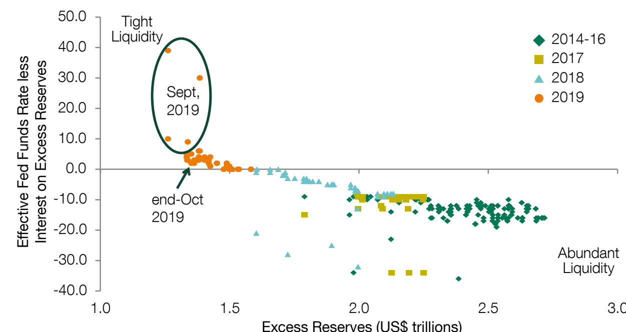
Sources: MSCI, Bloomberg Finance L.P. and UBP

Should fiscal momentum build in continental Europe in 2020, investors could similarly benefit from a small-cap, domestic focus against a backdrop of a strengthening Euro.

Liquidity risks remain moving into year-end

Though central banks are proactively attempting to avert the liquidity risks that began to emerge in September and October with the instability in US money markets, recent Fed and ECB action has eased the situation though not yet fully eliminated the risk (Chart 4).

Chart 5. Liquidity stress is easing but not yet eliminated



Sources: US Federal Reserve Board of Governors, Bloomberg Finance L.P. and UBP

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