MARKET BULLETIN

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End of history?

It was voguish as the Cold War thawed a quarter of a century ago to talk of an "end of history" – with reference to Francis Fukuyama's notion that liberal democracy had culturally triumphed – and assume, from the view of the world economy and markets, the smooth progress of free trade and globalisation, the efficient creation and transfer of prosperity, and peaceful co-existence across our planet. Twenty-five years later, Hong Kong citizens clash with the forces of a totalitarian-'lite' People's Republic; the Kremlin – headed by a former KGB officer – fights a proxy conflict in Ukraine and menaces its former Soviet neighbours; fanaticism and civil war has benighted the Middle East; military dictatorship holds sway over 67 million Thais. History is yet to be shaded in the neutral tones of liberal democracy (the West has failed to 'paint it beige').

In 2014, these and other geopolitical risks seem more legion than at any point in the last quarter of a century. Moreover, political uncertainty is rife from elections across the larger emerging market economies (Brazil, India, Indonesia, South Africa and Turkey) to, nearer home, the referendum in Scotland and the question of the UK's future in Europe. Perhaps, as Deutsche Bank suggests in a recent study on long-term assets, we are at a turning point as the influence of the world's dominant power, America, wanes and, during such historical shifts, geopolitical tensions structurally increase. Although markets have remained sanguine despite these uncertainties, the cheery disposition looks to have paled in September. Markets faced with more frequent geopolitical stresses may have to price in a higher degree of risk.

More immediately, the International Monetary Fund is concerned that geopolitical threats and a slowdown in emerging markets and the eurozone could spell a period of low growth for the global economy – despite the strength of the US and UK recoveries. (The World Trade Organization has also cut its trade growth forecast for the year from 4.6% to 3.1% and from 5.3% to 4% for 2015.) Moreover, the International Center for Monetary and Banking Studies (ICMB) has warned that record global debt levels with low growth could threaten asset prices (which have risen with the expansion of credit). Certainly, markets are alive to the threat of a global slowdown, particularly as they await a US Federal Reserve interest rate rise. As fund manager BlackRock's chief executive Larry Fink points out, these conditions, together with looser monetary policy in Frankfurt and Tokyo, could even persuade the Fed to delay its interest rate rise.

Draghi's heels

As anti-austerity protestors clashed with police last week in Naples, the European Central Bank's governing council in the city's grand Palace of Capodimonte did not move at the pace financial markets expected – or wanted. Two years ago, ECB president Mario Draghi pledged to do "whatever it takes" to save the euro, and has focused on holding down interest rates which are presently at a near-zero level. This is set to change after last week's Neapolitan gathering, with the introduction of an asset-purchase scheme. The ECB will purchase two types of securities that bundle up loans: outright purchases of covered bonds from mid-month and asset-backed securities sometime this quarter. However, there is no figure yet for the size of the purchases over the next two years, although the indications are they could be up to €1.1 trillion.

Markets had hoped for more detail from Draghi amid a range of concerns about the eurozone from growth and inflation – which is down to a five-year low of 0.3% – to the effect of Russian trade sanctions on the region's leading economy, Germany, and the wider bloc. Fund manager Schroders' European economist Azad Zangana warns that the pool of assets targeted by Draghi is too small to make a major impact on the economy. "The ECB is aware of the problem, which is why it has not set a purchase target," argues Zangana. As a result, European equities and bonds are trading lower, while the euro has appreciated slightly. The STOXX Europe 600 index lost 2% over the week. Meanwhile, the keenly anticipated €6.5 billion initial public offering of Rocket Internet in Frankfurt fell to earth as shares lost 12.9% on the first day, amid concern about its ability to create successful ecommerce start-ups.

Moving continents

Corporate America last week mulled over incursions by cash-rich German companies drawn west by the pace of the US recovery. Merck KGaA last week made a $17 billion move on Sigma-Aldrich, which it hopes will boost its life science business, while Siemens paid $7.6 billion for Houston-based Dresser-Rand as it looks to profit from the US shale gas boom. Meanwhile, the Obama administration's efforts to curb US companies buying foreign businesses for overseas tax bases have not halted AbbVie's $54 billion pursuit of Anglo-Irish group Shire, with the US pharmaceutical giant looking to complete the deal this quarter. The overall impact of the new US rules is not yet clear, such as how it will affect Burger King's $11 billion acquisition of Canadian coffee chain Tim Hortons or any further play by Pfizer for UK target AstraZeneca.

A stronger US economy and the Fed's stimulus measures continue to give momentum to US equities. Further positive signs for the US economy include 248,000 new jobs in September and the unemployment rate at a six-year low of 5.9%. The Fed last month said it would keep interest rates near zero for a "considerable time" after the end of QE. Markets are looking to mid-2015 for a rate rise. Although the Fed has indicated it could move sooner if data continues to exceed expectations, a global slowdown could act as a restraint. The positive news partially offset nervousness over geopolitical risks and a slowing global economy, which resulted in a 1% fall for the S&P 500 index over the week to 1,968 points (and by similar percentage points in September). However, the benchmark US index has advanced 6.5% so far this year.

In Asia, concerns about the global economy and hopes for the US recovery also played out in the region's main financial centre in Tokyo. The Nikkei 225 Stock Average closed at 15,709 points at the end of the last week, after losing 3.2% over the five-day period amid the downbeat sentiment for the global economy. However, the Nikkei recorded a 4.9% rise in September, which was its biggest monthly gain since November last year; so far this year, the Japanese equities index is down only slightly by 2.3%. Meanwhile, economic data continues to frustrate Japanese policymakers and the revitalisation programme championed by Prime Minister Shinzo Abe. Japanese factory output fell 1.5% in August from July, defying economists' expectations of a 0.2% rise.

Global Britannia

The UK stock market, with its international perspective, was alive to global developments, with stocks exposed to Hong Kong losing ground over the week – HSBC was down 2.7% and Standard Chartered fell 5.3%. UK supermarkets continued to suffer as Sainsbury's revealed a quarterly sales slump, while the Financial Conduct Authority launched an investigation into Tesco's £250 million accounting black hole. Each of the large supermarkets suffered their worse week on the stock market for more than a decade, with Tesco's shares down by 10.5%, Morrisons 7.9% and Sainsbury's 9.2%. US investor Warren Buffett described his investment in Tesco as a "huge mistake". UK large caps lost 1.8% over the week.

Britain's recent economic acceleration may also be slowing, with Purchasing Managers' Index (PMI) figures released by Markit for September easing slightly. However, Markit data suggest that the UK economy expanded by 0.8% in the third quarter; and although this is down by 0.1% from the previous three months, this is robust by historical standards and signals a continuation of the UK's strong economic growth spell. Moreover, with household and company balance sheets improving, confidence still high and inflation continuing to fall and ease the pressure on real incomes, analysts believe the recovery looks like it will continue in 2015 and 2016 with a growth rate of around 3%.

As on the other side of the Atlantic, the pace of economic growth in the UK has raised the possibility of an early interest rate rise. Mark Carney, the Bank of England's governor, has suggested that the strength of the recovery is such that the UK could handle higher rates, although these would be gradual and limited. The IMF last week also waded into the debate, stating that a rise in the UK and US could have a profound effect on the global economy. An ICMB report for the IMF argued that interest rates need to stay low for a "very, very long" time to enable households, companies and governments to service their debts. Meanwhile, it is believed that hard-pressed UK savers will look to early 2015 and wait for the first rise since 2009.

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