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September's Curse Lifted

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September, statistically speaking, is the worst month of the year for equity markets, during which, on average, they lose value. With the incredible access to historical data that investors have at their disposal today, I am assailed by all sorts of analysis which claims to have predictive capacity based on past performance, but I remain wary of taking any of it at face value. Certainly, it can be a good starting point for forming an opinion, but one has to assess what might be different today than in the past – for example the levels of growth, inflation and interest rates, what is driving them and what direction they are moving in. The starting point for asset valuations can also be very different to what it was in the past and investor positioning plays an important role too.

Anyway, for this year at least, the "September curse" was not fulfilled and global equity markets have continued to grind higher. Two notable exceptions are apparent – the UK's FTSE 100 Index and Japan. The UK's most-followed benchmark has struggled on two fronts. One of the reasons I went into in detail on last week, which is the uncertainty surrounding Labour's first budget at the end of October. That, along with its downbeat tone and the Bank of England's reluctance to join wholeheartedly the global interest rate cutting party, has held back domestic-focused equities.

Meanwhile, the more international companies have had to deal with the headwind of a stronger pound when translating their overseas profits into sterling. Sterling has been a strong performer this year, which might surprise those focused on all the political and economic uncertainty. But sometimes you only have to be the cleanest shirt in the dirty laundry basket to warrant being brought back into service. In Europe, for example, France has its own Gallic brand of political turmoil, while Germany's economy remains extremely sluggish. We should probably not rejoice that the Bank of England's hands are tied, to some degree, by the fact that core inflation (and wage growth) are subsiding less quickly here than elsewhere, but the fact that interest rates are projected by market participants to fall more slowly means that the yield is deemed to be attractive. The pound is at its highest level on a trade-weighted basis since 2016, although still has some way to go before regaining its pre-Brexit referendum levels.

I should also add that during a month of relatively small movements at the overall index level, the biggest company in the index, Astra Zeneca, has had a disproportionate effect. The shares have fallen around 12% on some disappointing drug development news, accounting for almost 100 points of the FTSE 100's 120-point fall. In fact, with the big oil companies Shell (-66 points) and BP (-27) also losing ground on the back of a falling crude oil price, you could spin the story more positively by saying that the FTSE 97 Index was up on the month. There we go, feeling better already!

The 1.9% reversal in September for Japan's TOPIX Index can also be remediated by looking at its performance in different currencies – it's marginally positive in dollar terms (even if not in pounds). Japan's equity markets and the yen tend to be negatively correlated and therefore move in different directions. Thus, what looks like a very volatile market at times in local currency looks less so in other currencies. That was very much the case over the weekend, when the TOPIX fell 3.5% in response to a victory for Shigeru Ishiba, who had been running third in the polls, in the ruling LDP Party's leadership election contest. He is deemed to be a policy "hawk" and supportive of the Bank of Japan's desire to tighten monetary policy. The leader in the polls, Sanae Takaichi, was seen as much more dovish and supportive of a weaker yen. The Yen jumped 2% against the dollar in response, dampening some of those equity losses.

We have been positive on Japanese equities to some reasonable effect, encouraged by the gradual return to growth in the economy with inflation heading towards the central bank's target. There has also been the revolution in corporate governance forced upon companies by regulatory authorities and activist investors. But although those trends appear to be sustainable, we are becoming slightly unnerved by the increasing levels of volatility developing as a result of greater policy uncertainty as Japan transitions back to normality and we would not discourage the taking of some profits.

The big story that unfolded towards the end of the month was the stimulus packages announced by the Chinese central bank and government. The initial salvoes fired were monetary in nature and were a combination of interest rate cuts and capital requirement loosening for banks. They came rapid-fire, which was a bit of a change from the piecemeal approach taken so far, and so perked up the interest of traders.

But the afterburners were lit on Thursday with a statement from the Politburo meeting chaired by President Xi himself. This promised fiscal transfers of RMB 1 trillion by way of subsidising the trade-in and renewal of consumer goods (think “cash for clunkers”) and to upgrade large-scale business equipment. Finally, something that might spur consumption. There were also funds made available for the purchase of equities, as well as plans for central government to raise another RMB 1 trillion in debt that it will pass on to local authorities to mop up unsold or unused real estate.

All of this suggested that the weakness in the economy had finally crossed the leadership’s pain threshold and it is at least attempting to put a floor under growth estimates that had been gradually declining all year. The aspiration remains for 5% GDP growth. It looks like a classic case of “cutting off the left tail (or downside) risk”, hence an aggressive squeeze in shorted and under-owned assets as well as short-term trading purchases on the long side.

But is there a meaningful “right tail” upside risk that needs to be addressed? Is this a sufficiently “big bazooka”? The monetary policy announcements tend to address the supply side of the economy, and, as we have pointed out before, it’s no good providing cheap loans if nobody wants to borrow – the classic “pushing on a string” metaphor.

That’s why the fiscal transfer element is more interesting and potentially pivotal. However, as much as RMB 1 trillion sounds impressive, it only amounts to around 0.8% of GDP. China’s famous, global GDP-supporting fiscal stimulus in 2008 amounted to RMB 4 trillion, but, in a much smaller nominal economy, that was worth around 12.5% of GDP. And so, as impressive as the initial reaction has been, there is good reason to take the view that there is insufficient evidence to press the long side of this trade, especially if one does not have the luxury of being able to take short-term trading positions utilising a trailing stoploss policy.

I would also argue, counter to others’ comments that I have seen, that this is not the direct equivalent of Mario Draghi’s “whatever it takes” moment in 2012 which effectively put an end to the eurozone crisis – at least not in the positive sense. Draghi, as President of the ECB, promised to provide a backstop to the bond markets of various European countries which were spiralling out of control, thus putting enormous pressure on both banks’ solvency and the affected countries’ fiscal positions. In a similar fashion to what had happened during the Global Financial Crisis, this was draining liquidity and confidence from the whole financial system again. China is not lacking liquidity. In fact, it is drowning in it. But there is limited appetite, outside government-directed companies, to borrow. And, in a way, that is more analogous to the situation in Europe, where households, even to this day, remain reticent when it comes to taking on new debt.

So, have these policy announcements put a floor under the downward spiral of China’s economy? Quite possibly. Will they turn it once again into a dynamic powerhouse able to overcome the structural problems of, for example, deteriorating demographics and the lingering effects of the bursting of a mammoth real estate bubble. That is by no means guaranteed.

Even so, the short-term effect has been quite stunning. On Monday, the CSI 300 Index built on last week’s 15.5% gains with another jump of 8.5%. But with the market now closed for the next week for the Golden Week holiday, there might well have been some desperate position squaring involved in that move. It will be interesting to see the extent to which China’s consumers might be tempted out of their shells during this period having seen the news.

Economic Commentary

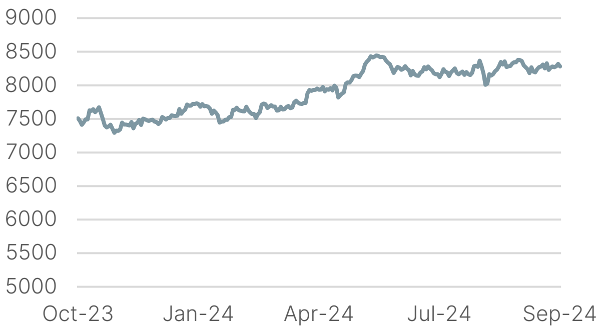
FTSE 100 weekly winners

Burberry Group plc	17.5%
Anglo American plc	14.5%
Antofagasta plc	14.2%
BHP Group Ltd	13.8%
Glencore plc	12.8%
Ocado Group PLC	11.8%
Prudential plc	11.6%

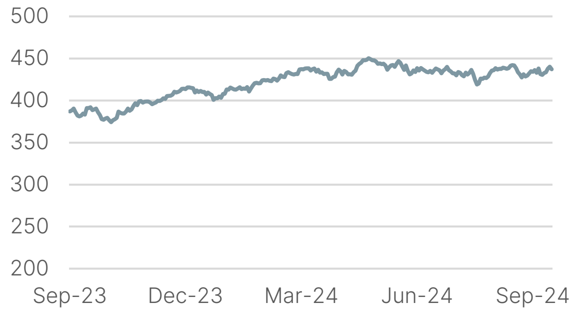
FTSE 100 weekly losers

Shell Plc	-5.4%
Shell Plc	-5.4%
BP p.l.c.	-5.2%
Pershing Square Holdings, Ltd. Public Class USD Accum.Shs	-3.5%
Barratt Developments PLC	-3.5%
BAE Systems plc	-2.4%
Next plc	-2.3%

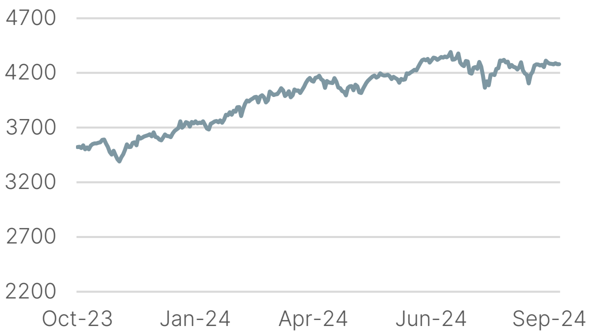
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

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