



August 24th, 2020

Fuzzy Markets

- **Economic data shows that investors have to keep half an eye on a slowdown.**
- **European and Japanese confidence data fails to convince - services a notable weak point.**
- **Tesla share price gains defy logic, except to Robinhood investors.**
- **China's asset management and asset markets continue to attract foreign capital.**
- **The trees are on fire.... again**

Markets find themselves in a fuzzy zone. Markets are trading sideward, with half an eye on the threat of a slowdown in the global recovery. While the US equity market was higher on the week, it left in its wake negative returns for the Japanese and European markets. The market senses that economic activity could be losing momentum. The rally in the 10-year US government bond yield, dropping back from around 70bps to close the week at 63bps, is a reflection of the weaker data. Just a couple of months ago, investors were concerned that the US 10-year government bond yield could be on its way back towards the 89bps level hit in June. In the US equity market financials, energy, autos and utilities all retreated during the week with technology the standout star performer. The Nasdaq was up 2.7%.

There is no marked deterioration in economic data, but it has become more mixed. In Japan, the headline indicator of the Tankan survey of industrial confidence showed good improvement. However, the detail was less convincing. For manufacturers, current conditions and expectations for the future improved. However, in the service sector, current conditions saw a modest rise and expectations for the future fell. In the eurozone, the August PMI at 51.7 was below expectations of 52.9. Services were a particularly weak spot with an index of 50.1 versus expectations of 55.5.

We are concerned that the hesitant recovery in the services sector is a more accurate reflection of the weakness in the momentum of the global recovery. The manufacturing sector, by contrast, has benefitted from a positive re-stocking effect. Lockdowns will have led to the build of supply shortages to end consumers. Hence, when the government's eased lockdowns supply lines of manufactured products would have had to be refilled. Thus, manufacturing companies may have seen a surge of orders that at least for the moment gives the impression of strong demand growth. The service sector, by contrast, has less in the way of supply lines – the recovery will reflect much more underlying demand today with limited pent up demand or supply lines to refill.

Without a rotation of themes in the equity markets, the aggregate global markets may struggle for momentum. Among country classifications, European and Japanese equity markets are failing to accelerate. Among sectors, financials and value stocks strive to maintain any significant absolute gains. Year-to-date the global technology sector is up 27% while the global bank index is down 31%.

Economists point to the weakness of the service sector indicators. Europe has failed to convince, and we have backed off from switching from US equities into other markets at least for the moment.

The near 50% rise in Tesla stock price since its share split (announced August 11th) defies mathematical logic but

has been one factor behind the incessant increase in the NASDAQ given its 3.2% weight in the index. Academic studies have shown that the announcement effect and the positive 'aura' effect of a share split are factors that tend to push the share prices higher for stocks that have a share split. The argument runs that these companies are typically growth stocks – a truism as a stock price that has risen and decides to split its stock is usually a growth stock by definition and that investors see a stock split as a sign of management confidence. We still feel that a 50% rise post a stock split is stretching it. Robinhood data has another angle on the share price. On the May 14th there were 200,000 Robinhood brokerage platform investors in Tesla. As at the last data point of August 14th there were 563,621! By comparison, Tesla had global unit sales of 546,250 over the past 18 months. On current trends, the company seems likely to gain more shareholders than unit car sales between now and the actual share split coming on August 28th.

The opening up of the Chinese financial markets continues at a pace. In just the past week, Chinese authorities approved a wealth management joint venture between BlackRock Singapore's Temasek Holdings and China Construction Bank Corp. As we have argued before we see the challenges of US trade policy and issues in Hong Kong has transitory concerning China's ongoing efforts to assimilate into the global economy. Chinese asset markets will be better represented in global indices as China allows unfettered access. Blackrock is amongst a small group of heavyweight players that have taken advantage of the Chinese government's relaxation of foreign ownership of asset managers to allow majority ownership.

Climate change issues are uppermost in our minds again with news of forest fires out of control in California. Lightning strikes have lit a tinderbox of parched forests. Death Valley recorded its highest daytime temperature ever of 130 degrees F (54.4C). The hottest temperatures on earth since 1913. In seven days, the California blazes have charred nearly one million acres according to Cal Fire three times a typical fire season. Sadly, the blaze has burnt through the state's oldest park of redwood trees that are between 800 and 1500 years old.

Investor focus on environmental issues cannot come quickly enough. This is particularly the case in the United States where the leadership of the country remains in denial of climate change and mostly works to create more problems. In just the past week, the Trump administration weakened regulations designed to reduce climate-warming methane gas emissions from oil and gas fields. All investors, but particularly intuitional investors, should with urgency call companies to account for their green credentials. There is simply too little time to put right the mistakes of the last 100 years before the scale of the damage to the globe registers sufficiently with policymakers and singularly profit focussed industries.

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