RAYMOND JAMES

Out With The New, In With The Old!

Jeremy Batstone-Carr, *European Strategist, Raymond James Investment Services*

April, wrote TS Eliot in his epic poem The Wasteland, is the cruellest month and many investors holding portfolios of financial market assets in diverse geographical locations would likely agree. This most capricious of months has been characterised by pronounced unpredictability and, particularly in the case of the stock market, a sea-change in fortunes following the blowout returns of the first quarter of the year. Bonds, too, have struggled to reverse the weakness suffered since the turn of the year. Yet embedded in the concept of portfolio diversification lies the fact that spreading the risk associated with the usual slings and arrows of investment fortune reduces ones' exposure to the travails of a single or closely correlated group of asset classes.

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Perhaps it was inevitable that, at some point, the boundless optimism hitherto apparent in investor enthusiasm for the so-called "new economy", particularly that associated with technology and more narrowly, that part of the technology sector associated with artificial intelligence (AI) would be put to the test. But while the month has concluded with a partial recovery in "big tech" fortunes, triggered by another round of generally stellar results from global (mainly US) sector leaders, it was the revival in the "old economy" that really caught the eye. The index of the UK's largest 100 quoted companies, replete with energy, mining and banking names and for so long the laggard, returned to the fore, hitting a series of fresh all-time highs as the month progressed.

But why now, after so long have the UK stock market's fortunes revived? The answer lies both in domestic and international developments, the latter highly relevant especially to a benchmark index in which around three-quarters of its constituents are large international companies, the majority of which earn revenue and profit in US dollars but report in sterling. Therein lies a key factor. Although reviving towards month-end, the pound has been weak on the foreign exchanges over the early part of April in particular and especially against the euro and the dollar. In part the latter's strength reflects the world's reserve currency's safe-haven status during periods of elevated geopolitical uncertainty and there was no shortage of that as Middle Eastern conflict escalated into direct confrontation between Israel and Iran. Beyond that, concerns have mounted regarding US inflation which has proved sticky despite the Federal Reserve's aggressive rate hiking programme, also serving to support the US currency. US financial assets have repriced to expect only very few, if any, rate cuts this year, in direct contrast to the UK where falling inflation is thought likely to spur the Bank of England to cut rates both sooner and by more than its US counterpart.

Of course, from the perspective of the financial markets the threat posed by escalating conflict manifests most obviously in the price of oil. Irrespective of the fact that Middle Eastern crude supplies are, for now, still flowing freely has not prevented speculation that at some future point they might not be, an upward price adjustment now described as a "war premium". Beyond conflict, increasing evidence that the global economy is achieving a slow synchronised recovery, for the first time since the aftermath of the 2008/09 financial crisis, is thought likely to buoy demand at a time when the OPEC cartel is maintaining a strong grip on supply and Russian oil is still the subject of ongoing sanction. The resultant general strengthening in commodity prices (and note that copper is also integral to silicon chip manufacture), not to overlook the return of takeover discussions, have provided a handy boost to the "old economy" so weightily represented on the UK stock market.

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And the UK economy is recovering too, a slow and still shallow revival from the equally shallow contraction over the second half of last year. Thus, the UK stock market's improving fortunes are not limited purely to externally facing companies, but more domestically-focused entities too. Smaller and medium-sized businesses having long suffered the twin pressures of high inflation and high interest rates are beginning to look forward to a brighter future. Households too, are slowly emerging from a long and painful hibernation. Confidence, while still at a low ebb, is gradually returning, falling inflation providing a welcome boost to real wages. Furthermore, the cut to national insurance tax confirmed in the March Budget should provide a further boost to disposable incomes and falling mortgage rates since the start of the year should ease pressure on the housing market. The Bank of England, for its part, is signalling that the first rate cut may not be far away.

Welcome as the revival in the UK stock market's fortunes has been, the question now is can it last? UK shares are still attractively rated in financial market terms, deeply discounted against their US and European counterparts. Yet despite this, and as is well known to both domestic and international investors, investment returns can be augmented by handy (and reliable) dividend payouts. Be that as it may, a number of UK quoted companies have raised concerns regarding the persistently low valuation placed on their stock, one such senior official going so far as to describe the once vaunted London stock market as a sort of "Jurassic Park". Others, still few in number but notable nonetheless, have opted to delist from London and seek a higher profile elsewhere.

Ascribing the UK stock market's prolonged underperformance to Brexit, or an uncertain political backdrop may be in-vogue excuses, but they do not go far enough. Regulatory adjustments, notably in the pension industry, have long-forced funds to reduce exposure to the stock market in favour of the gilt-edged and other bond markets. This has deprived UK stocks from a significant source of demand and contributed notably to the prevailing situation. Encouragingly, the government has taken notice and is urging the pension industry to do more in support of UK businesses a move which, if successful might go a long way towards restoring the UK stock market's lustre and London's role as the gateway to Europe in the eyes of overseas investors. Rome (or London) was never built in a day; reviving productivity and restoring potential take time to take root, but a start has been made and with support a more prosperous future lies in store.