INFORMATION FOR INVESTMENT PROFESSIONALS

Market updates

Investment team updates | 23 October 2020

US equities

Economy

- Following a big rally the previous week, US markets were a bit more subdued last week (ending 16 October), but still trended in a mostly positive direction. The S&P 500 was up slightly by 0.2% and the Nasdaq by 0.8%. Small caps were slightly negative for the week. Growth outperformed value but it was a modest advantage.
- At a sector level returns were mixed. Industrials stocks did best, followed by communication services which were helped by a strong week from Google. Energy and real estate did worst and there was also some weakness in financials given a slightly underwhelming response to bank earnings.
- At the high level, market moves were still being dominated by the twin narratives of the pick-up in coronavirus cases in the US and Europe on the one hand, and vaccine optimism on the other. There also seems to be a decreasing likelihood of Congress getting a coronavirus relief bill through before the election, but this negativity has been somewhat offset by the prospect of a more substantial round of stimulus should the Democrats win the presidency and both houses in November.

Earnings

- By the end of Wednesday 21 October nearly 25% of the S&P 500 by market cap had reported Q3 earnings. So far the picture has been one of earnings significantly exceeding expectations, by around 17% in aggregate, with 85% of companies beating estimates so far. This is a big beat rate and bettered only in recent times by last quarter. However, we have to hold this against the fact that these two quarters were subject to drastically lowered expectations.
- At this stage, the estimated year-on-year earnings per share for Q3 is -17.5%, and if you exclude cyclicals that figure improves to an estimated decline of -2.4%. But if the current beat rate continues for the rest of earnings season, we might expect those headline numbers to improve a little.
- As well as JP Morgan early in the previous week (ending 16 October), Goldman, Citi, Morgan Stanley and Bank of America all came out with positive EPS surprises. Generally, the banks have been boosted by increased revenues from trading during the market volatility, especially those with large investment bank operations, alongside lower than expected provisions for bad loans in Q3.

- Taking the first three quarters of the year as whole, across Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase and Morgan Stanley, investment banking and trading revenues are up 34% from the same period last year, which highlights the advantage of those banks leveraged to trading.
- We recently initiated on Morgan Stanley and sold Citi in core portfolios. The former is an example of a bank which is shifting its business mix away from the more volatile transaction-driven model to more of a stable fee-driven firm. The recent announcement of its acquisition of Eaton Vance will also help to accelerate that shift and create a business with 60% of revenue coming from asset management. We also initiated on BlackRock given its dominant market position, investment in technology and operating leverage.
- Despite the good headline results, the stock price response from banks was pretty muted. The outlook given by banks was not especially favourable as credit visibility is poor.

M&A

- There has been more consolidation in the US oil and gas sector following the announcement on Monday 19 October that ConocoPhillips will purchase shale oil producer Concho Resources in an all-stock deal for nearly $10 billion, giving the combined company an enterprise value of $60 billion to become the number three player in US shale production. This comes on the back of Chevron’s purchase of Noble Energy in July and Occidental’s acquisition of Anadarko last year. On the surface, it is a good deal for Conoco which is barely paying a premium for some high-quality assets and stands in stark contrast to Occidental’s expensive deal last year, providing more evidence that the new oil price environment is changing the economics for shale producers.

Fixed income

Markets

- Tuesday 20 October saw markets break out of long-held ranges, which was mostly maintained throughout the rest of the week. Core government bond yields moved appreciably higher: both US and German 10-years were both +5bps. Based on BofA Merrill Lynch Bond Indices, credit spreads moved a little tighter, with Global IG at 127bps on Thursday 22 October from 129bps at the end of the previous week (ending 16 October), and Euro HY was at 466bps, from 477 the previous week. Equities, meanwhile, moved higher, with the S&P +0.5% led by banks.
- In FX, after a quiet start to the week by Thursday 22 October both the Euro and GBP were stronger, with the Euro at 1.186).
- On Wednesday 21 October oil slipped back lower to $40 per barrel.
- In Italy government spreads hit 137bps on Wednesday 21 October and are now 15% tighter year to date.

News

- On Thursday 22 October the final US presidential debate passed without too much hullaballoo. The US jobless claim fell to 787,000, the lowest since the Covid-19 crisis began.
- In Europe consumer confidence fell to its lowest since May, perhaps a result of a continuing rise in Covid cases across the continent, with France registering 42,000 on Thursday 22 October, and the UK and Spain both around 21,000. Manchester has now become a Tier 3 city like Liverpool, and further curfews were imposed in Italy.

- The UK and EU are to resume talks around Brexit, which made the GBP stronger and gilts weaker. Still in the UK, house prices rose 0.7% month-on-month and 2.5% year-on-year. In London prices rose +3.3% y/y. CPI inflation, meanwhile, rose to 0.5% year-on-year, up from 0.2% last month.
- This week saw some solid company results from Nestle, Reckitt and Unilever in the fast-moving consumer goods sector.
- In China GDP grew 4.9% year-on-year in Q3, which is strong growth but not as much as expected.

Multi-asset

- In data news, retail sales in the US maintained its strong run, despite employment numbers looking far more patchy. Job losses have been stubborn, with a concerning trend of flat-lining jobless claims numbers at elevated levels.
- Meanwhile, we remain unconvinced that a new fiscal package will be agreed this side of the election, or before the end of Q1 2021. This is important for the US Federal Reserve which, having factored $1 trillion of fiscal stimulus, is likely to have to step in with further monetary easing.
- In Europe, the European Central Bank put its (already low) inflation forecast at risk on the downside, prompting increased expectation of further easing.
- In asset allocation we continue our focus on China and surrounding Asian economies, which is our preferred area to take equity risk alongside the US. There are clearly significant Chinese bottom-up opportunities, particularly in equities – and valuations do not look particularly stretched against global peers, supported by reasonable earnings expectations.
- Policy, especially in China, has been supportive and has helped Asia to have what might be described as a pretty good crisis. But continued structural concerns in China, and upcoming US elections that could exacerbate these further, lead us to maintain Asia at favour, rather than raise exposures any further just yet.

Note: all data as at 22 October 2020, unless otherwise specified. Source: Bloomberg.