MONTHLY MARKET BLUEPRINT

Why Financial Planning Matters

October 2020

MAZARS

CONTENTS

Foreword 1

Market Performance – In a Nutshell 2

Asset Allocation 3

Risks Ahead 4

Global Macroeconomic Backdrop 5

UK Macroeconomic Backdrop 6

US Macroeconomic Backdrop 7

Europe 8

Japan and Emerging Markets 9

Macro Theme 1: COVID-19 11

Macro Theme 2: Pound Strength or Brexit Myopia? 12

Macro Theme 3:The Federal Reserve's Historic Moment 13

Fixed Income Spotlight: Reaction to the Fed 14

Equity Spotlight: Tech Earnings Dispersion 15

Gold and Cash Spotlight: Safe Havens? 16

FOREWORD

Why Financial Planning Matters

Covid-19 comes at the back of 11 years of sluggish growth, rock-bottom interest rates but absence of inflation, negative global capital investment, manifest income inequality, stagnant wages and low consumer confidence levels, often dubbed "Secular Stagnation". It is more of an understatement to say that these pressures were "greatly exacerbated" by the pandemic, and probably more accurate to say that the additional strain of the worst quarter for economic output since the end of World War II brings significant dangers to the stability of the global economic and financial systems.

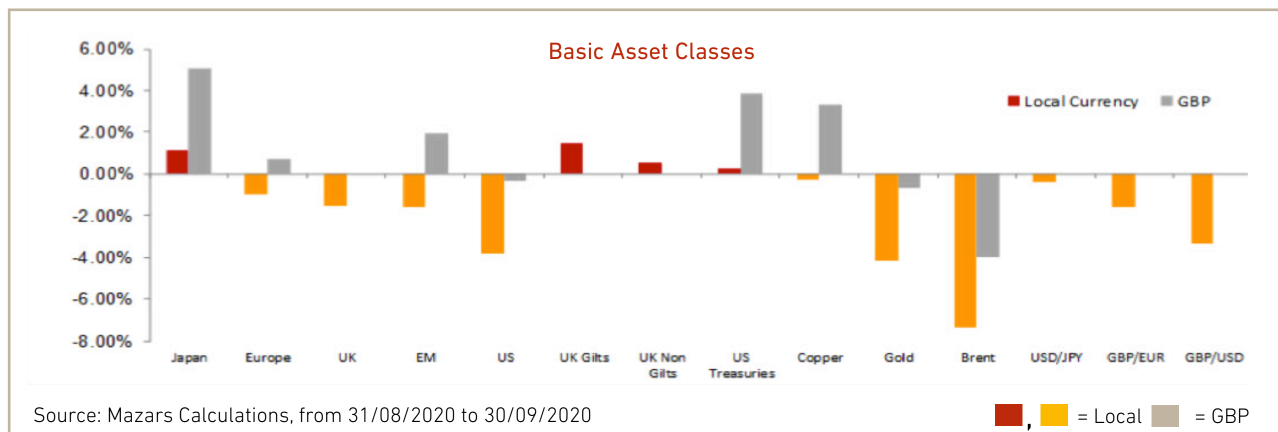
If growth acceleration was a difficult proposition before February 2020, with both left-wing and populist mercantilist approaches having virtually no positive effect on local or global growth, the pandemic renders 5% sustainable growth for developed economies a very low probability event.

With growth projected to be sluggish for a long time and the Fed doing its best to resuscitate inflation, in a bid to prevent the vicious cycle of deflation, our investment committee felt that we need to be realistic about where we can get growth for our portfolios. It means we have to lower fund charges. This quarter, we will be replacing some regional exposures for a much cheaper global index fund, without compromising alpha sources. I means we need to stay diversified, despite very low bond yields. It also means working harder, so in the next few months we can meaningfully reduce UK home bias in our portfolios, while still taking into account the fact that our clients are Sterling-based. Improvements like these are marginal, but without great growth, we can only work on the margins to improve performance. It's a lot of hard work, on a lot of small things, the sum of which might just make the difference between a growing and a stale portfolio.

As for financial planning? Sluggish economic growth eventually will mean sluggish investment growth, which means that income from allowances must be maximized. We must thus navigate through laws as efficiently as possible, with no room for error. In a world where the state is bound to have a heavier hand than in the past, where less free markets will mean less growth, lower ROICs, more zombie-companies and more state intervention, it means this is the exact time when a call with a financial planner is warranted.

George Lagarias
Mazars UK Chief Economist

MARKET PERFORMANCE – IN A NUTSHELL



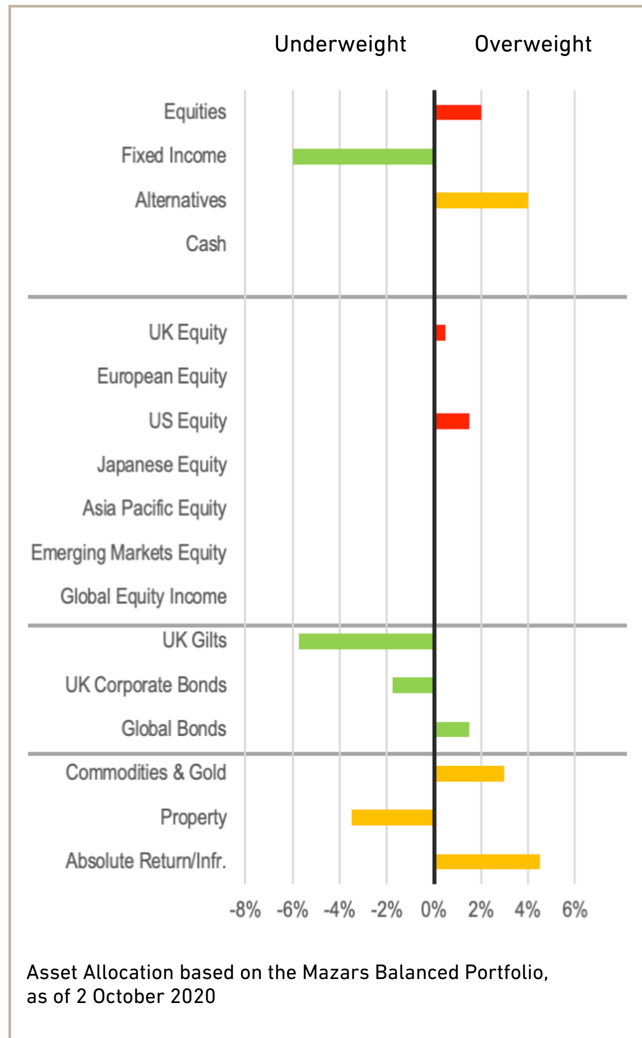
Source: Mazars Calculations, from 31/08/2020 to 30/09/2020 , = Local = GBP

The month in review: Falling Sterling Supports Equity Returns to British Investors

After a strong August, equities were generally negative in local currency terms in September. Japanese equities led major equity markets, rising +1.3% in Yen terms. The British Pound Sterling sold off sharply in September, down -3.4% against the US Dollar to $1.30, down-3.7% against the Japanese Yen, and down -1.6% against the Euro. The weakening currency boosted returns in Sterling terms to British investors, global stocks which were down -3.4% in local currency terms were flat in Sterling terms. UK equities were down -1.5%. US growth stocks which have been some of the best performing assets year-to-date lost some momentum in early September. Valuations in the US remain elevated relative to historical figures and positive sentiment on a vaccine could drive a rotation towards cheaper stocks. After a pause, not uncommon in large clinical trials, the Oxford-AstraZeneca trial resumed and could be approved by year-end. US markets also faced headwinds from rising political uncertainty caused by the upcoming election. Trump had gained ground on Biden in September in some key swing states, however the first Trump-Biden debate, at the end of the month, was marked by a lack of real breakthrough from either camp.

European equities were some of the best performing on a relative basis in local currency terms, but the lack of movement in the exchange rate, a key driver of performance in September meant European equities rose +0.7% in Sterling terms. Globally, all sectors were negative but Utilities and Industrials were the best performing sectors, with Financials and Energy the worst hit sectors. Europe has begun to see an uptick in Covid-19 cases ahead of the Autumn with Spain, France and the UK in particular showing evidence of 'second waves'. Government yields fell slightly in September. The UK 10-year fell -8.2 basis points to 0.23% whilst the US 10-year fell just -2.1 basis points to 0.68%. The German 10-year fell -12.5 basis points to -0.52%. In credit markets, US yields generally rose, and with the lower credit ratings typically showing the greatest rises in yields. Gold fell -0.7% for the month to $1,908.6 and Oil fell back -2.2%, now down -35% for the year.

ASSET ALLOCATION



Asset Allocation based on the Mazars Balanced Portfolio, as of 2 October 2020

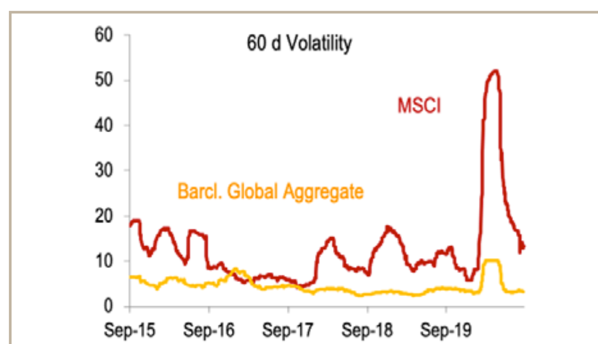
Outlook and portfolios

- The 11-year global economic and financial expansion cycle has come to an end, the result of a rare "Black Swan" event, a global pandemic. Economic data sharply deteriorated throughout March, April and May as a result of an unprecedented global lockdown. From June onwards we saw a meaningful rebound in economic activity as global economies reopened, albeit against a backdrop of deteriorating virus data. The data is still volatile, mostly suggesting that the recovery is petering out. The economy we saw both demand an supply shocks which have damaged supply chains. Meanwhile, unemployment figures are still subject to upside revisions. Business and consumer confidence indices are still well below their long term averages.
- Governments and central banks responded with unprecedented fiscal and monetary stimulus, the result of which was a stabilisation of equity and bond markets. The Federal Reserve has added $3tn of liquidity into the system since last September, almost three times greater than the first QE tranche in 2008, and abandoned it's long standing hard-inflation target, suggesting that interest rates might be left unchanged until the end of 2023 and that there's possibly more QE on the way. However, transmission mechanisms for monetary and fiscal policy haven't been yet successful in stabilising economic growth yet.
- Global stock markets have rebounded, but with a great dispersion in returns, as investors seem to be more focusing in Dollar investments.
- In the face of these developments, our investment committee decided to keep broad positioning unchanged and trust in the long-term properties of asset allocation. However, we have increased weighting in passive global stocks, to reduce the cost of portfolios in light of projected sluggish investment growth. We remain roughly neutral on equities and underweight bonds.

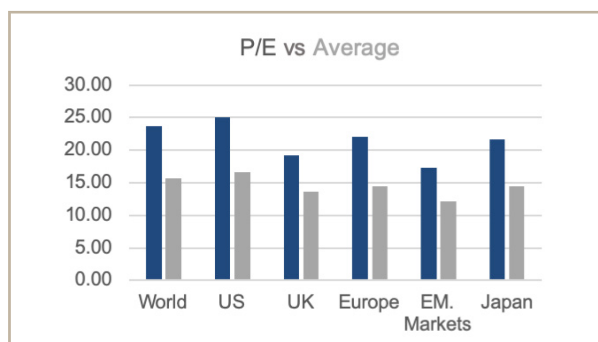
Charts Source: Mazars calculations

RISKS AHEAD

- Global economic growth faltered at the swiftest pace since WWII. Over the short-term, Covid-19 has had a significant impact on both economic fundamentals and market sentiment, while adding to de-globalisation pressures. At the time of writing, new cases have been going up globally, and the world is in the middle of a second wave, however policy reaction has been much more benign wirhno universal lockdowns. The system looks better prepared and hope that the invention of a vaccine is closer has reduced concerns for investors.
- In fact, despite the new coronavirus being the primary driver of economic performance, markets' focus has been fixed on quantitative easing, with investors convinced, for now, that central bank risk suppression will is potent enough to weather the economic storm. However, we wonder whether that is actually the case over the long term.
- Global bond yields might be low, and are likely to remain so for some time especially as the Fed has now effectively removed its 2% inflation target. But now companies find themselves with weaker balance sheets. Possible inability to raise new debt or refinance old debts, especially in the face of a sudden stoppage of operational cash flows, could have devastating consequences, especially for smaller/ mid-caps and companies teetering at the edge of the investment grade spectrum. In the US, apart from the recession, investors are now worried about the impact of a change in the presidency next year, or a tumultuous transfer of power, the possibility of more divided government, as well as illiquidity in the short-term debt market.
- In the UK, we are seeing a record-drop in aggregate output, compounded by pressures of a potential hard Brexit at year's end.
- In China, investors will be looking closely to assess the pace of the recovery, to make sure that growth doesn't falter again.
- In Europe some of the risks were mitigated, as countries have coalesced to mutualise some debt raised to fight the virus.
- We feel that short-term systemic risks are dominating and that longer term risks are building up. Even more liquidity may be needed. We need to wait for further clarity, as the world is currently in flux, before assessing the damage and further consequences of this new crisis.



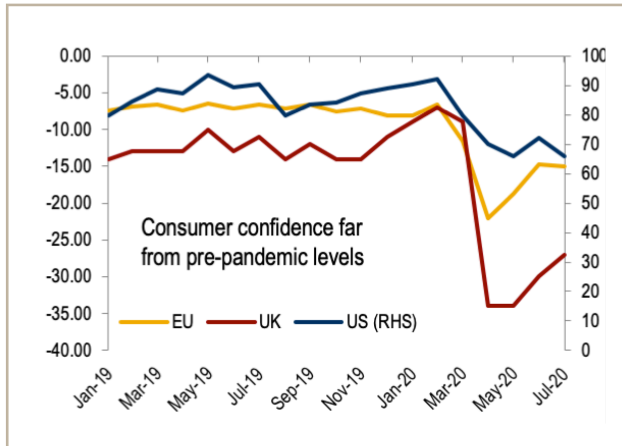
The Fed has successfully supressed risk after spring 2020.



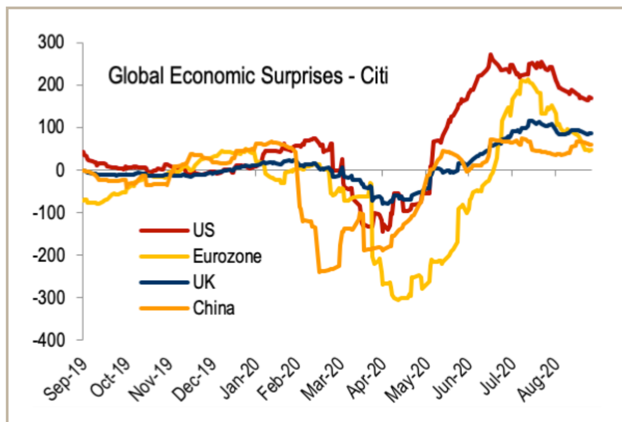
Valuations are excessive versus the recent past.

Charts Source: Mazars calculations

GLOBAL



Economic activity has rebounded somewhat, but it doesn't seem to be picking up significant momentum.



The global economic momentum seems to be petering out

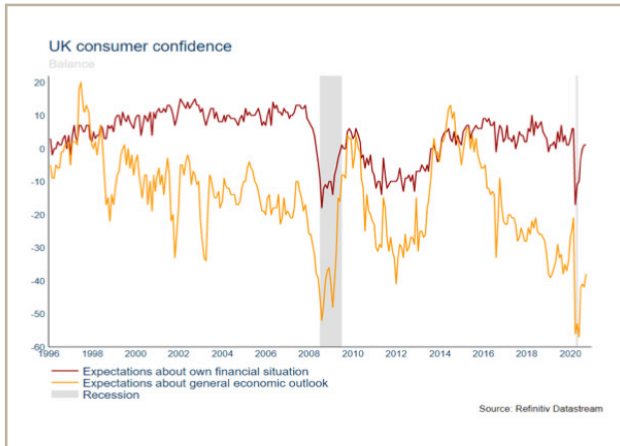
For the period, global stocks fell by 3.4% (0% in GBP). The highest performing sectors were Utilities and Industrials while the worst performers were Energy and Financials. Equities were trading at 23.83x times forward earnings, 51.5% above long term average. Gold fell 4.2% and oil prices fell 5.6%.

Q2 global aggregate economic contracted at the fastest pace in recent recorded history. The IMF predicted a 4.9% drop in global GDP for 2020, with risks to the downside. The global services sector has suffered the most because of the "Great Lockdown", however manufacturing is also subject to a shard drop in activity.

Despite dismal Q2 GDP data, indicators have shown a rebound of aggregate economic activity in early Q3 on pent-up demand, as economies have started to gradually reopen. Nevertheless, we would expect the economic rebound to slow down, as Covid-19 cases rise as stimulus in the US is delayed. US unemployment figures have come down somewhat, although they could still come back up after stimulus runs dry. The numbers in Europe differ significantly, but this is mainly because of furloughing (furloughed employees don't count as unemployed) and lack of mobility which doesn't classify a lot of workers as unemployed according to ILO standards. Inflation remains subdued, with central banks mostly fearing demand-driven deflation. Supply chain pressures from China have eased, as the country makes its way back to a "new" normal, but manufacturing shutdowns in Europe and the US have resulted in renewed supply pressures on certain industries. Global trade conditions have also deteriorated significantly. Supply chain disruptions could result in short-term inflationary pressures in some countries, like the UK. The crisis has seen record capital flight, especially from Emerging Markets. Responding to the crisis, central banks have floored interest rates and restarted Quantitative Easing to maintain market liquidity.

Charts Source: Mazars calculations

UK



Confidence has continued to recover, albeit from extremely low levels. Expectations about consumers own confidence has recently turned positive, though is stalling. Expectations for the general outlook remain strongly negative.

Despite the Covid-19 pandemic, the UK housing market has experienced growth. Houses rose 5% year-on-year as sales began to complete again following lockdown and cuts to stamp duty boosted demand. This annual growth rate is the highest since September 2016.

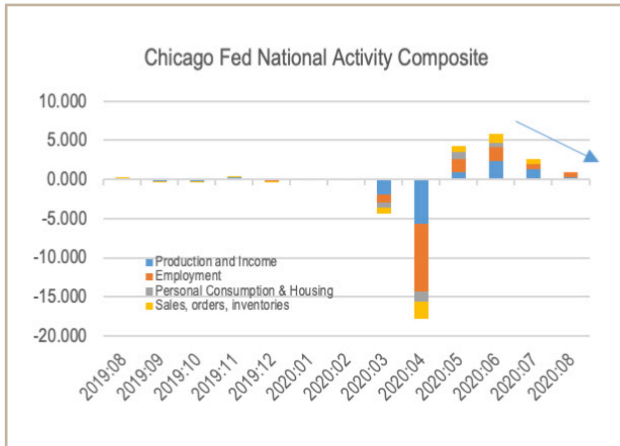
UK stocks sold off -1.5% in September, taking the yearly return down to -20.0%. In a recurring theme this year, Financials and Energy were the worst performing sectors, whilst Consumer Discretionary was the best performing sector. UK stocks are trading at 19.11x forward earnings, at a discount of 20% to the MSCI World. The 10 year Gilt yield fell -8.2 basis points to 0.229%

The Chancellor elected not to submit an Autumn Budget, instead announcing targeted measures to combat the current economic situation. The government had been under increasing pressures to announce a continuation of the furlough scheme due to end on 31 October. The new job scheme will see employees working 33% of their hours receive 77% of their salary, with 22% covered by the government. The measures are intend to protect 'viable' jobs with the Chancellor admitting he cannot protect every job from redundancy. UK inflation was marginally better than expected, rising at an annualised rate of 0.2% against 0.0% expected. Retail sales continued to rise, with the volume of retail sales up 0.8% in August compared with the previous month, helped by strong demand for home improvement goods. This reading suggests home workers are supporting the recovery, however a shift to greater precautionary saving is expected if lockdowns continue to be necessary.

Outlook: The economic outlook continues to depend on Brexit. Leaving without a deal could materially dampen the outlook not just for the immediate trade impact but the longer term repercussions too. Even a so-called 'skinny' deal gives the platform for future negotiations in a way in which a no-deal Brexit will not.

Charts Source: Mazars Calculations, Refinitiv Datastream

US



US growth petering out

The S&P 500 is still near all-time highs despite a retrenchment near the end of September

For the period, US stocks fell by 3.8% (0.3% in GBP). The highest performing sectors were Homebuilding Index and Materials while the worst performers were Telecoms and IT. Equities were trading at 25.21x times forward earnings, 51.9% above long term average and 5.8% above the MSCI World. 10y bonds fell 2 bps at 0.684%.

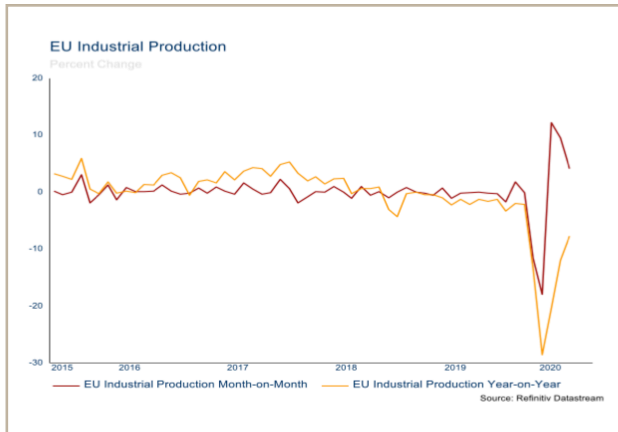
The US economy is slowing precipitously and entered a recession, losing 5% on an annualised basis in Q1 and down almost 10% year-on-year after Q2. Nevertheless data improved somewhat in the past few months. Unemployment slightly improved, from 14% to 7.9%. Inflation is still tame, but lack of demand hasn't pushed prices down with the supply chain suffering from COVID-related disruptions. Consumers and businesses appear to have a modicum of optimism about the future. For Q2, S&P 500 earnings per share fell 34% and projections for the year-end were suggesting a 25% drop in overall profits.

As a result, the central bank continued to print a record amount of money and shed its long standing 2% inflation goal.

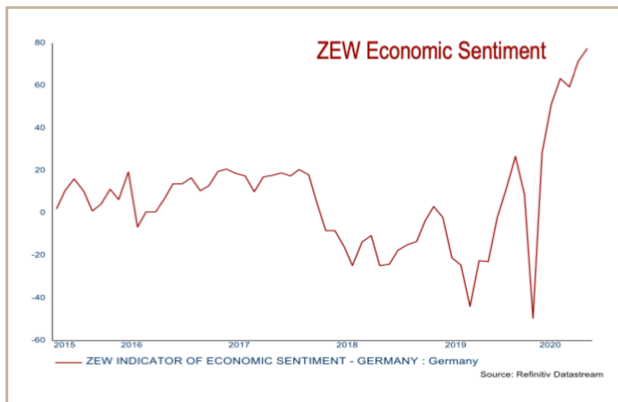
Outlook: The US economy is slowing at a rate commensurate to that of the rest of the world, and is additionally hamstrung by supply chain disruptions. However as the Fed remains dovish the outlook for US assets, which feature very high ROE (return on equity) companies, continues to remain upbeat relative to the rest of the world.

Charts Source: Mazars calculations

EUROPE



Although industrial production is improving month-on-month, figures are still significantly below their levels this time last year.



Despite the current crisis, German Economic Sentiment is far higher than it has been in recent years, with the rise to 77.4 well above expectations for a fall to 69.8.

In September European stocks rose by +0.7%%. The best performing sectors were Retail and Autos while Financials and Energy were the worst performing sectors. 10Y Bund yields rose 13 bps to -0.522%.

The growth outlook for the Eurozone has been mixed. Manufacturing is picking up in Germany, with the latest PMI in expansionary territory at 56.6 and ZEW Economict Sentiment jumping to 77.4 in the bloc's largest economy. Indeed the EU wide manufacturing figure rose to 53.7 from 51.7. However EU Consumer Confidence remains low, largely unchanged in September at -13.9. Inflation remains in negative territory with interest rates floored at -0.5% and in August unemployment ticked up to 8.1%. As with much of the world, Europe is facing a resurgence in Covid-19 cases.

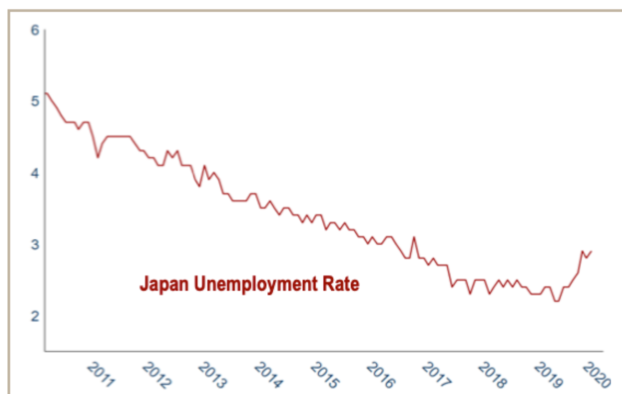
EU leaders also face various geo-political issues, with the disputed elections in neighbouring Belarus, the poisoning of Russia's opposition leader Alexei Navalny as well as simmering tensions between Greece and Turkey. Not to mention that Brexit negotiations appear to be going to the wire.

Outlook: Europe seems to be facing a perfect storm of geo-political issues but with limited ability of monetary or fiscal policies to help growth pick up following COVID. On a forward P/E basis it is also more expensive than all major regions aside from the US. We have moved underweight European equities as part of our move to having more of our Global equity exposure hedged.

Charts Source: Mazars Calculations

JAPAN AND EMERGING MARKETS

China's Manufacturing and Services PMIs remained in expansionary territory as the domestic and global economy continued to recover from the pandemic.



The Japanese economy shrunk at its fastest rate on record as GDP fell -7.8% for Q2 2020.

In September, Japanese stocks were up +5.4% and +1.3% in Sterling and local terms, respectively. Emerging market stocks rose by +1.9% in Sterling terms but fell by -1.6% in local terms. Japanese and emerging market equities were trading at 21.2x and 17.9x times forward P/E respectively, higher than their long term averages.

In China, exports jumped by +9.5% YoY to USD 235.3bn in August 2020, accelerating from +7.2% gain in the previous month. This marked the third straight month of increase in overseas sales and the fastest rate since March of 2019, amid further improvement in global demand as more countries lifted coronavirus-led restrictions. Chinese exports have been boosted by record shipments of medical supplies and robust demand for electronic products. Manufacturing activity in September was little-changed at 53.0, slightly below previous months PMIs of 53.1. Factory managers indicated that activity has maintained its recovery momentum in the wake of Covid. New orders grew the most since early 2011, with new export business expanding at the fastest rate since August 2017. The services sector reported a solid increase as well. The official NBS Non-Manufacturing PMI for increased to 55.9 in September 2020 from 55.2 a month earlier, signalling the fastest growth in the service sector since November 2013.

On September 15, Yoshihide Suga replaced Shinzo Abe and became prime minister of Japan after winning a landslide victory in elections to lead the ruling Liberal Democratic party. Mr. Suga has been at the centre of Japan's government as chief cabinet secretary for the past eight years and his victory means continued support for monetary stimulus by the Bank of Japan and the closest possible security alliance with the US.

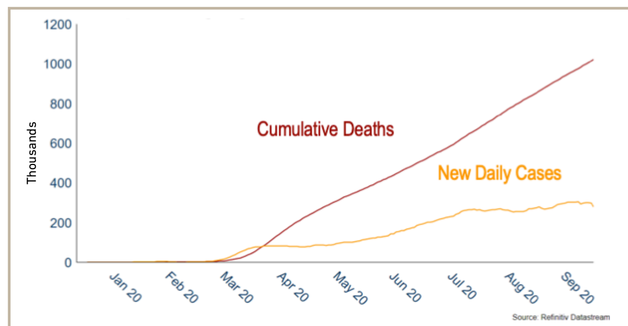
Unemployment in Japan rose to 2.9% from 2.8% previously but came in below market expectations of 3%. Unemployment in Japan remained relatively low when compared to other developed nations but wage growth fell to -1.3% for the same period. The Jibun Bank Japan Manufacturing PMI was higher in September at 47.7, up from 47.2 in the prior month, and beating market expectations. The sector was boosted by rising demand from China and South East Asia.

Outlook: As a significant drop in global demand for goods and tourism hits Asia due to COVID-19, the risks for Emerging Market economies have risen. These economies have experienced significant capital outflows, but according to the IMF, overall liquidity provisions have balanced the outflows.

Charts Source: Mazars Calculations

OUR THEMES

MACRO THEME 1: COVID-19



As several countries have begun to see a second wave of COVID-19 cases, the global death toll has now crossed 1 million.

After February 21, when it became apparent that COVID-19 was developing quickly outside of China, markets followed the "virus narrative". However, this did not last long. Traders and longer-term investors who have, for a decade, been conditioned to respond directly and primarily to central bank stimulus, began to focus on the $3tn and the €1.35tn of new money added to the markets this year by the Federal Reserve and the ECB respectively. Unsurprisingly, the financial and media narrative began to follow the stock market rebound, and investors started focusing on a more hopeful future. Both US and global stocks are near pre-COVID, February 2020 levels. More importantly, they are all trading at very high valuations versus projected 12m earnings, which suggests that traders are dismissing the COVID-19 related earnings drop and focusing on life after. However, we need to remember that this particular crisis is exogenous. Thus we believe that markets may have been too optimistic in their narrative so far.

Although there has been recent movement in developing a widespread COVID-19 vaccination, there is still no indication as to its completion. The European Medicines Agency's Human Medicines Committee (CHMP) has started the first 'rolling review' of the COVID-19 vaccine being developed by AstraZeneca and the University of Oxford. However, much of the evidence supporting the vaccine's safety and effectiveness are yet to be submitted.

Additionally, if and when a vaccine does become available, the likelihood is that only those most at risk will receive it. For example, in the UK, the head of the vaccine task force has suggested that less than 50% of the population will receive the vaccine, with priority given to those over 50 years old, as well as health and care home workers.

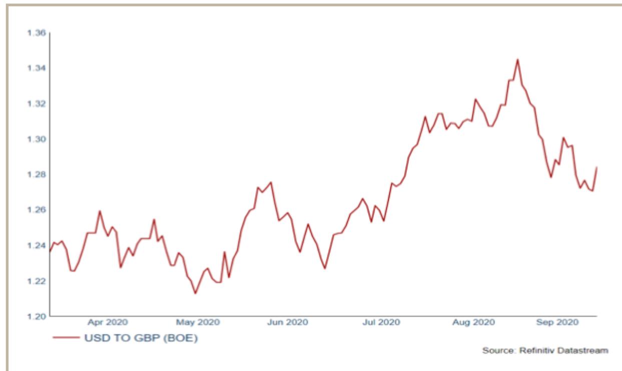
While the world awaits the arrival of a vaccine to help cure and prevent the virus, many countries are experiencing a resurgence of new COVID-19 cases, pointing towards the occurrence of a global second wave. European cities such as Paris and Madrid have imposed stricter lockdown rules, whilst outbreaks are beginning to surge in parts of south-east Asia. Current WHO estimates suggest that about 10% of the global population may have been infected by the virus, implying the majority of the world remains at risk.

Globally, the jobs hit of the COVID-19 crisis has been 10 times larger than the first few months of the Great Recession in 2008, based on the drop in employment and the reduction in hours worked among people who kept their jobs. According to the OECD, a second wave of the novel coronavirus around the world could leave 80 million people out of work in the world's developed nations. The US economy shrank by an annualized -32.9% in the second quarter of 2020, its biggest contraction on record. Several other economies also witnessed record-low GDP growth. Even though this is anticipated to pick up in third quarter data as economies have begun to gradually open up, overall activity is likely to remain subdued for a while. Sectors such as tourism, travel, entertainment, restaurants and accommodation are unlikely to return to normal as long as no vaccine or treatment is widely available.

We recognise that a good narrative is necessary for consumers and investors to have confidence. We also recognise, however, that exogenous events are not affected by the narrative.

Charts Source: Mazars Calculations

MACRO THEME 2: POUND STRENGTH OR BREXIT MYOPIA?



Sterling ceded gains in August, falling back to June levels, before rallying somewhat towards the end of the month on positive sentiment regarding both rates and Brexit. Volatility in the currency has been subdued recently but will likely spike around major political events between now and the end of the transition agreement.

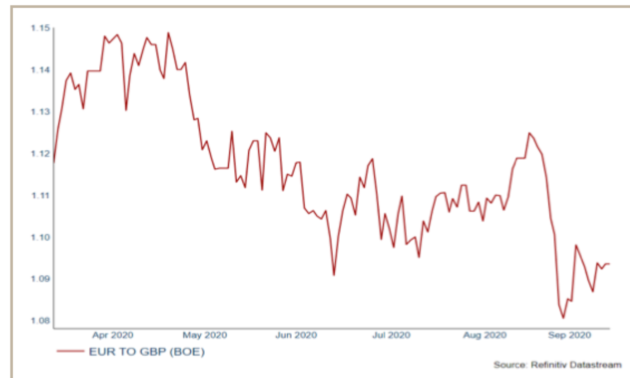
1 September represented a peak for Sterling. Sterling touched US $1.345, a level not seen since mid 2018. Then the currency began to slide back down, a brief rally in the third week of the month gave way until right at the end of September we have seen another uptick in value. If not Brexit myopia, what is driving the currency now?

In the final week of the month Sterling rose above €1.10 and US $1.28. This was driven by two factors, the first has been the clarification of the mixed messaging coming from the Bank of England. Over the last few months Andrew Bailey, Governor of the Bank of England, has described negative rates as, 'in the toolbox'. Then at a Monetary Policy Committee meeting the Bank said there was 'structured engagement on the operation considerations' of how negative rates could be implemented in practice. All else equal, a cut in interest rates in an economy lowers to the incentive to invest there. This in turn drives the flow if international capital markets, when a country cuts their policy rate this typically causes a sell-off in their currency.

The result of the Bank of England's signalling that negative rates were possible was a drag on Sterling, as investors became more fearful of a seemingly ever more likely cut, they lowered their valuation of Sterling. When Andrew Bailey clarified that a move to negative rates was unlikely, followed by the Deputy Governor's comments that they were not 'imminent', Sterling rallied by 1.4% against the US Dollar.

The second cause of the fall, and late rally this month in Sterling might be viewed somewhat similar to the concept of Theta in options trading. As time has been drawing closer to the deadline, the value of Sterling falls as a deal has less time to be agreed.

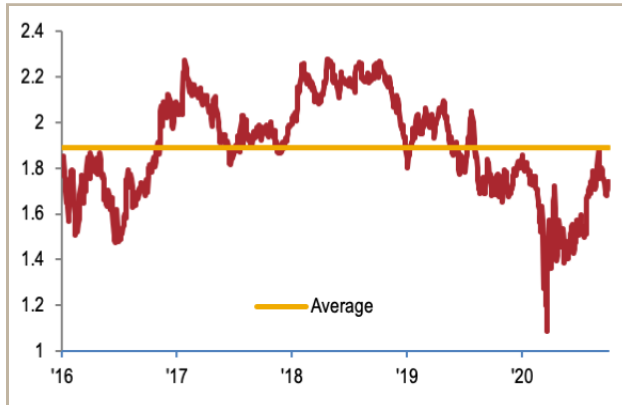
Positive news has been coming from both camps, ahead of a crunch summit on 15th October. The last week of September represents the final week of negotiations and drafts of a final legal agreement have already begun. Investors appear somewhat more cautious than the last rally, and the consensus view is for high volatility in Sterling as markets try to price in the ever-changing likelihood of a Brexit deal.



Sterling's first half of the month fall against the Euro was more pronounced than against the US Dollar, though lasted relatively shorter. The UK has lagged Europe in Covid-19 cases, and is 'catching-up' the continent's second-wave of cases. Despite this, Brexit should remain the primary driver of the currency pairing until at least year-end.

Charts Source: Mazars Calculations

MACRO THEME 3: THE FEDERAL RESERVE'S HISTORIC MOMENT



US (5 year) inflation expectations briefly rose but they are still well below average.

The US Federal Reserve has put a long-standing 2% inflation goal on hold saying it will tolerate higher prices changes for some time. The move is an acknowledgment that more monetary stimulus is needed to stoke faltering demand. However, there are many risks attached, either if it succeeds or not.

Inflation, prices going up, has been often used as a tool to speed up purchases of many assets, especially expensive ones.

If the policy succeeds, combined with Quantitative Easing, it might wreak havoc in the bond market. On the one hand, investors will be faced with a very strong buyer, the central bank pushing yields lower, on the other inflation upping the opportunity cost for holding a bond.

An inflationary environment has traditionally been good for equities. However, with a lot of companies having re-leveraged, many of them below investment grade status, it remains to be seen how potentially higher yields will help with refinancing efforts, or how higher inflation will make those bonds attractive at the low yields they need to refinance their debt.

We fully expect some real assets to thrive, like real estate and precious metals, but these markets are not deep enough to cater for global demand.

And then there's the probability of failure. While we would be surprised – the Fed is a very strong player in global markets and economies- the sound of that failure would be resounding and the US would be confirmed as a "Japanised" economy. This could have a profound effect on the Dollar, not in terms of initial trading reactions but it terms if its long term status as a reserve currency.

The truth of the matter is that the global economic system, as an mechanism to allocate resources has been damaged. In the decade preceding the Covid crisis, savings rates rose, investments in capital expenditure fell, as real incomes stagnated. The term "secular stagnation" (as opposed to "cyclical") was very much thematic at the end of 2019. Inflation is a mechanism to prevent demand from drying up and reducing the real debt burden. But it cannot create demand for goods and services, anymore than a real estate agent can create a sale by imposing time limits on clients who don't really like the property in the first place.

The Fed has been instrumental and potent in fighting off financial crises. This crisis, however, is more economic in nature, and needs fiscal and policy responses far beyond the stability of financial markets. Until we see these responses, we would remain in the camp that markets currently are, and not expect inflation to pick up materially.

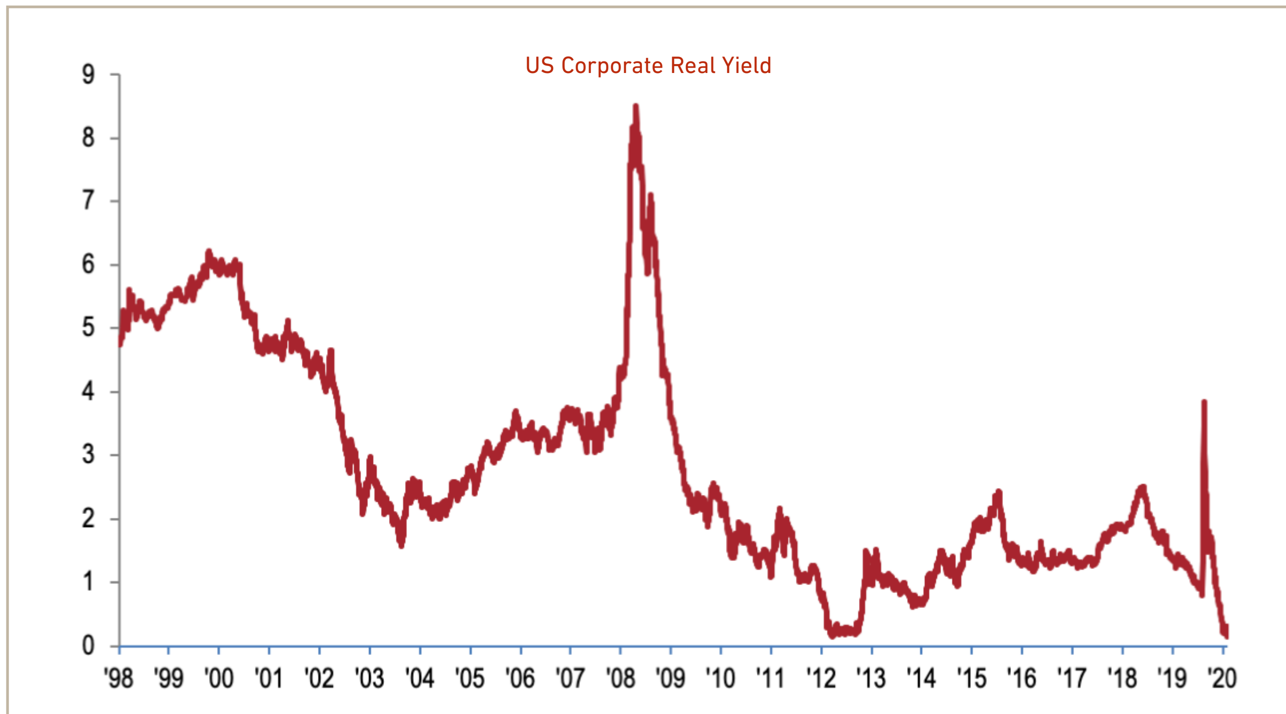
Charts Source: Mazars Calculations, Refinitiv Datastream

RISK ASSET SPOTLIGHT: REACTION TO THE FED

After the US Federal reserve stated that it would abandon its 2% inflation target, the immediate reaction was a jump in equities and long term bond yields as well as a moderate tightening in yield curves, consistent with a more inflationary environment. However, overall yields have remained low, as investors believe the Fed will increase the rate of bond buying operations, even if inflation expectations ticked higher.

As a result, US real corporate yields fell to nearly zero (or below by some metrics).

At this point, bond yields and implied inflationary expectations don't discount inflation much higher than 1-5%-1.9%, i.e. markets are waiting for the Fed to unveil more stimulus in September before they start pricing in the consequences. This is an indication that communication policies will not be enough to bring inflation, but that a successful package of monetary and fiscal measures will be required to stoke demand-driven inflation, a result of more investments and higher wages.



Charts Source: Mazars

EQUITY SPOTLIGHT: TECH EARNINGS DISPERSION

As some (Apple, Amazon, Google, Facebook) of the big tech CEOs answered questions surrounding competition and regulation, the group's earnings each beat expectations. Against the backdrop of the worst ever quarterly fall in US GDP this is all the more impressive. Big tech companies hold the top five spots of the S&P 500 index and account for the largest share of the index since the 1980s.

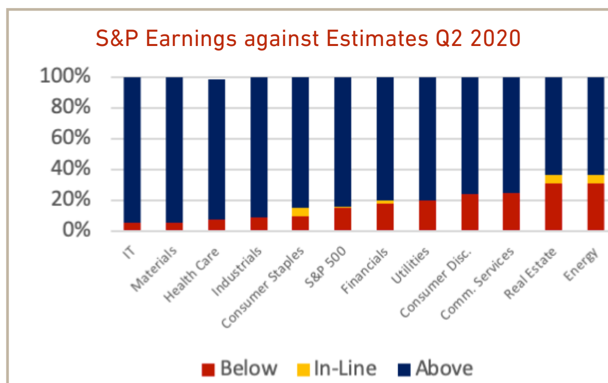
Amazon and Facebook were two of the clear winners during earnings season. Amazon reported diluted earnings per share (EPS) of $10.30 per share, analysts were only expecting $1.46, after tax profits at the online retailer doubled to $5.2bn. Facebook posted results of $1.80 per share, almost double its value a year ago and beating EPS estimates by 57%. Investors were concerned about the impact of the advertising boycott on Facebook, but revenue growth of 11% shows the firm isn't overly reliant on any source of income.

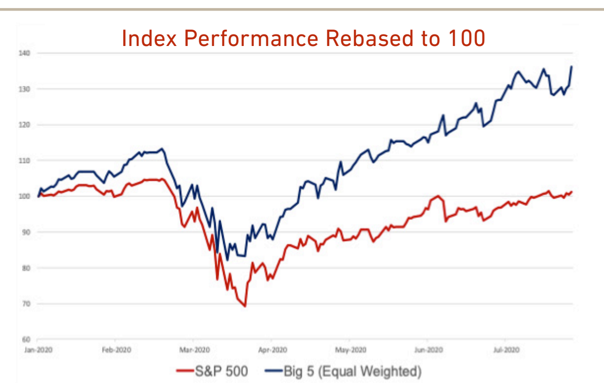
Alphabet, owner of Google, did actually see contractions in revenue and earnings, its first ever decline in sales, but ultimately beat expectations. Diluted EPS fell to $10.13 but still some way ahead of expectations of $8.34. Microsoft's revenue grew 13% on an annualised basis in the quarter to June 30, and marginally beat expectations on both revenue and EPS. Apple saw iPhone handset sales grow 25% despite the smartphone market contracting 14%, all other top five vendors had falling sales with Samsung's down 30%.

The table below helps show the strong performance of tech relative to other sectors. Accounting for Amazon being included within Consumer Discretionary only helps to further this rising inequality between tech and 'the rest'.

What we are seeing is a polarising market, even in the best performing sectors for earnings, less than half of companies saw earnings grow. At -35.7% for Q2 2020 looks set to post the largest decline in blending earnings since Q4 2008.

The graph below shows YTD performance of the entire S&P 500 market, against that of the top 5 on an equal weighted basis. Performance to March is fairly similar, but as consumers and investors have come to terms with the 'new-normal' it has been the big tech companies who have benefited the greatest. Another possible explanation for the rise in big tech has been the increased accessibility of speculation to the armchair investor. The rising inequality between the Big 5 and the S&P 500 coincides with the rising popularity of commission free trading platforms such as Robinhood where the Big 5 are often the most popularly traded stocks suggesting an increased role of amateur investors in the stock market rally.





Charts Source: Mazars Calculations, Factset, Refinitiv Datastream

GOLD AND CASH SPOTLIGHT: SAFE HAVENS?

A lot of investors are asking whether we can still trust traditional safe havens, like Gold or Cash. The narrative behind these questions has some merit:

Gold is an asset that has no yield, next to no industrial use and only has the value we ascribe to it. In a world of modern finance it may be considered outdated by some and its value is increasingly subject to speculation after the introduction of gold ETCs.

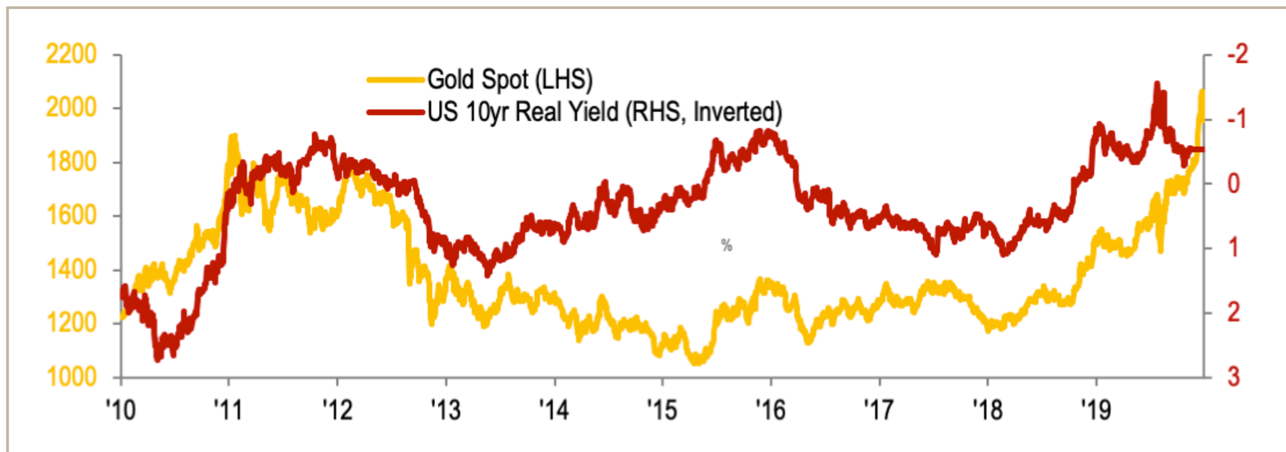
Cash is still, and will always be, king, especially in a liquidity crises. But Cash has a negative real yield (0% return and positive inflation) and, in a world were fiat currencies come under question, it might be a more dangerous asset than previously believed.

However, we still believe both assets have a place in portfolios for a number of reasons:

a. They both exhibit low correlations with traditional risk assets, which tend to increase in an age of quantitative easing. Low correlations are the foundation of portfolios.

b. Gold's value is behavioural, but that argument goes for most financial assets: Why pay 15-30x a company's earnings, when we have visibility only over the next 2-3 years, for reasons other than trust? Why include bonds with assured negative real returns in a portfolio over the longer-term? Because behaviourally they are a safe haven. When inflation is up and trust in fiat currencies erodes, Gold is still considered a safe haven.

c. When volatility spikes, cash pots allow investors on drawdown to live on the cash and not sell assets in distress, but rather wait for mean reversion. With markets propped up by QE (the post-crash recovery was the shortest in market history) mean reversion (a return to previous trend) is more likely than it may appear after a few bad days for the stock market.



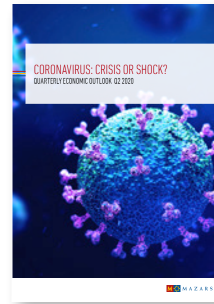
Charts Source: Refinitiv

MAZARS

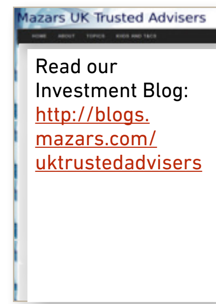
MORE READING...

Weekly Market Update

Investment newsletter



Quarterly outlook



Investment blog

Contact us

T: +44 (0)20 7063 4000 E: wealth.management@mazars.co.uk

Investment team

David Baker - Chief Investment Officer E: david.baker@mazars.co.uk

George Lagarias - Chief Economist E: george.lagarias@mazars.co.uk

James Rowlinson - Investment Analyst E: james.rowlinson@mazars.co.uk

Prerna Bhalla - Investment Analyst E: prerna.bhalla@mazars.co.uk

Stephanie Georgiou - Operations E: stephanie.georgiou@mazars.co.uk

Patrick McKenna - Investment Analyst E: patrick.mckenna@mazars.co.uk

www.mazars.co.uk

Chart Sources: Bloomberg. The information contained in this document is believed to be correct but cannot be guaranteed. Opinions constitute our judgment as at the date shown and are subject to change without notice. This document is not intended as an offer or solicitation to buy or sell securities, nor does it constitute a personal recommendation. Where links to third party websites are provided Mazars Financial Planning Ltd accepts no responsibility for the content of such websites nor the services, products or items offered through such websites.

Mazars Wealth Management is a trading name of Mazars Financial Planning Ltd. Mazars Financial Planning Ltd is a wholly owned subsidiary of Mazars LLP, the UK firm of Mazars, an integrated international advisory and accountancy organisation. Mazars Financial Planning Ltd is registered in England and Wales No 3172233 with its registered office at Tower Bridge House, St Katharine's Way, London E1W 1DD. Mazars Financial Planning Ltd is authorised and regulated by the Financial Conduct Authority.

© Mazars LLP 2020-10 38572