Global Matters Weekly

27 July 2020

How flow can you go?

– *Alex Harvey, CFA*

After a bumper few months for equity markets, a recent report[1] from Calastone, the global funds network, showed June was one of the worst months on record for outflows from UK equity funds. That follows positive UK market performance for each of April, May and June. The selling was broad based with even passive funds showing a rare negative flow print, so why the rush for the door and are investors cashing in their UK equity chips too early?

> The first quarter collapse in bond yields and commodity prices did little for an index heavy on financial and energy names. It was the perfect storm descending on an already choppy sea

When you look at what the UK market has been hit with in recent months, and what the rest of year holds (think Brexit), it is perhaps not surprising that investors want to take some profits off the table after the second quarter rebound. The first quarter collapse in bond yields and commodity prices did little for an index heavy on financial and energy names. It was the perfect storm descending on an already choppy sea. As oil prices dived and the global economy ground to a halt, UK equity prices sank as earnings got heavily discounted. Then when the market added nearly 10% in Q2 – and 17% in the case of small caps – the loss aversion bias kicks in as investors lock in the quarter's gains, despite remaining down for the year to date. The pain of giving up those gains outweighs the prospect of further upside, leading investors to sell early.

> We may finish the year seeing dividend payouts cut by a third or more as companies look to retain more cash on the balance sheet and build a buffer for the quarters ahead

Dividend cuts compound the problem for UK equities in a regional market previously well liked for its income. We may finish the year seeing dividend payouts cut by a third or more as companies look to retain more cash on the balance sheet and build a buffer for the quarters ahead; the forward-looking dividend yield has fallen by almost a percentage point compared to a year ago.

We have seen a lot of share issuance recently as companies have tapped markets, both to fund ongoing business and in some cases no doubt to fund future acquisitions, so it's rational to retain more cash than bear the cost of raising it through equity issuance. Some will do both.

> On the political front, the UK is now stepping up the latest round of negotiations with the EU in order to strike a deal ahead of the end 2020 deadline

UK GDP contracted by 10.4% in the three months to April and fell by 20.4% month on month from March to April, a record drop since the monthly data began in 1998. Industrial production, construction and retail are all notable areas that suffered. On the political front, the UK is now stepping up the latest round of negotiations with the EU in order to strike a deal ahead of the end 2020 deadline. With most of Europe about to head out of the proverbial home office for August on their summer vacations, we shouldn't expect much headway on this in the coming weeks.

> Even with the lower dividend payouts, UK equities yield a multiple of corporate bonds, and many times gilts

Despite much seemingly negative newsflow we should remember that the UK remains a cheap market today, at its widest discount versus the US since before the 2016 referendum when forward price earnings were almost the same across the two markets. Since then sentiment has been firmly against the UK and positioning remains heavily underweight. This leaves the UK as one of the cheapest of the major developed markets today. Even with the lower dividend payouts, UK equities yield a multiple of corporate bonds, and many times gilts. With around two thirds of revenues coming from overseas, UK equities are a cheap way to access a more globally derived equity earnings stream.

[1] Calastone - Fund Flow Index - July 2020

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The **Marketplace**

- US-China tensions rise, EU members agree firm recovery path
- Global Covid-19 cases top 15 million
- Brent crude rose 0.5% ending the week at $43.3 a barrel
- Gold rose 5.1% to $1902.0 an ounce as metals rallied

Market **Focus**

US

- Initial jobless claims rise to 1.4 million, up from 1.3 million last week, the first rise since March
- Tensions flared as the US closed China's Houston consulate after spying accusations. In response China closed the US consulate in the western city of Chengdu, calling the charges 'groundless'.
- A mixed week for major indexes despite coming within touching distance of all-time highs. Mid-caps and value outperformed, whilst technology stocks fared badly with names such as Apple and Intel declining, the latter by 16%. Energy stocks were boosted by the higher oil price.
- The US dollar index slumped to its lowest level since February 2019 whilst the US 10yr Treasury yield fell -3.8bps to 0.59%

Europe

- Euro-area July composite PMI rose to 54.8 vs 51.1 forecast. Positively, both services and manufacturing were expansionary, though demand remains muted and headcounts continued to decrease for the fifth consecutive month
- EU leaders finalised their EUR 750 billion stimulus plan after several days of intense talks. The package will involve roughly 50% in grants and 50% in low-interest loans
- Many countries reporting increases of Covid-19 infection. Spain notably saw new cases rise to ~1000 per day. Belgium, France and Germany are also seeing upticks

UK

- Talks between the UK and the EU over the post-Brexit relationship ended in deadlock. The EUs chief negotiator, Michel Barnier, says there are 'big differences' between the two sides, with both claiming a lack of concessions. Both sides are cautiously optimistic a deal can be agreed by September
- Retailers saw sales volumes increase in June to near pre-lockdown levels. They grew by 13.9% vs 7.3% expected
- The Chancellor, Rishi Sunak is reportedly considering a new tax on online sales to boost government revenues and aid bricks-and-mortar businesses
- AstraZeneca and Oxford university announced a breakthrough in their vaccine research with test subjects producing encouraging numbers of antibodies and T-cells

Asia/Rest of The World

- Australian PMIs point to a continued recovery with services at 58.5 vs 53.1 the previous month and manufacturing increasing to 53.4 from June's 51.2
- The latest Reuters poll expects Japan's economy to contract by 5.3% in the 2020 fiscal year ending March 31st 2021
- China's benchmark composite equity index declined by 0.5% amidst a further ratcheting up of tensions with the US

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 July 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-0.3%	3.8%	0.3%	8.0%
United Kingdom	GBP	-2.7%	-0.8%	-18.4%	-16.7%
Continental Europe	EUR	-1.3%	2.7%	-6.8%	-0.9%
Japan	JPY	-0.1%	0.9%	-7.3%	2.5%
Asia Pacific (ex Japan)	USD	0.2%	6.0%	-0.5%	5.2%
Australia	AUD	-0.2%	2.1%	-8.5%	-7.9%
Global	USD	-0.1%	4.2%	-1.9%	5.2%
Emerging markets equities					
Emerging Europe	USD	3.2%	4.7%	-21.1%	-12.7%
Emerging Asia	USD	0.2%	7.1%	3.3%	12.2%
Emerging Latin America	USD	2.8%	10.5%	-28.4%	-26.9%
BRICs	USD	0.4%	8.3%	0.1%	7.3%
China	USD	-0.5%	7.5%	11.3%	20.0%
MENA countries	USD	-0.5%	0.8%	-15.7%	-17.4%
South Africa	USD	-0.2%	8.3%	-17.9%	-19.8%
India	USD	2.9%	10.0%	-11.8%	-7.4%
Global emerging markets	USD	0.6%	7.0%	-3.4%	3.0%
Bonds					
US Treasuries	USD	0.4%	0.9%	10.2%	12.3%
US Treasuries (inflation protected)	USD	0.5%	1.7%	8.2%	10.2%
US Corporate (investment grade)	USD	1.0%	3.0%	8.2%	12.5%
US High Yield	USD	1.6%	3.8%	-0.2%	3.4%
UK Gilts	GBP	0.3%	-0.1%	9.7%	9.7%
UK Corporate (investment grade)	GBP	0.6%	1.6%	4.9%	6.5%
Euro Government Bonds	EUR	0.4%	0.6%	2.7%	2.1%
Euro Corporate (investment grade)	EUR	0.4%	1.2%	0.0%	-0.3%
Euro High Yield	EUR	0.9%	2.0%	-3.4%	-0.9%
Japanese Government	JPY	0.0%	0.2%	-0.9%	-1.7%
Australian Government	AUD	0.1%	0.0%	4.1%	4.2%
Global Government Bonds	USD	1.2%	2.2%	6.9%	8.0%
Global Bonds	USD	1.2%	2.4%	6.1%	7.6%
Global Convertible Bonds	USD	0.5%	3.4%	8.4%	11.9%
Emerging Market Bonds	USD	1.4%	3.1%	2.6%	3.6%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 July 2020	Month to date	YTD 2020	12 months
Property					
US Property Securities	USD	-0.6%	-0.8%	-19.6%	-15.5%
Australian Property Securities	AUD	0.6%	1.5%	-21.7%	-26.1%
Asia Property Securities	USD	-1.1%	0.2%	-18.4%	-16.6%
Global Property Securities	USD	-0.2%	0.6%	-19.3%	-14.7%
Currencies					
Euro	USD	1.7%	3.5%	3.6%	4.4%
UK Pound Sterling	USD	1.8%	3.3%	-3.6%	2.3%
Japanese Yen	USD	1.3%	2.0%	2.7%	2.3%
Australian Dollar	USD	1.4%	2.9%	1.0%	1.6%
South African Rand	USD	0.0%	4.3%	-16.1%	-16.8%
Swiss Franc	USD	1.8%	2.7%	4.8%	6.8%
Chinese Yuan	USD	-0.3%	0.7%	-0.8%	-2.1%
Commodities & Alternatives					
Commodities	USD	2.1%	5.3%	-21.6%	-18.0%
Agricultural Commodities	USD	-0.2%	2.8%	-8.5%	-5.9%
Oil	USD	0.5%	5.3%	-34.3%	-31.4%
Gold	USD	5.1%	6.6%	24.9%	33.7%
Hedge funds	USD	0.4%	1.5%	0.3%	3.8%

Source: Bloomberg. Past performance is not indicative of future returns

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