TAM INTERNATIONAL INVESTMENT NOTE

Is it time to run for the hills or stand your ground?

Earlier this month in a note to clients, TAM's CEO alluded to the return of volatility and extolled the virtues of owning a defensive investment strategy in these uncertain times. Well, since then markets have been unable to shrug off a sense of gloom, forcing capital markets deeper into negative territory to the point that we want to revisit the topic of volatility and shine a light on what's behind this sell-off and where we might be going from here.

October 2018 has not broken with the tradition of October being an unstable month in markets. This week has seen some of the most volatile trading sessions since the financial crash of 2008, with the S&P wiping out its total returns for the year and leaving global equities facing even steeper declines. It will come as no surprise if I tell you that the VIX index, the stock markets gauge of how much investors are prepared to pay to insure their portfolios against a sell off, has spiked up by 52% already in October.

Now, what's driving the sell-off is almost exclusively macro based - with geo-politics such as Italian budget fears, Brexit posturing, US led trade wars taking the headlines against a background of an all-consuming fear that the US Federal Reserve is going to tighten interest rates so much that they choke off any growth that may be bubbling away.

It must be said that the sell-off over the last couple of days has been exacerbated by fears around US corporate earnings beginning to peak despite around 80% of US corporates beating earnings estimates. However, most headlines we have read in the last three months are now lining our wastepaper bin. Yes, they need our attention and they need to be taken seriously, but there's no new development in these last weeks that can claim responsibility for the state markets have gotten themselves into during October.

If truth be known any one of the macro headlines could be blamed for October's lurch lower in the same way any one of them can't actually be responsible. What seems a more plausible explanation for October's sell off is based on a simpler narrative - markets and investors have been buying into this bull run for over 10 years and it's running out of steam. Good news now needs to be brilliant news to produce the sort of rallies that we saw in 2017 and when there is no brilliant news we are seeing volatility return in spades. Everyone wants to stay at the party, but we all need increasingly better reasons to stay invested.

So, where to from here? It is true that October's rout puts global markets into negative territory for the year but when we see these convulsive sell-offs, we have also historically seen a rally back out of the quagmire.

We are not expecting a meteoric leap to new highs, but we do see a recovery from where we are today. Fundamentally, 80% of US corporates beating their earnings forecasts in Q3 is most definitely positive news despite the market trying to convince itself otherwise. Positive earnings surprises like these are the silver lining that we believe is going to keep the market from running for the hills over the next 6-8 months because it tells us that US economic indicators are still in growth mode. Whilst this by no means ensures success for stock markets it does contradict the narrative that we are in the middle of an economic tail spin which is only going one way.

When markets rally back in periods of strength TAM will be looking to take profits for our clients by trimming global equity positions but right now it's about seeing out October and holding our nerve!

We will keep bolstering the defensive moats in our portfolios. One such example is gold bullion – in which TAM has been building an investment position. Gold has suffered at the hands of a strong dollar this year but is regaining that all-important status as a safe haven asset in times of uncertainty. No surprise then that gold mining companies are up over 10% in October against the negative backdrop of the global market.

In short, October has shown a pickup in volatile markets where going forward returns are by no means assured. We have entered into a new era of uncertainty and markets are hitting the sell button on little or no news a lot faster than they have done in the past.

That's not to say there are no more opportunities to make returns. On the contrary, there are many parts of the market which are looking very attractively priced after October's sell off, but investors need to be aware that the risks are now noticeably higher and thus investing has to be undertaken first and foremost with capital preservation over capital generation being the overall objective.

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