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9th September 2020

Market Update

Showdown

The mood in Brexit talks have soured further in recent days with the revelation of plans by the UK government to override aspects of the EU-UK Withdrawal Agreement regarding Northern Ireland. This has furthered the narrative of Boris laying the path for a no-deal departure from the transition period, which appears set for an October showdown. Commentary is still split on the PM's true intentions, but one thing that does seem certain is there will be high drama in the coming weeks. As ever, the pound is the clearest indication of market perception on Brexit and in recent days sterling has seen significant falls, unwinding the gains achieved since late July.

Tech Trips, Tesla Tumbles

The shares of leading technology companies have been amongst the most popular investments of 2020 as their high growth rates at times of increased remote working have driven prices rapidly higher, while the rest of the market has broadly faltered. With a high concentration in tech companies, US investment markets have been major beneficiaries. Yet, valuations are high and concerns over their sustainability are justified. These concerns now appear to have come to the fore. The Nasdaq 100, an index of the largest tech stocks in the US, has fallen by nearly 11% over the past week. No single catalyst can be seen for this change in fortune; profit taking is likely one factor, while unease over record price levels is likely another.

One specific example worth highlighting is that of Tesla, the electric car maker. The stock of this inventive and trendy company has soared in popularity over the last year, with its share price up over 700%. Such gains have elevated the company to the position of the world's most valuable car producer, despite producing a mere fraction of the number of vehicles the company it displaced, Toyota, does. Such gains have driven excitement in the prospects for this stock, with the illogical, but all too human, trait of big gains drawing in more investors. However, the tech sell off of recent days has shown the risk of such highly valued and rapidly growing stocks. Since August 31st Tesla's stock is down nearly 34% and this includes a 21% one day fall on Tuesday 8th September. While the growth of this company's operations is likely to continue and its share price may yet climb higher again, this should serve as a useful reminder that regardless of the momentum that may exist in an investment, fortunes can change very quickly, especially if prices appear divorced from economic fundamentals.

Inflation Targeting

The Federal Reserve, the US central bank, recently adopted a change in policy that is small in wording, but potentially large in long term impact. As with its peers the world over, the Fed is tasked with maintaining economic stability, part of which is a stable inflation environment. Until the change on 27th August, the Fed's aim was to maintain inflation at 2%. This has now been changed to targeting inflation at an *average* rate of 2%, meaning that inflation above this level can be tolerated without any action immediately required. While central banks are currently more concerned with falling inflation, the time of quickly rising prices will return. When this does happen the Fed, based on this policy adjustment, will be slower to raise interest rates. This is positive news for the US, and by extension, the global economy, as growth sapping rate rises will be delayed, but this calls into question the sustainability of the extreme price levels we currently see in long term bonds. Higher inflation rates being tolerated will increasingly become a major challenge for these bonds, whose fixed returns are particularly eroded by inflation. This is unlikely to create a sudden collapse in bond support, but as we move through the economic recovery from the Covid-19 crisis, then the potential changing inflation environment must be considered when assessing all investment options and bonds are unlikely to pass through unscathed.

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