

Stocks for the (very) long run

– Andrew Hardy, CFA

It was a rocky week for stock markets last week, driven by weaker than expected economic data, particularly around the service sector in the US and Europe, which until now had been holding up well despite very weak manufacturing sector performance. Constantly taking the temperature of economies globally is a key part of what our team at Momentum does, as it informs our asset allocation decisions. But, while investor sentiment shifts as economies wax and wane, driving changes in valuation multiples and thereby share prices, should shareholders in market leading companies really worry about short term swings? I would say, no. Instead we firmly believe that the key to achieving long term investment goals is to set a strategy and stick to it, without drifting off course.

When the macroeconomic environment deteriorates, it's easy to forget that some businesses are less vulnerable to economic cycles. For instance, when Ferrari recently launched a new model of the popular Spider, the next three years of production sold out within a matter of days, with profit margins way above a typical auto manufacturer. MercadoLibre, the Amazon of Latin America that is headquartered in Argentina, announced year on year revenue growth of 102% in their latest quarterly results, while volumes for their new payments business grew at a multiple of that. Meanwhile, Tencent in China overcame a prolonged ban on new online games with 26% growth in operating earnings. From Italy, to Argentina, to China: all countries that are under intense macroeconomic pressure for various reasons but host some world leading companies that will barely miss a beat if the local economy stutters.

The anaemic macroeconomic backdrop of the last ten years has drawn more and more investors towards such higher growth businesses, resulting in them commanding a larger than usual valuation premium over broader markets. As

we've written in the weekly digest recently¹, value stocks will not underperform forever and when they rebound investors without adequate exposure will see their returns lag broader markets. The more we hear the argument from clients and investors that valuation doesn't matter for the best growth stocks, the closer that scenario feels. Indeed, value stocks staged a brief but very powerful rebound in the first half of last month.

However, the rewards for investing in the best growth businesses for the long term stand up for themselves and can vastly outweigh the effects of short-term contractions in relative valuations. A recent study published in the Journal of Financial Economics² highlights the extent to which a narrow group of stocks accounts for a disproportionate amount of the long term returns for broad equity market indices. The study found that "the best-performing 4% of listed companies explains the net gain for the entire U.S. stock market since 1926". The corollary was that the other 96% of companies performed poorly with lifetime returns less than one-month Treasuries! It would have been easy for holders of those top 4% to get distracted by new trends or market swings, but potentially very costly. Very few investors have built a strong performance track record through market timing as it is so difficult to get right.

Admittedly, identifying those companies that go on to become winners and that can sustain their market dominance is never easy. At Momentum we invest in these sorts of high growth businesses through various specialist managers, all of whom have delivered strong outperformance of market indices over the last five years, in many cases topping their peer group rankings. This provides powerful support for the case for investing with the very best active managers in equity markets, rather than overly diluting a portfolio of quality investments with passive index tracking strategies.

1. 'Value investing – dead or alive?' by Stephen Nguyen, CFA. 10th June 2019.

2. 'Do Stocks Outperform Treasury Bills?' by Hendrik Bessembinder. 28th May 2018.

The Marketplace

- Most markets saw a third consecutive week of losses
- US employment metrics paint a mixed picture
- Brent crude oil fell 5.7% ending the week at \$58.4 a barrel
- Gold rose 0.4% ending the week at \$1508.5 an ounce

Market Focus

US

- Futures markets price in a 90% probability of a rate cut at the October monetary policy meeting
- ISM non-manufacturing data was much weaker than expected at 52.6 vs 55. The ISM manufacturing index fell to its lowest level since 2009
- Average hourly earnings fell to a 12-month low
- Headline job growth was 136K for August, below expectations but the unemployment rate hit a 50-year low
- The 10-year US treasury yield hit its lowest level in a month at 1.5%.

Europe

- The major gauge of European equities fell by 3% last week on the back of weak economic data and a weak export market
- German services data was weaker than expected as the malaise spilled over from manufacturing. The composite growth forecasts for Europe were cut to 0.5% from 0.8%

- The US has announced tariffs of 25% on many European goods ranging from aircraft to whisky in response to some member states' subsidies to Boeing rival, Airbus.

UK

- Weak data out of the UK increased the recessionary fears, the weak data in question was the services purchasing managers index falling below the 50.0 level indicating a contractionary services sector
- UK equities fell during the week, ending down by 3.6% in local currency terms
- UK Gilts gained 0.6%, whilst their investment grade counterparts performed flat over the week
- The UK's Prime Minister Boris Johnson proposed a new Brexit deal to the EU in an attempt to avoid a hard border between Ireland and Northern Ireland following Brexit, but the EU remained unmoved.

Asia/Rest of The World

- The main gauge of Japanese equities fell by 2.1% last week
- Chinese markets to reopen following a week's closure, the focus will be on renewed talks with the US scheduled for October 10th and 11th in a bid to prevent the US increasing tariffs to 30% on October the 15th
- Japan's government bonds suffered as the 10-year note saw its lowest demand level since 2016. This occurred following the Bank of Japan indicating that it could purchase less bonds across four major maturities to steepen the yield curve.

Asset Class/Region	Currency	Currency returns			
		Week ending 4 Oct. 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	-0.3%	-0.8%	19.0%	3.2%
United Kingdom	GBP	-3.6%	-3.4%	10.0%	0.4%
Continental Europe	EUR	-2.6%	-3.0%	17.1%	4.5%
Japan	JPY	-2.0%	-0.9%	7.8%	-10.4%
Asia Pacific (ex Japan)	USD	-0.9%	-0.9%	6.8%	1.3%
Australia	AUD	-3.0%	-2.6%	19.4%	10.1%
Global	USD	-1.0%	-1.2%	16.2%	1.5%
Emerging markets equities					
Emerging Europe	USD	-2.5%	-1.5%	15.5%	12.0%
Emerging Asia	USD	-0.3%	-0.6%	5.4%	-0.1%
Emerging Latin America	USD	0.2%	1.0%	7.3%	5.2%
BRICs	USD	-0.3%	-0.3%	8.3%	5.8%
MENA countries	USD	-1.3%	-1.5%	2.2%	0.6%
South Africa	USD	-0.8%	1.1%	-1.6%	1.5%
India	USD	-3.2%	-2.8%	2.3%	11.4%
Global emerging markets	USD	-0.5%	-0.4%	5.5%	1.2%
Bonds					
US Treasuries	USD	1.1%	1.1%	9.3%	13.1%
US Treasuries (inflation protected)	USD	0.9%	1.1%	9.2%	9.6%
US Corporate (investment grade)	USD	0.9%	0.8%	14.1%	14.9%
US High Yield	USD	-0.5%	-0.5%	10.9%	6.1%
UK Gilts	GBP	0.6%	0.6%	12.7%	16.2%
UK Corporate (investment grade)	GBP	0.0%	0.1%	11.3%	11.8%
Euro Government Bonds	EUR	-0.1%	0.0%	10.0%	12.1%
Euro Corporate (investment grade)	EUR	0.1%	0.0%	6.8%	6.4%
Euro High Yield	EUR	-0.6%	-0.6%	8.7%	4.6%
Japanese Government	JPY	-0.2%	0.1%	3.5%	5.5%
Australian Government	AUD	0.6%	0.9%	11.4%	14.8%
Global Government Bonds	USD	0.8%	0.9%	7.6%	10.8%
Global Bonds	USD	0.6%	0.8%	7.3%	9.5%
Global Convertible Bonds	USD	0.1%	0.1%	6.1%	2.1%
Emerging Market Bonds	USD	0.7%	0.7%	9.7%	10.7%

Asset Class/Region	Currency	Currency returns			
		Week ending 4 Oct. 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	0.3%	0.3%	26.1%	20.9%
Australian Property Securities	AUD	-0.6%	-0.1%	17.0%	14.7%
Asia Property Securities	USD	0.5%	0.5%	8.6%	13.1%
Global Property Securities	USD	0.4%	0.3%	19.4%	16.9%
Currencies					
Euro	USD	0.4%	0.7%	-4.1%	-4.5%
UK Pound Sterling	USD	0.1%	0.3%	-3.3%	-5.2%
Japanese Yen	USD	0.9%	1.2%	2.6%	6.5%
Australian Dollar	USD	0.1%	0.3%	-3.9%	-4.3%
South African Rand	USD	1.0%	0.9%	-4.3%	-0.9%
Swiss Franc	USD	-0.5%	0.3%	-1.2%	-0.2%
Chinese Yuan	USD	-0.4%	0.0%	-3.8%	-3.9%
Commodities & Alternatives					
Commodities	USD	-1.3%	-0.3%	4.2%	-10.7%
Agricultural Commodities	USD	1.1%	0.0%	-6.2%	-8.7%
Oil	USD	-5.7%	-4.0%	8.5%	-31.0%
Gold	USD	0.4%	2.6%	17.7%	25.9%
Hedge funds	USD	-0.1%	-0.2%	5.7%	0.1%

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