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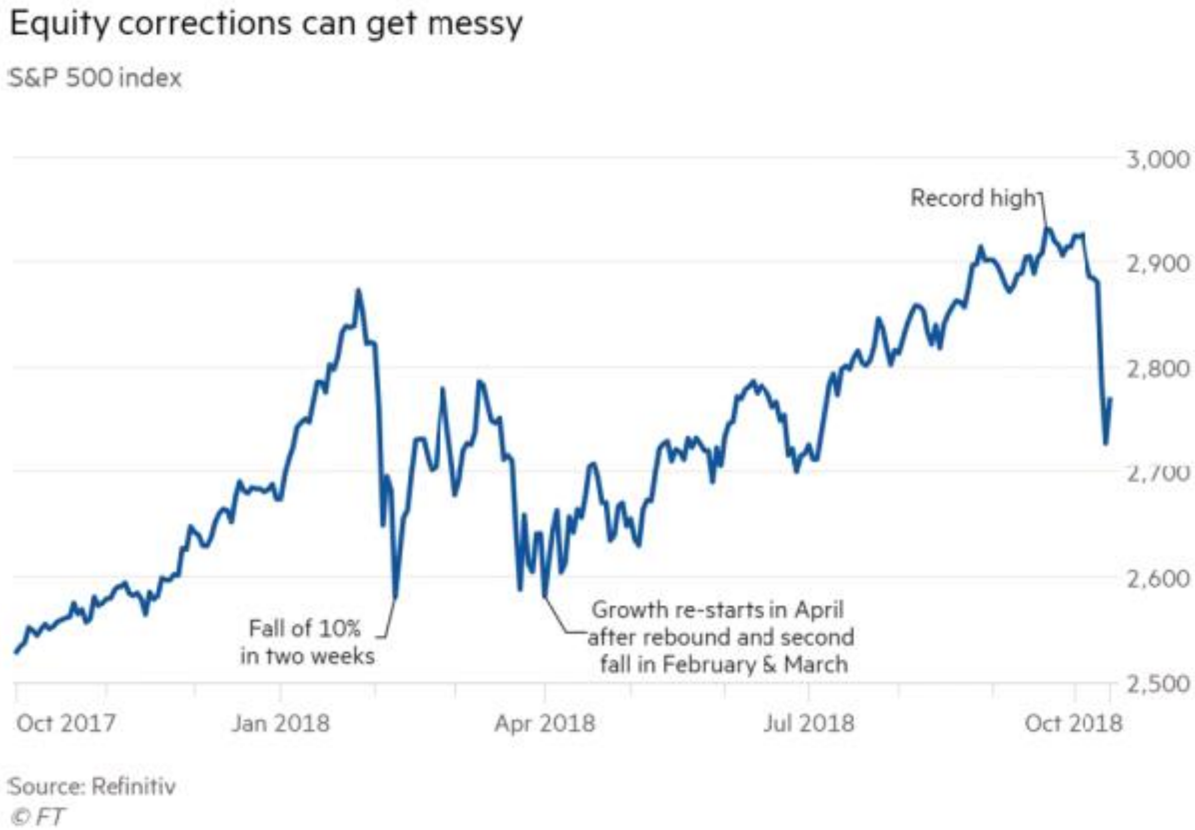
Lothar Mentel

Lead Investment Adviser to Cambridge



Market corrections tend to occur in waves; illustrated with the example of the US stock markets in 2018

Autopsy of a stock market sell-off

Last week, we wondered why stock markets had not reacted more negatively to the latest upward wave of bond yields, when this had led to a formidable stock market correction back in February. As it turned out over the course of this week, it seems to have just haven taken them a little longer to come to terms with the fact that, whether it's higher inflation expectations or better than expected growth that's pushing bond yields higher, the outcome is the same: higher bond yields that choke equity market upside prospects.

By the end of this week, the stock market sell-off has become more pronounced, with equity markets around the world having lost around 6% since their September highs. We're not quite yet in correction territory (-10%), but the fact that, compared to February, this has pushed them in many cases below their 200-day moving average does not bode well for investor sentiment in the shorter term. Experience tells us that once certain critical threshold levels have been broken it is much less likely for markets to resume their previous upward (or at least sideward) trend.

Most commentators remained somewhat baffled that this time it had been positively surprising US economic data that appeared to have caused the trend reversal. Consequentially, the search for other culprits was in full swing all week. Slowing demand from China, Trump's path towards an exploding US budget deficit – which makes even Italy look fiscally responsible – as well as the looming trade wars with China were all put forward as reasons why the 2018 US equity market rally had suddenly hit the buffers.

Unfortunately, as is usually the case, the stock market downdraft is highly contagious and so stock markets around the world were caught in the spiral. Given the other industrialised regions around the world are still operating far earlier in the economic cycle with still far lower rates of interest, bond yields and equity valuations, the $1million question is whether this sell-off will herald a change in market leadership away from the US, where growth may still be strong but also turning over.

We are obviously not happy that investment returns have turned negative but having anticipated and positioned Cambridge portfolios for this very development to happen since the spring, we are not entirely dissatisfied that our view has panned out.

So, what next? Well, market slumps like this one tend to unfold in waves and we will not be surprised to experience a sharp relief recovery wave next week, as it already started late on Friday in the US market. Given the general economic and sentiment environment is not dissimilar to the February correction, this one may well follow a similar pattern: the relief rally petering out, another swing down, before more positive investor sentiment prevails. That is, unless the economic environment should have deteriorated in the meantime.

With the Q3 2018 corporate earnings season having kicked off on Friday and US banks broadly beating already high expectations, we can expect positive economic news flow to provide a soothing effect.

Amongst the obvious negatives, this equity market setback also has a few positives. Firstly, it has stopped the upwards draft of bond yields which should mean that, just as before, the economy and capital markets have time to assess and adjust the impact of gradually normalising bond yields. This slower unwind of overvalued bonds from the past decade lowers the risk of a 'bond market riot', where bond holders collectively head for the exit and cause a cycle-ending capital market shock to the economy.

Secondly, US president Trump has claimed the positive US stock market as one of his personal achievements. This suggests that, the longer and deeper the current ructions last, the higher the incentive for him to strike a deal with China before the November Midterm elections in order to regain the stock market tailwind.

Over in the 'old world', Italy's populist government continues to annoy the Brusselites with defiance of their austerity dictate. Given the sums involved, we don't expect much lasting damage, even if the resultant hike in Italian bond yields defeats the very point of looser fiscal policy. However, the rest of the EURO area benefits from the squabbles by holding down the value of the €-EUR, which helps to divert some of the US growth momentum across to Europe.

The opposite was the case for the UK this week, where £-sterling rose to its highest levels against the US$ and €-EUR on the back of persistent rumours of a wider Brexit negotiation breakthrough. Together with an extension of transition periods and invoking of the Northern Ireland backstop (which would keep the whole UK in customs union with the EU until a more sustainable framework for future trade relations have been defined), turned markets more positive.

This is all very much what we have suggested to happen over the past weeks. And while capital markets and the business community may be sighing in relief, the political side should become quite hairy under such circumstances. It's not entirely inconceivable that the terms of the initial Brexit will have to be passed by the parliament with a cross party majority of the moderate middle rather than being sabotaged by the minority extremists on both sides of the spectrum. It would be refreshing to see a temporary cross-party consensus of the pragmatists for the good of the nation prevail over those happy to sacrifice the common good in order to achieve their ideological ideals.

Bonds, Rates and Markets

Interest rates and government bond yields are more directly affected by the underlying economy than any other asset class. If we knew more accurately about the future course of the economy, bond markets would rarely be surprised. However, even the present is difficult to know, and the future extremely difficult. And then there's the final and most important element of any market: whether there are more buyers or more sellers. Below, we look at why US government bonds (Treasuries) have recently lost considerable capital value, why yields have risen sharply and look at some clues for the future.

Knowing what's happening in an economy at the present time is quite difficult because collecting, compiling and analysing economic data requires time and effort. It's therefore always already out of date by the time it is released. That's why data on recent activity is usually partially estimated, and then has to be often revised in months later.

But capital markets' 'addiction' to data is hardly surprising, considering that interest rates are set with regard not just to the current state of the economy but its expected development. At least, this is true in the UK, US, Japan and Europe, where central banks are independent (though Donald Trump's recent comments suggest that might not be the case in the future). The rationale for this is to depoliticise monetary policy and provide a more stable rate regime. For the most part, short-term rates are set to maintain a given inflation target. This is typically around 2%, but recent debate has questioned how reasonable this target is. In the US there is also a "full employment" goal though it is not specified what rate constitutes "full".

The idea of inflation fighting came as a response to the stagflation of the 1970s, although specific inflation targets weren't generally fixed until the 1990s. Despite the complexity of the central banks' challenge in setting a suitable interest rate at any time, from an academic angle the solution can be expressed quite simply. Most use some form of a rule derived by professor Taylor. Here's a version:

Short rate (interest rate) =
current annual real growth rate (plus [or minus] an adjustment) +
2 x (current inflation minus target)

Exactly what that adjustment is has become more key after the global financial crisis (GFC). It relates to expectations of real GDP – the long-term non-inflationary stable real growth rate. This rate is decidedly difficult to estimate at a single point in time and will vary if the economy's structure changes. But the central banker's difficulties go further. Given the aim is to contain inflation expectations of businesses and consumers – which have shown to become a self-fulfilling prophecy – even knowing what inflation measure to react to can be difficult to determine: Overall or core? Consumer inflation or whole economy inflation? Is it even possible to know inflation? How do we account for the changing nature of goods (sometimes called Hedonic adjustment)?

In recent times, central banks have thought that transparency and clear communication of their long-term thinking would help markets form expectations of future monetary policy – making surprise shocks less likely. But the US Federal Reserve (Fed) appears to be now less convinced that it helps and may be moving away from this policy. We think there are two main reasons for this. Firstly, the Fed believes that markets have to often misinterpreted their pronouncements. Secondly, under pressure from the president and facing a huge change towards vastly expansive fiscal policy, they have had to get more political themselves.

We said after the August central bank get together at Jackson hole that the market had misread the Fed's thoughts when they saw them as dovish (less rate rises). This week seems to vindicate our view. Fed Chair Jerome Powell said that growth was likely to be stronger in the longer term (hawkish – more rate rises). Unsurprisingly, this pushed market-determined short term interest rates higher, under the expectation that the Fed's next rate hikes would come sooner and be more frequent than anticipated. However, for longer bonds, an important impact was to push up the expected long-term neutral interest rate. In terms of the rule, the market moved the Taylor adjustment higher. Longer bonds reacted, and yields recorded a considerable step up – similar in magnitude to the move that upset capital markets in January/February.

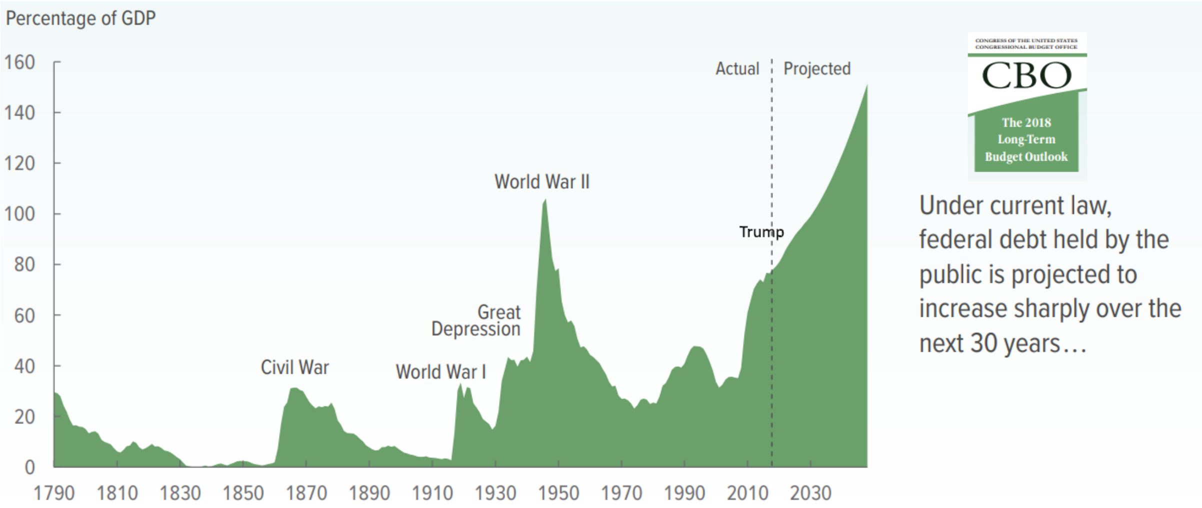
With some idea of how the economy will unfold, and how that will make the central bank react, you can come up with a likely path for interest rates which can then be translated into a path for T-bills or deposits. Then you can compound those up to give an overall return and compare that to the yield on government bonds to see which offers higher expected return. In general, investors are thought to prefer the stable principal of the rolling deposit rather than take the potential volatility of the capital value of the bond as rates change, so generally the bond yield has a "term premium": Investors will have an expectation or demand for slightly higher yields for the longer term fixed coupon bonds than the rolling deposit.

In fact, there are markets for future T-bills and for fixing the rolling deposit rates out into the future, so the term premium can be calculated directly. In the years when quantitative easing (QE) was in full flood, the term premia in developed government bond markets declined to around zero. This was because central banks used QE bond purchases to bring down long term yields, so that lower cost of long term finance would support asset prices (think property) and stimulate corporate investment. However, as gradual normalisation has moved central banks to reversing QE through quantitative tightening (QT), it has risen – especially in the US.

There's a simple explanation: The cash rate market and government bond markets have separate investors with different incentives and needs. And although they can be compared, they are not so easy to arbitrage – as Long-Term Capital Management (LTCM) found in 1998. Unlike deposits, the supply and demand interplay is crucially important in bond markets.

The Great Financial Crisis saw a massive transfer of debts from the private sector to governments. However, this had no impact on bond yields because the central banks soaked up the bonds through QE. The Obama administration made sure in the US that the banks quickly raised sufficient capital to pay back the state bailout and the ensuing swift economic recovery meant that tax revenues recovered as well. This limited further credit demand by the government which, together with QE, held rates and yields very low.

Enter Donald Trump. The first two years of the his administration have seen the implementation of a vastly expansive fiscal policy of tax cuts and military spending increases, which will reaccelerate the debt to GDP ratio expansion. The chart below illustrates the dimension of this development (issued in June 2018, before the Mid-term election campaign kick-off) and is somewhat above doubt, because it was produced by the non-partisan Congressional Budget Office.



What the chart can't show is that, unlike during the GFC, over the next couple of years the Fed will add to the net issuance by selling bonds rather than buying them. And the midterm election campaigns have shown that neither political party is in favour of fiscal discipline. The republicans want yet more tax cuts, and the democrats want a debt-funded infrastructure program, over and above the tax cut splurge we've already seen. Growth will most likely be boosted further in the short term. But what's more pertinent for bond investors is that supply (government borrowing) will be humongous. It's no wonder the term premia have stopped being zero. Indeed, many investors have stepped away from bonds in favour of cash.

In fact, BlackRock's flagship US exchange-traded bond fund – the largest bond ETF – suffered record outflows of nearly $2bn in a single day this week, as investors were spooked by last week's treasury rout. But this may mean that, before US bonds bleed much further, foreign investors will be enticed out of their low yielding bonds (German 10-years are still around 0.5%) and into US markets. But to do so, they will need to take currency risk, since the benefits of higher yields are destroyed if they hedge the currency.

That could be a stabilising factor, but it won't be the Treasury's saving grace. As the budget expands and growth ploughs ahead just when there is the least spare capacity since the 1970s and tight labour markets push up wages, the Fed has no choice but to tighten monetary policy to prevent inflation from taking hold. All of this suggests little upside in US bonds, no matter what Trump says about a "crazy" Fed.

What rising bond yields do to equity valuations

Is a "crazy" US Federal Reserve (Fed) solely responsible for the week's marked falls in global equity prices?

President Trump tweeted that the Fed's current monetary policy was a "mistake" being "so tight." The implication is that it was to blame for the market falls – rather than the uncertainty for business that his looming trade war with China brings.

Higher interest rates lead to higher discount factors, which reduce the net present value of a stream of future cash flows. These future cashflows are effectively what an investor gets when they buy a company's stock. This time discount puts downward pressure on already lofty US valuations, particularly for US technology stocks that pay hardly any dividends and led markets upwards over the past few years when discount factors were negligible. It has been widely assumed that this relationship between equity valuations and rising bond yields across the maturity band is the reason for the latest stock market sell-off.

So, is Donald Trump for once not 'making it up'? As usual, reality is more nuanced than a mere tweet. Longer term bond yields are not set by central banks but determined by supply and demand in capital markets. As we discuss in the article on this topic above, Trump's excessive government borrowing plans may have played a bigger role here than the Fed's quite pedestrian pace of rate rises.

However, every break in the previous market momentum direction has the potential to introduce new market dynamics. One of those is whether these falls might catalyse a shift in away from 2018's theme of US equities dominating returns. It is therefore worth taking a look at market action thus far by the numbers.

Source: Bloomberg	% change over 5 days	% away from 200 Day Moving Average	PE Ratio
Facebook Inc-A	-3%	-14.5%	21.2x
Apple Inc	-6%	13.6%	19.7x
Amazon.com Inc	-10%	4.9%	175.0x
Microsoft Corp	-6%	6.6%	30.0x
Alphabet Inc-Cl C	-8%	-4.3%	-
Netflix Inc	-12%	-1.3%	141.2x
S&P 500 Index	-6%	-1.4%	19.7x
Nasdaq 100 Stock Indx	-7%	-1.0%	24.2x
Dax Index	-6%	-8.1%	13.6x
Nikkei 225	-6%	0.6%	16.4x
MSCI World	-5%	-4.1%	17.6x
FTSE 100 Index	-6%	-6.3%	15.6x

Technology stocks (the first 6 lines of the table) posted the longest losing streak of the Trump era, with tech heavy Nasdaq index down near 7%. Global car stocks also had a torrid time, with Ford alone retreating below $9 a share – the lowest level since November 2009. Various indices broke below their shorter-term (50 day) averages, which are seen as technical support levels and are holding either above or around the longer-term moving average (200 day). The Dow Jones broke below the psychologically important 26,000 level.

UK markets have held up relatively well considering the international nature of the FTSE 100 and 250.

For those who follow equity markets, it will have been no surprise that the sell-off occurred during October. 45% (or 9 out of last 20) of the biggest one day falls on the Dow Jones have occurred in October, including the two largest ever recorded on 19 Oct. 1987 and 28 Oct. 1929. That is an extremely disproportionate frequency. October has a strong tendency to deliver negative market surprises in the form of sudden crashes.

But October is not actually that bad on average. Overall, markets seem to go sideways in October, with a slight upward tilt. There are more gains than losses posted over the past 29 years. If a client had held a long position in every year, they would have been ahead with a (below-average) total profit despite the excessive falls during October 2008.

We believe there are a number of other factors beyond interest rates that need to be added into the mix to help explain this week's movements. Technology shares came under severe pressure after a number of semiconductor firms warned of slowing growth, perhaps foreshadowing the end of the current two-year boom for chip makers and a wider slowing across the sector.

Growth stocks (primarily technology) have provided strong market leadership over the past few years. The momentum behind growth/tech shares was impressive, causing significant outperformance of US equities versus everyone else. For context, the tech sector powered 22.3% of the 300% gain in the S&P500 Index since the start of the current bull market in 2009, with consumer discretionary accounting for 16% and financials 13%.

Of that 22.3%, Apple alone accounted for 4.1% of the gain in the S&P500. Microsoft accounted for 2.4% and Amazon 1.4%. Contrast this to the 1.2% contribution of ExxonMobil (one of the world's largest oil firms) and 1.3% for healthcare giant Johnson & Johnson

These price increases have left the valuations of the biggest technology stocks like Amazon, Facebook, Microsoft, Apple and Netflix looking lofty relative to other sectors. Bond investors look at measures of duration (sensitivity to interest rates). So tech stocks like Amazon, who trade on a PE multiple of nearly 180x earnings (i.e. it takes 180 years of annual profits to get back the original investment) could be thought of as having an extremely long duration and therefore a high sensitivity to higher interest rates. But it's not just US tech that's feeling the pain. Hong Kong listed Tencent – Asia's largest stock – lost 20% of its market cap in just the last 10 days, going from the world's 5th largest firm down to the 11th largest.

This should provide greater context for investors around why higher interest rates can disproportionally impact high valued (growth) stocks. Another factor is that as rates rise, debt servicing costs increase, which pressures the balance sheets of highly indebted (leveraged) companies.

JP Morgan estimated that, at current rates, markets should be around 2/3% lower (less than this week's retracement) on higher discount factors alone. So perhaps the market was previously underestimating the extent to which interest rates may have to rise to keep a lid on inflation, after the recent positive economic data surprises.

Next up were a growing chorus of firms, particularly in the automotive and luxury goods sectors, warning on slowing sales in China. Two weeks ago, Ford and Nike said Chinese demand was under pressure from negative consumer sentiment towards the US from Trump's trade wars, higher tariffs and new customs checks at Chinese airports. This week, wine, perfume and handbag maker LVMH warned of weaker demand in Asia. Buying expensive luxury goods at home and selling them overseas while on 'holiday' was a convenient way for Chinese to circumvent capital controls to get money outside of China. The fact Chinese airports are now conducting checks for goods taken abroad, rather than being brought back, strikes us as interesting. The China factor may have been another dynamic that had not been fully appreciated by investors until now.

In summary, the market movements this week cannot only be attributed to rising interest rates. While this is undoubtedly a powerful effect, the indigestion for share prices is clearly causing turbulence for sectors which have high valuations – like tech.

Looking ahead, it is important to note that market downturns typically occur in waves of three – known in Elliot Wave theory as an ABC correction. This weeks' movements can be seen as wave A. Wave B follows with a solid but short-term relief rally, which then turns into wave C: a final retracement and exhaustion of negative sentiment to the point where investors see value in re-entering positions.

Fears about Chinese demand certainly add to downward pressure. But with the Q3 corporate earnings season about to kick into high gear, investors might find comfort in the knowledge that analysts predict further solid profits and sales growth. Rumblings of decent progress in Brexit negotiations may yet provide another line in the sand.

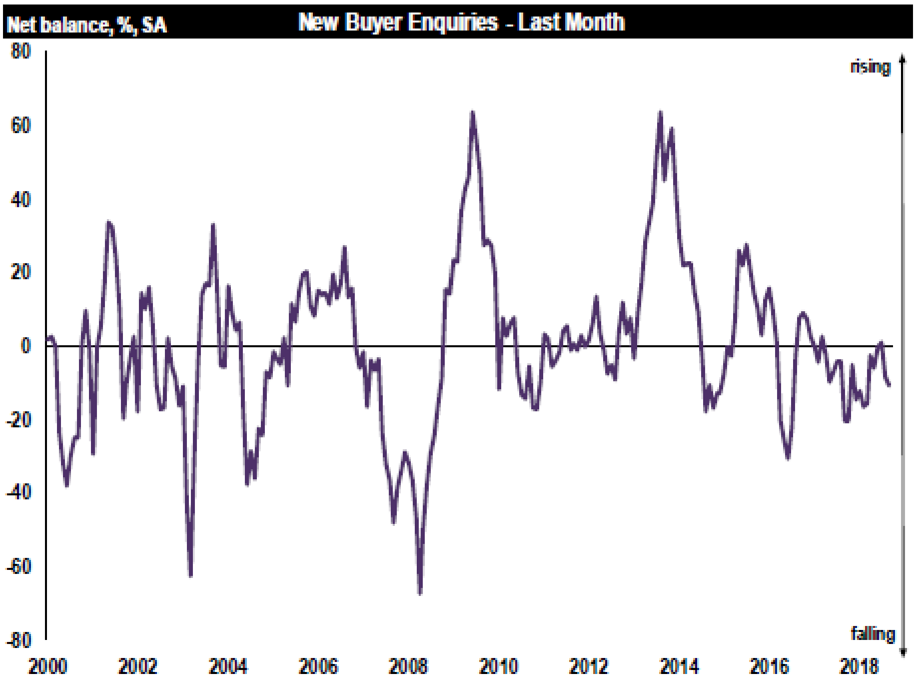
We suspect that price leadership of the tech sector may have come to an end and value stocks (i.e. financials) might benefit from a rising rate environment. If true, that could portend the global leadership shifting from US stocks to other areas.

We doubt the selling pressure has fully finished yet. But whether this current episode turns into a deeper correction, or if it is just another buying opportunity in what is now the longest bull market in history has yet to be determined. From a technical perspective, markets potentially look oversold, so don't be surprised if a possible relief rally (as per wave B) takes place over the next week or so.

UK Property: End of the good times?

News this week showed that the struggles in Britain's property market are continuing. The much-observed Royal Institute of Chartered Surveyors' (RICS) September report revealed that demand from new buyers had weakened for the second successive month, with net enquiries coming in at -11%, after a -9% reading for August. Virtually all of RICS' indicators point to a lethargic market. The time taken to complete a sale has now risen to approximately 19 weeks –

National Enquiries - Past month



the longest period since RICS began recording.

The RICS survey also comes after Halifax's figures painted a similarly dour picture. Recently, Britain's top mortgage lender revealed that prices had fallen to their lowest level in six months, and that the number of homes for sale was at a decade low.

Struggling house prices are not a new development. The last couple of years have seen upward momentum drop out of the UK market, mostly in London and the surrounding south-east. What's significant about RICS' latest data is that it shows more of a drop off in the regions outside the capital. Until now, prices in the regions stood in stark contrast to a sluggish London. But, as often tends to be the case in UK housing, contagion seems to have spread across the nation. And while prices in the regions aren't struggling as much as in the south east (particularly in Wales and Northern Ireland, which are still going fairly strong), a drop off is starting to show.

Estate agents, experts and media commentators were virtually unanimous on the cause: Brexit. Recent news has made Brexit prospects look bleak, and this has dampened sentiment, leading to a fall in activity. According to RICS chief economist Simon Rubinsohn, "There are several themes running through the comments of respondents this month, but uncertainty relating to Brexit negotiations is at the very top of the list"

There is undoubtedly some truth to this. It's no coincidence that the turn in house prices coincided with the Brexit referendum two years ago. This is particularly true for London, where uncertainty has been off-putting for foreign buyers – taking away a key source of demand.

But there is a deeper story here. Beneath the ephemeral shifts in confidence, structural features that had previously led to a runaway property market are now holding it back. It will shock no one to hear that affordability is a major issue in Britain. Property prices for younger first-time buyers became unrealistic – particularly in London – long ago and, despite recent falls, are still out of reach.

This is largely to do with the distribution of wealth – across both social and age groups. In the 30 years following WWII (often called capitalism's golden age), booming economic growth was coupled with booming wage growth. In economic terms, labour's share of growth exceeded capital's. Consequently, the baby boomer generation generated vast amounts of capital for themselves. When stagflation hit in the late 1970s and neoliberal economic policies took hold, this dynamic reversed: for the following 30 years, the return on capital exceeded wage growth.

As well as driving the rise in inequality seen over the period, this also created a great generational divide in wealth dispersion. Naturally, much of this capital ended up flowing into the housing market. House prices then became a pillar of the UK economy, as consumers could run up debt against the value of their homes and thus expand their demand for goods beyond their current income. The fact that wage growth has been so slow (particularly since the financial crisis) also kept inflation down, which kept interest rates down and allowed for even more borrowing. Such borrowing could then fund the buying of more properties to rent, but only for those who constitute good credit risks from the lenders perspective: home owners.

This made the process self-reinforcing and is why affordability has become so stretched relative to wages; the main buyers just aren't reliant on wages.

This process can't continue indefinitely. At some point, property prices have to come back into touch with wages – their underlying base – particularly as the older generation's housing stock starts to come onto the market.

And it's no surprise that Brexit should be the catalyst for this. As we have written before, the Brexit-induced fall in sterling is going some way to rebalancing the UK economy toward export-led rather than consumer-led growth. In bringing down Britain's current account deficit (exports minus imports), it also leads consumers to rebuild savings (which the process described above has run down to historic lows). This, combined with a Brexit-induced fall in real (inflation-adjusted) wages, puts downward pressure on house prices.

Interestingly, a similar process is going on in China. There, stellar economic growth and credit bubble of historic proportions have massively pushed up house prices in the tier 1 cities (Beijing, Shanghai, Shenzen, Gunagzhou, Tianjin). Just like here though, rising inequality has left affordability incredibly stretched. Aware of this problem, the government is making a concerted effort to keep a lid on property prices. The struggling housing market is even leading to political problems: a recent 30% discount offer on new homes led to protests among homeowners.

However, despite a structural shift in the housing market stalling prices, we don't expect a substantial fall. While real wage growth remains sluggish, the fact that employment (the underlying base of house prices) is at historic highs means any sharp falls are unlikely. If unemployment shoots up faster than expected (a possibility in the wake of Brexit), that could change – particularly if the Bank of England is forced to raise rates to prevent a further deterioration of sterling's value. That's what seems to be happening in China, which is why the property outlook there is somewhat dourer.

Overall, UK housing is likely to stay in neutral. Brexit uncertainty may be the short-term driver of the current slowdown, but the longer term structural changes mean it would be the case even if the Brexit outlook improves.

Traditional automotive companies beyond their prime?

It has been a big period for news in the auto sector, with the somewhat disappointing debut for Aston Martin Lagonda Holdings capturing the headlines. The stock has retreated some 16% from issue price at the time of writing. Combined with today's news that BMW is to pay $4.1bn to raise its stake in its Chinese car venture, it seemed worthwhile looking at the health of the Auto sector around the World:

Jaguar Land Rover reports that sales in China slumped 46% last month as Chinese households baulk at buying big ticket items, forcing it to shutter its Solihull plant for 2 weeks. They cited the uncertainty generated by import duty changes and continued trade tensions. BMW and Daimler have both previously cited the trade war as reasons for issuing profit warnings. This is almost certainly driving today's BMW move to increase its onshore presence, given that it is one of the most affected brands (it ships its popular SUV models to China from Spartanburg in the US).

Last week, we had the September UK car sales numbers showing a headline 20.5% decline year on year. Although there were some mitigating circumstances: a strong preceding August, confusion over diesel policy and VED tax changes. Most of Europe (including the UK) saw sales being brought forward before the introduction of the new WLTP test on September 1st. Manufacturers offered very attractive deals on pre-WLTP vehicles, skewing the data (WLTP Worldwide Harmonised Light Vehicle Test Procedure for emissions and fuel efficiency). Year to date in the UK, private sales are down 7% with business/fleet sales -8%, so there's weakness across the board.

Interestingly, it is Volkswagen that has struggled the most with the WLTP examination. Their sales were down 55% in September in the UK with both the Golf (2nd best selling car YTD) and Polo (6th) falling out of the top 10 for the month.

In the US, the rising interest rates from the Federal Reserve have killed off the 0% finance deals that had been driving the market for so long.

"Initially everything was 0%, but then the 48 month loans disappeared and buyers were pushed to take 60 month, then 72 month loans" said one dealer. But in September, the percentage of new cars financed with an interest rate of 1% or less fell to 5.3%, down from 8.2% in Sep '17 and 11.7% in Sep '16, the year US auto sales peaked.

The average financing rate for a new-car purchase was 5.75% in Q2 and the average car loan payment in the US is now $523, thought to be up 10% from the lows. Surveys show that while student loans are millennials' biggest debt in the 50 biggest metropolitan US Cities, in 15 of the Cities it is actually Auto loans which make up an average of 33% of millennials' total average debt.

To sum up, European and UK data is skewed heavily by the WLTP test, but there is clear weakness in China on trade tensions and in the US on the back of rising interest rates.

Interestingly, used car sales, particularly in the US, have recently risen steeply. This could be explained by the financial pressure of rising finance costs for new cars. But equally there may well be an expectation that car technology is at the brink of a break towards electric and hybrid cars. While these are currently in short supply for buyers, such a change in preferences would drive depreciation of old technology cars – an experience owners of diesel cars have already experienced across Europe.

The resulting 'watch and wait' attitude may therefore be another piece in the jigsaw puzzle which is starting to brew into somewhat of a perfect storm for traditional car makers. No wonder then that they are all investing heavily to switch their fleets to electric and hybrid over the coming years, despite the fact that Europe's national grids are highly unlikely to be able to cope with the vast increase in electricity demand in residential areas.

We therefore anticipate a tough period for shares of car makers. On the bright side, the volume of both manufacturer investment and electricity distribution investment may well lead to a forced – but much welcomed – push for increased levels of capital investment across the developed world.

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15th October 2018

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	6995.9	-4.3	-302.6	↘
FTSE 250	18988.1	-4.7	-929.9	↘
FTSE AS	3859.5	-4.2	-168.7	↘
FTSE Small	5540.3	-3.3	-189.0	↘
CAC	5113.9	-4.6	-245.5	↘
DAX	11549.2	-4.6	-562.7	↘
Dow	25350.1	-4.1	-1096.9	↘
S&P 500	2771.4	-4.0	-114.2	↘
Nasdaq	7134.3	-3.6	-264.8	↘
Nikkei	22694.7	-5.3	-1281.0	↘
MSCI World	2045.0	-4.9	-106.5	↘
MSCI EM	954.7	-4.6	-46.1	↘

Global Equity Market - Valuations

MARKET	DIV YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.5	15.7x	12.6x	13.1x
FTSE 250	3.5	16.0x	13.6x	13.9x
FTSE AS	4.3	16.0x	12.8x	13.2x
FTSE Small	4	-	15.1x	13.8x
CAC	3.4	16.3x	13.6x	13.2x
DAX	3.3	13.6x	12.5x	12.5x
Dow	2.2	18.0x	16.0x	15.0x
S&P 500	1.9	20.0x	17.0x	15.7x
Nasdaq	1	24.8x	20.0x	17.7x
Nikkei	1.8	16.4x	16.0x	20.0x
MSCI World	2.5	17.6x	15.4x	15.0x
MSCI EM	3	11.5x	11.0x	12.0x

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
RANDGOLD RESOURC	7.0	HARGREAVES LANS	-14.3
MARKS & SPENCER	5.3	ASHTEAD GROUP	-13.4
BT GROUP	3.2	DS SMITH	-11.6
SAGE GROUP	2.5	SMURFIT KAPPA	-11.0
KINGFISHER	2.4	HALMA	-11.0

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.32	0.32	OIL	80.4	-4.5
USD/EUR	1.16	0.29	GOLD	1218.0	1.2
JPY/USD	112.12	1.43	SILVER	14.6	-0.3
GBP/EUR	0.88	-0.02	COPPER	281.3	1.8
CNY/USD	6.92	-0.78	ALUMIN	2020.0	-6.9

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W YIELD
UK 10-Yr	1.632	-5.2	-0.09
US 10-Yr	3.156	-2.4	-0.08
French 10-Yr	0.864	-4.5	-0.04
German 10-Yr	0.499	-12.9	-0.07
Japanese 10-Yr	0.150	-3.2	-0.01

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.34
2-yr Fixed Rate	1.71
3-yr Fixed Rate	1.81
5-yr Fixed Rate	2.01
Standard Variable	4.38
10-yr Fixed Rate	2.7

* LTM = last 12 months' (trailing) earnings; **NTM = Next 12 months' estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, please email enquiries@cambridgeinvestments.co.uk

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel