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MULTI-ASSET PROCESS

Market review

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The so-called October effect was in full force this year, with markets around the world in freefall and wiping out 2018 gains as several indices dipped into correction territory. Many of the worst market falls in history have come in October, primarily Black Tuesday (1929) and Black Monday (1987), and while the 'effect' might be psychological rather than driven by anything concrete, this month gave us the worst rout in six years.

Markets staged a small recovery at the end of the month but with President Trump having boasted that booming equities are a measure of his success, these declines put a dent in his armour heading into mid-term elections.

Little new emerged in October in terms of triggers to stoke market fears but as we have said before, the longer trade war talk continues without resolution, the more volatility it creates. For us, the pullback in the US was expected after such a long run but we were surprised to see other markets with less momentum dropping back as far as they have.

New Deutsche Bank research shows that if the year finished now (at end October), a record percentage of assets would be in negative territory in dollar terms; this is in stark contrast to last year, when the exact opposite was true. According to the bank, this perhaps highlights a world where we have moved from peak quantitative easing and everything being expensive, to quantitative tightening.

Despite a flood of strong earnings announcements, many came with warnings about the future impact of tariffs and rising costs and a number of America's tech giants fell on these concerns and dragged the market with them. As the US is later in the cycle than the rest of the world, we would expect growth to slow and so far, Europe has proved unable to pick up the baton.

Central banks now face a tougher balancing act than they have for years. Amid discussion of whether the Federal Reserve might slow its tightening given worsening conditions – and ongoing criticism from the Oval Office – vice chair Richard Clarida backed further gradual rate hikes while delivering an upbeat assessment of the economy in his maiden speech. The central bank is "as near as it has been in a decade" to meeting its twin goals of full employment and price stability, he said.

Elsewhere, the situation in Italy has also contributed its share to overall volatility. To recap, the country's government confirmed it is seeking a 2019 budget including a deficit of 2.4% at the end of last month; to no one's surprise, the European Commission rejected this and told Italy to revise its figures, an unprecedented move with regard to an EU member state.

We now appear to be at an impasse: while the Commission says it is worried about the impact of higher spending on already sizable levels of debt in Italy, the country's populist government has vowed to push ahead with campaign promises including a minimum income for the unemployed. In the modern way, Italian deputy prime minister Luigi Di Maio wrote an inflammatory response on Facebook: "This is the first Italian budget that the EU doesn't like," he said. "No surprise: This is the first Italian budget written in Rome and not in Brussels."

In a further blow for European stability, German Chancellor Angela Merkel will not run for re-election as Christian Democratic Union (CDU) chairwoman in December after heavy losses in regional elections, although she intends to see out her term as head of state. Merkel has been chair of the CDU since 2000, becoming one of its longest-serving chairs, but this latest result in Hesse is seen as another damning indictment of her leadership from the country's populace.

In the UK, Brexit debate continues and while the Prime Minister claimed a deal is 95% done, ongoing uncertainty is clearly harming sentiment: a study from Hargreaves Lansdown shows the lowest confidence in the local stock market since the mid-1990s.

Meanwhile, bringing forward this year's Budget statement to two days before Hallowe'en was a headline writer's dream and my main takeaway was that this is clearly a Budget concocted by a spooked government. With Brexit lurking in the background, Philip Hammond has little room for manoeuvre and has already admitted that if our exit from the EU does not go as the government wants, we can basically rip up these policies and start again.

While this Budget failed to move us to any great extent, it also failed to move markets dominated by far greater economic concerns – including trade wars, European politics and a liquidity drain as central banks start on the path towards normalisation. As we have continued to stress, despite the reams of press surrounding UK-centric events such as Brexit and the Budget, there are currently much bigger events driving the fortunes of a properly diversified portfolio.

We believe financial markets are driven over the long term by the path of global growth and global inflation but neither of these work in straight lines, and setbacks such as we have seen in the past few weeks are commonplace. All in all, we are late cycle but we still believe there is further room for risk assets to rally: while the Fed is approaching normalisation with monetary policy, other major central banks are yet to get off the blocks. The danger signal we are looking for is the next recession but there are few signs of this occurring as yet.

We maintain portfolios that are focused on the long term and diversified by asset class, geography and manager style to help to ride out short-term moves in markets. We remain fairly neutral in terms of tactical asset allocation, maintaining an overweight in equities and, as stated, focusing on more attractively valued markets. We are also globally diversified, meaning the portfolios are not correlated to the ongoing Brexit situation, and tilted towards value holdings.

Whenever FAANG (Facebook, Apple, Amazon, Netflix and Google) stocks struggle, we see a flood of commentary extolling the virtues of value: we made the call to move over early and still believe this part of the market is due a run, as well as offering useful downside protection.

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