Markets in a Minute

8 September 2020

Tech rally falters

Global markets fell last week as the result of a sell-off in technology stocks, which were arguably ripe for a correction. The Nasdaq had broken through the 12,000 mark earlier in the week, less than a month after it breached 11,000 for the first time, before falling on Thursday and Friday. The tech-heavy index has risen a staggering 75% since its March lows, and the sector has been producing equally astonishing headlines, such as Apple's market capitalisation now eclipsing that of the entire FTSE100.

Last week's markets performance*

- FTSE100: -2.75%
- S&P500: -2.3%
- Dow: -1.8%
- Nasdaq: -3.27%
- Dax: -3.27%
- Hang Seng: -2.85%
- Shanghai Composite: -1.4%
- Nikkei: +1.4%

**Data for the week to close of business, Friday 4 September.*

A positive start to the week

UK shares made big gains yesterday, boosted by a sharp fall in the pound due to growing fears of a no-deal Brexit. A weaker pound helps big UK companies because it boosts the value of their international dollar-based earnings.

The FTSE100 closed up 2.4% at 5,937.40. Sterling fell by 0.84% against the dollar to $1.31, and 0.63% against the euro to €1.114. European shares, too, had a good day, with the pan-European Stoxx600 index rising 1.67%. The US market was closed for the Labor Day holiday.

Tech bubble?

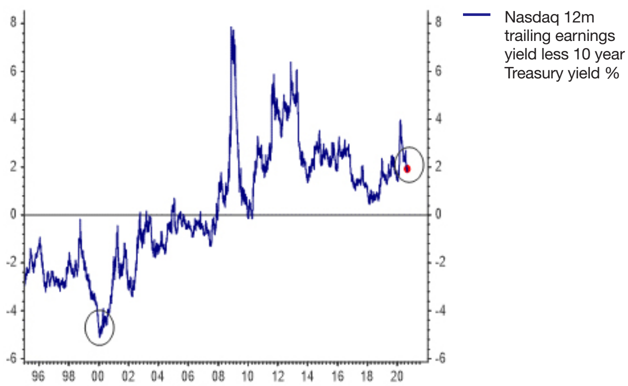
Given the run-up in tech stock valuations, it would be impossible to say that the current correction is over, or to rule out further corrections in the coming months. But what we can say is that it doesn't look like we are in a market bubble similar to that of early 2000, for several reasons.

- First, valuations are not nearly as stretched, as the chart below shows. This is partly because the tech and "new economy" names have been generating very strong profits that have underpinned their rise. And if we zero in on the valuation of the technology sector plus the so-called FANG stocks (Facebook, Amazon, Netflix and Google/Alphabet), as at the end of August, these four companies were trading on roughly a 60% valuation premium relative to the S&P500. The recent sell-off will have brought the tech sector plus FANG stocks back to the average premium they have traded on relative to the S&P500 since 2012, when Facebook went public.

- Second, the monetary policy backdrop today is very different to that of the late 1990s and early 2000s. Back then, after the Nasdaq peaked in March 2000, the Fed hiked rates by 0.5% to 6.5%. Today, the Fed is going out of its way to say that rates are not going to move above zero for a very long time.

The low yields on Treasuries are supportive of Nasdaq valuations. Nasdaq investors are currently getting a yield that is 2% greater than available on a 10-year Treasury. Back in 2000, the 10-year Treasury offered a yield that was 5% higher than the Nasdaq.

So, while further volatility looks likely, it's probably premature to think that the bull run of these tech and "new economy" names has come to an end.



Source: Refinitiv Datastream

Back to school and Covid-19

While children are typically super-spreaders of respiratory diseases, particularly during back-to-school weeks, thankfully Covid-19 seems to be an exception.

This may partly be because they are less symptomatic but, more encouragingly, they also seem to be less prone to catching the virus.

Despite that, the evidence from schools reopening has been quite mixed. The process went swimmingly in Denmark and Norway where case numbers were already quite low but bringing older children (who are more susceptible than younger ones) back to schools in Germany has been associated with higher transmission rates and the recent pick up in several US states is also partly attributed (rightly or wrongly) to the return of college students. It remains to be seen how this will affect the UK although the fact that the third wave in the US does seem to be less worrisome than its predecessors for now should provide some comfort, likely because it is mainly the more resilient younger population that is getting infected and more vulnerable members of society are still taking greater precautions.

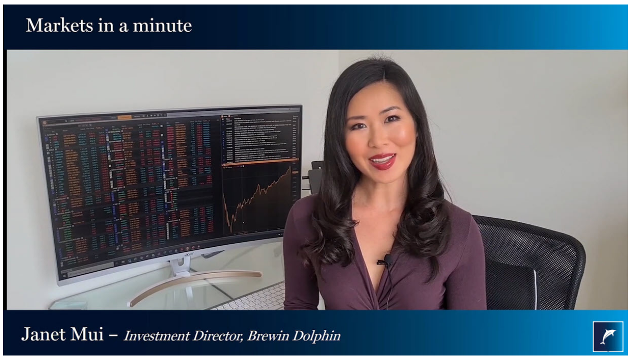
US labour market

Last Friday the US labour market provoked a pretty positive employment report. Over 1.3m new jobs were created and based on the continuing claims data of last Thursday, that momentum looks like it is being maintained (continuing claims number reported fell by over 1m).

Average hourly earnings rose 0.4% when we might have expected it to be depressed by people returning to low paid positions.

This makes the Federal Reserve's recent remarks about the worrying trend in the US economy appear overly bearish but that needn't have any impact on their actual actions given the new approach of inflation "average targeting" which allows inflation to overshoot for periods.

And that's appropriate too because the underlying labour market is still weak as evidenced by permanent job losses creeping up again (they were flat in July).



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