The 10 year itch

As the year begins, it is commonplace for many of us to reflect on the 12 months gone by, as well as wonder what the future might have in store. When that new year also marks the start of the next decade then this behaviour is amplified all the more. To think, in January 2010, Barack Obama was starting the second year of his Presidency, the word Brexit would have been unfamiliar to us all and Instagram had not yet been invented. In terms of world events, everyone will have their personal uplifting highlights, which for us include the dramatic rescues of the trapped miners in Chile (2010) and the young Thai footballers from their flooded cave (2018). Whilst we recognise it was not a global story, establishing Affinity Private Wealth (2011) also features high on our list of highlights from the last decade.

From an investment perspective, the last 10 years have been dominated by US assets and particularly all things tech. Our mobile devices have enabled the creation of a digital environment, in which each of us are uniquely defined. The majority of us produce data 24/7, enabling anyone who is interested to learn details such as availability, interests, appearance and privacy. US tech corporations such as Apple, Facebook and Google generate billions of dollars in earnings and are not just technology services we routinely use, but staples in many investors’ portfolios, on whose continued success their financial futures depend. However, will the love affair with the US, its tech sector and her currency be as wealth enhancing through this next decade as it was the last? Or will they be susceptible to a 10 year itch?

How long do investors commit to their relationship with big investment themes?

The 2010s were an American era
But big investment themes rarely outlast a decade

Data as of December 31, 2018
Source: MSIM, Bloomberg, Factset, Haver, Equity Total Returns, USD, Commodity Spot Prices USD
Lines show cumulative performance indexed at 1 at the start of the decade
This highly informative chart was presented to us at Morgan Stanley’s Ideas Conference, in February 2019. It illustrates, through each decade, a specific theme has dominated global investment markets and the 2010s were clearly all about America and the FANGs. The US stock market now represents c.56% of global equity market capitalisation, but its economy accounts for just 24% of global GDP. This is similar to Japan in the late 1980s, when it represented 45% of the value of global listed equities; that imbalance subsequently lead to a painful and prolonged relationship breakdown. Apple alone – a market darling – is now valued at US$1.3 trillion, higher than the combined GDP of Malaysia, the Philippines and Vietnam (2018). When corporations are worth more than major economies, investors should be starting to ask questions.

We should also highlight the chart was produced at the end of 2018 and does not include the 30% plus returns delivered by the S&P500, over the last 12 months. Each theme has tended to accelerate into its final relationship stage before leadership transfers. Thereafter, the former favourite underperforms global equity market returns over the subsequent decade.

**So, what could prompt dissatisfaction with the US and her asset markets?**

Evidence through most of 2019 suggested the US economy was slowing. The uncertainty created by trade disputes, an overly aggressive Fed through the second half of the previous year and the fading impact of the Trump fiscal stimulus, all combined to put a brake on the real economy. Corporate earnings were expected to come under increasing pressure as demand faded and margins were squeezed by rising wages. Wall Street, however, looked through this and continued to re-rate stocks higher, through multiple expansion, believing the Fed’s policy pivot and increasingly dovish language would keep this cycle going. And so it has proved – the US economy once again seems to be gathering pace with consumers buoyed by cheaper mortgages, boosting the house building sector and suppliers of white goods and furnishings.

Notwithstanding this rosier picture for the real economy, the multiple expansion referred to above has left US equities looking expensive versus their peers. They are also over-owned and investor capital is concentrated in one sector. Additionally, we believe the earnings of the tech giants may prove more cyclical than is currently priced in and thus vulnerable to a downgrade in earnings expectations. The forthcoming US Presidential election and the threat of tighter tech sector regulation, to appease growing societal demand, could also be a headwind for the group of FANGs and their peers.

With the Fed staying dovish and the US carrying the worst twin deficit – current account gap, plus public budget shortfall – among major developed and emerging economies, this environment has started to weigh on the Greenback. Aside from a sudden deterioration in the geopolitical landscape, we expect the dollar to weaken further and this, coupled with the more general overvaluation of US equities, could potentially be an important catalyst in triggering investors’ roving eyes to look elsewhere.

**Can we see signs of new relationships forming?**

In the near-term we have some visibility over what might happen next, based on the points we have just raised. Emerging market (EM) equities are likely to benefit from a more stable growth environment, a weaker dollar and supportive valuations. The chart
below highlights, for the first time in a long time, emerging market growth is outpacing that of the developed markets. This has not gone unnoticed and EM equity indices rallied strongly through the final quarter of 2019.

![Emerging markets outpacing developed](chart.png)

With attractive yields, stable or falling inflation, alongside inexpensive currencies, EM bonds are also eye-catching in absolute terms. This allocation affords diversification benefits to a portfolio of emerging market assets, which is much more difficult to achieve across developed market equivalents.

Looking closer to home, the most unloved market, namely the UK, has started to look more appealing to global investors, with both cheap sterling and de-rated financial markets proving attractive bedfellows and difficult to resist.

Keeping a focus on the near term, numerous commentators have argued the decade long-bull market in equities has been the most loathed in history. According to EPFR data, investors withdrew USD221 billion from equities, whilst investing a net USD400 billion into global bonds, during the first 10 months of 2019. According to investor surveys, equity allocations remain close to their lowest levels in 10 years and such positioning suggests there should be a floor under broad equity markets, if any relationship quarrel in the form of a sell-off, occurs.

**What do we think investors will fall in love with longer term?**

We have written several times before about the futility of forecasting and few investors would have foreseen the extent of the US dominance, when the last decade dawned. That said, we do expect to see sustainability continue to grow as a theme, within the investment community. Savers are increasingly engaged in how their money is being put to work, while numerous sustainability issues are high on international policymakers’ agendas. Fixing the world’s problems costs money. For example, it is estimated the energy transition from fossil fuels to renewables will require US$120 trillion, between now and 2050. This will result in numerous winners and losers through time, as new relationships are formed and others fade away. Undoubtedly, some of these companies will be US based, but we anticipate many of the success stories will be little known enterprises today, located
elsewhere. This requires investors to look beyond the US and mega tech names, to discover their future darlings.

Please do contact us with any questions.

Julia Warrander and Russell Waite

Affinity Private Wealth is a trading name for APW Investors Limited, which is regulated by the Jersey Financial Services Commission. Registered office 24 Seale Street, St Helier, Jersey JE2 3QG.