LGT Vestra Monthly Market Commentary in association with PIA Wealth Management

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The last month has seen equity markets retreat from their highs of the year so far. This latest bout of jitters came about as President Trump raised more tariffs on US imports of Chinese goods. The Federal Reserve (Fed), while cutting rates for the first time in over ten years, disappointed the markets by indicating that this may not be the start of a prolonged series of cuts. Trump later relented slightly on the tariffs, delaying some of them to mid-December, thus reducing the impact on Christmas shoppers. Whilst he claims that the cost of tariffs will fall on the Chinese, he is clearly worried when approaching an election year that the US consumer may be penalised with higher prices. Trade tensions, rather than higher yields, are threatening global economic growth, with particularly negative news coming from German manufacturing data.

As equities fell, government bonds have rallied, taking yields in many cases to new lows. Despite their words after the last rate cut, the Fed is expected to cut rates twice more this year. In Europe, the European Central Bank (ECB) is also expected to take rates further into negative territory and as we write, the thirty year German bond is yielding negative 0.25%. In the UK, the Bank of England still professes a core belief that there will be a smooth Brexit and that rates will rise "at a gradual pace and to a limited extent". However, they have expressed less confidence in this view and the market is expecting an interest rate cut rather than a rise. Against this background, the ten year gilt yield has made a new low of 0.43%. As ever, the UK economic outlook is clouded in the fog of Brexit.

The arrival of Boris Johnson as Prime Minister with a Cabinet committed to leaving the European Union on the 31st of October has raised the probability of a no deal Brexit. This is negative for the pound, which has weakened since it became clear that Johnson would win the Tory leadership contest. However, many in his own party are against a no deal Brexit and with only a single seat majority, he may find that he has an even more "awkward squad" than Theresa May had. As
a result, he could resort to calling a General Election for post October and the UK would exit without a deal by default, but there will be attempts to stop this. Boris Johnson has said that he expects to get a new deal from the European Union, but there is little sign of any give from them. As ever, the outcome is impossible to predict but for now, the currency appears to be pricing in a greater likelihood of a no deal outcome.

It is a difficult time for investors, and at such times it is important to look through the noise. The US equity market, which has returned value to shareholders in other ways, now has a dividend yield that exceeds the ten year US Treasury. The FTSE 100 Index yields 5.1%, with ten year gilt yields at 0.43%. This appears to be pricing in a lot of bad news. In the financial crises of 2008/9, the FTSE 100 Index cut dividends by 27% (mostly from banks). Even with that size of cut, which seems unlikely, the yield would be 3.7% or over 8 times what you get in the gilt market, providing a level of support despite Brexit.

With Trump tweeting, trade tensions rising, protests in Hong Kong and Brexit being as unclear as ever, we expect equity markets to remain volatile. This is exacerbated by thin trading in the summer months. However, given returns available on cash and bonds, we believe that equities will continue to provide the best potential long-term returns.