MARKET VIEW

Darius McDermott
Managing Director,
Chelsea

While the 10th anniversary of the collapse of Lehman Brothers has allowed us to reflect on the rapid passing of time, those of us of, ahem, with a far longer tenure in the industry recognise the abnormality of financial conditions of the past decade, distorted by quantitative easing from the world's major central banks.

Amid all the doom and gloom that followed those dark days in September 2008, it's worth remembering that investors have made a lot of money since. Indeed, 22 August this year represented something of a landmark date as the US S&P 500 – a benchmark for the world's largest equity market – passed the previous record for the longest-ever sustained bull market run of 3,453 days.

That does not mean we've seen a straight line of growth. There have been four major market falls during that time, where the index lost more than 10% (a loss of more than 20% represents a move to a bear market phase and a period of falling share prices) but the US, and other developed markets including the UK, have largely delivered sustained returns that should bring investors cheer.

As a football man, I see the period since March 2009 as something of a game of two halves. The years immediately following the financial crisis was a boom time for 'quality', defensive, 'non-cyclical' growth stocks. For example, Nestle and Unilever, where consumers are still going to buy their baby milk and toothpaste whatever the economic conditions. As investors have been willing to pay more for these types of companies in a low-growth environment, so the price of company shares have become more and more expensive.

It wasn't until a few years later that people began to talk about the so-called FAANG tech stocks (Facebook, Apple, Amazon, Netflix and Google) which dominate the US market today. It is these stocks that are most expensive of them all, with Apple and Amazon each surpassing a milestone of $1trillion in value. Share prices have continued to rise since then in August and September.

A common way to judge how expensive the market looks is to use the 'Shiller Cyclically-Adjusted PE Ratio'. Without bogging you down with details about what this is and how it works, the key takeaway is the S&P 500 stood at a measure of over 32x as of June this year against a long running average of around 25x, according to JP Morgan*. In a nutshell, the market looks expensive, and the FAANGs are much to blame for this (find out more about the investment case for technology on page 34).

But does this mean we're forgetting value in other markets? Compared to the US, we think the UK looks fair value, while you could make a relative argument for value in some European and Asian markets too. A strong dollar since April has adversely hit emerging markets, but we think this represents an attractive buying opportunity, given favourable long-term prospects. US money tends to flow to emerging markets when the dollar is weak, because of potential superior returns, but when the dollar is strong, the money returns home. Underneath all of this short-term noise, demographics and the rise of the consumer in these developing countries are stories that look robust.

So how should we be navigating through the months ahead? We think investors need to remain aware of these expensive valuations, and so diversify their portfolios between different equity markets and other asset classes. As regular readers will know, we think bonds are expensive too, so putting our faith in good fixed income managers who can guide us through what could be difficult times ahead will be key.

Amid all the doom and gloom that followed those dark days in September 2008, it's worth remembering that investors have made a lot of money since

*JP Morgan, Guide to the markets, Q3 2018