N+1 SINGER

Equity Market Report 2018

EQUITY MARKET REVIEW

Overview

We are certainly living through an interesting period for global markets! Volatility is at extended levels for the first time for a period, trade wars seem to have been in the headlines every other day, and their impact are reverberating around the world. Trade wars are inflationary and kill economic growth, so any signs of resolution are a positive for equity markets.

Market Stats*

FTSE 100 -12.9%
FTSE 250 -15.8%
FTSE Small Cap -13.3%
FTSE All Share -13.4%
FTSE Aim Index -19.2%

US
Dow -7.5%
S&P 500 -7.7%
Nasdaq 100 -5.4%
Russell 2000 -13.6%

Asia
Nikkei -11.42%
Hang Seng -13.92%
CSI 300 -24.84%

Europe
Dax -18.1%
CAC 40 -12.1%

Commodities
Oil – Brent -20.6% WTI -22.9%
Gold -3.3%
Copper -17.2%

**YTD as at 21st December 2018*

The US Economy

The US 'experiment' with a 'populist' President continues to roll on, but 2018 saw Trump losing the advantage of his party controlling both US Houses. We could see the 'tweets' becoming more urgent as we move through 2019, if that is at all possible, especially with his lawyer about to spend 3 years in jail. The big question for markets is 'has US economic growth peaked?' We are 10 years into the recovery from the 2008 financial crisis, which is lengthy measured against previous cycles.

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Previous cycles, however, did not see the huge impact of global Quantitative Easing (QE) which is now being gradually removed. US Treasury yields are now rising, with the latest move in interest rates happening, as expected, in December. The question now being asked is 'how many more rises will there be in 2019?' Interest rate futures predict just one rise but other forecasters still see up to two or more.

Markets are likely to be very focused on data releases and that could lead to volatility remaining at raised, or you could say more normal levels after the recent QE inspired 'stability'. However, US confidence measures currently remain at high levels both for the consumer and industry. We shouldn't forget though that 2019 on 2018 will see the stimulatory impact of the Trump tax cuts dropping out of the economic growth equation.

Remember that companies have used a fair part of that benefit to buy back their shares through 2018 to the tune of around $1trillion; the much discussed de-equitisation. Have they been buying back their equity right at the top of the market, paying peak valuations? Only time will tell. On balance, we believe 2019 should see the US continuing to grow but at a slower rate.

Asia and Europe

In Asia, Chinese growth continues to gently slow with the perennial worries over Chinese indebtedness at the fore, especially at the regional government level. The US actions on trade will not be helping this 'new normal' growth scenario. The reverberations will wash around the wider South East Asian economies which have become more and more dependent on Chinese demand, with Australia being a prime example.

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In Europe, Italy also have a populist government and their proposed Budget is challenging the European Union's GDP deficit rule to the chagrin of the other member states. It is thus somewhat ironic that with rioters on the streets in France, their populist President Macron has announced fiscal concessions that are likely to push their deficit over 3% in 2019.

Returning to growth, or rather the lack of it, Q3 saw a number of European countries delivering negative growth, namely Germany, Switzerland, Italy and Sweden. If the same occurs in Q4 they are going to be in technical recessions! Export led countries like Germany are suffering from the impact of the aforementioned trade wars. Meanwhile the EU continues with its protracted negotiations with the UK over Brexit and we must now look at the position in our home market. The first half of the year saw equity markets peak in May and, to use that well used phrase, it has certainly been a 'year of two halves'.

As the Brexit deadline grows closer, uncertainty has ratcheted up and uncertainty is of course both an enemy of activity and of markets. From the May peak, the FTSE AllShare has fallen over 13%. Volatility remains at elevated levels, valuations are under pressure, profit warnings are prevalent and a growing number of IPOs have been pulled or postponed, whilst issuers wait for more favourable conditions. Capital remains scarce and the competing factors of protecting year end performance and continued redemptions mean that many fund managers remain inactive. Share price moves are being exacerbated therefore, as volumes and support levels reduce. All combined, this suggests that 2019 could be a pretty difficult year to navigate.

Nevertheless it is important to say that UK markets are not alone in seeing these trends. Volatility is high globally, with the major US, European and Asian markets all down.

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We suspect that an influence on this is the impact of the gradual withdrawal of the QE stimulus and the ending of "free money", plus of course global trade concerns. Whilst 2017 saw synchronised global growth, 2018 has seen countries knocked off that growth perch one by one. That has had a knock-on effect on equity valuations. Bond yields have been rising as QE has been withdrawn, and now the forecast cash flows from businesses are also coming under pressure, with a resultant impact on share prices. Share prices are effectively the discounted future cash flows that the business is expected to earn.

Brexit

Returning to the UK, the stock market and the economy are also having to deal with the additional uncertainty of the Brexit negotiations. The uncertainty emanating from Parliament is creating what could be a dangerous period for the economy.

In your own businesses, you may well be aware of projects or transactions that are being postponed or cancelled. In addition, you may have begun making preparations for a 'hard Brexit' and may be stock piling to protect against supply disruption. The faster we get a resolution to this pivotal moment in the UK's history, whatever the result, the better it will be for UK plc. Uncertainty is the enemy of activity.

The UK equity market is said to have seen $1trillion of outflows since the Brexit vote in 2016 according to EPFR, a data provider. Much of this will have been withdrawn by overseas investors to the extent that the UK stock market was rated the least popular of 22 asset classes in the recent and widely followed Merrill Lynch survey of global fund managers. One has to consider whether UK equity sentiment can get any worse? Are we now at or close to the point of maximum uncertainty?

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Investors, and in particular overseas investors including the global macro funds, are arguably substantially underweight in the UK market.

Flows of capital move markets and, on a lessening in the current levels of uncertainty, we would argue that even a move solely to a less underweight stance could drive a strong turnaround for UK equities. The UK equity market is by no means expensive with the FTSE AllShare trading on a December 2018 Price Earnings ratio of 12x with a 4.6% yield, a level of yield only exceeded on three occasions in the last thirty years. This also compares favourably with other developed markets.

On a more positive note, from the end of Q1 2018, the UK consumer has seen their disposable income growing after being under pressure for much of the period since the financial crisis. No doubt there will be some rebuilding of consumer balance sheets, but on a recovery in confidence, some of those monies are going to boost economic growth.

Remember that the UK economy is 80% services, which helps to size the potential boost. Adding to that, the UK has the most people in employment since records began.

N+1 Singer's Performance in the City

It has been an increasingly turbulent year for market participants as well, and not least as the investment community has adjusted to MiFID II, a process that is, of course, still on-going.

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You will no doubt have seen some of the effects, whether for example in reduced liquidity or reduced broker research.

We are pleased to report, however, that N+1 Singer has maintained its strong momentum and, despite the hiatus of the last quarter, we enjoyed another successful year across the firm. At our core, we remain committed to advising and funding UK small and mid-cap growth companies. We believe that this segment represents the life blood of UK plc and we are proud to represent such a diverse range of market-leading businesses.

We continued to invest in high-quality people and established our new Corporate Broking and Syndication departments. In total, we completed 30 transactions, including 6 IPOs and raised over £950 million for our clients, £117 million more than in 2017. Notable IPO transactions include the IPO for CEIBA Investments, an Aberdeen Standard Life managed investment fund, focused on Cuban real estate with a market capitalisation on admission of £137 million, RenalytixAI, which raised £22.5 million and AVI Japan Opportunity Trust, which raised £80 million upon listing on the Premium segment of the Main Market.

Our M&A practice also had a busy year, with a good number of buy and sell-side mandates completed. Despite market conditions, RBS acquired our client, FreeAgent, for £53 million. This is the first time since the 2008 financial crisis that RBS has acquired a business. Other notable transactions include the acquisition of Produce Investments for £55.29 million by our client Promethean Investments, and the £34.4 million recommended cash offer for Abzena by sector specialist private equity firm WCAS.

Above: Market Opens on the London Stock Exchange's Premium Segment of the Main Market for AVI Japan Opportunity Trust plc

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In addition, we have been selected to advise for a further fourteen corporate clients since June 2018. In H2, this includes: Miton Group, Curtis Banks, Directa Plus, SmartSpace Software, Surgical Innovations Group and Urban Logistics REIT, bringing our total number of clients to ninety-three.

Our strong performance is reflected in our corporate adviser rankings as both Financial Adviser and Stockbroker, where we are placed as one of the top three firms by number of clients.

In trading, N+1 Singer has stood up to the challenges presented this year, which culminated in a sharp sell-off in all indices in Q4. The near 10 year bull run we've had up until Oct '18 has seen small cap & AIM stocks outperform their bigger counterparts as investors have looked for high growth companies to maximise returns in a favourable market.

However this trend was sharply reversed in Q3 as liquidity rapidly evaporated with the increased socio-economic uncertainty, and investors flocked to the 'relative' security of more liquid large caps.

AIM has retreated 23% so far in Q4, putting it in bear market territory on volumes down 40% on last year. The FTSE 100 has retreated just 11% in the same period, 15% from its May high, with volumes down just 10%. Despite this demanding backdrop, N+1 Singer has further committed to the UK small cap space, increasing our coverage & cementing our top five status in AIM volumes & Extel rankings.

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On the private side, the UK economy doesn't appear to be slowing down and we were delighted to see so many on the rise in both the Fast Track and Tech Track 100 league tables, which we have been a proud sponsor of since 2016.

What can we expect in 2019?

2019 will hopefully see an end to the UK specific uncertainty with a resultant improvement in global investor sentiment towards UK equity markets.

An interesting point to consider is that if the Theresa May Brexit deal is voted through, the Bank of England scenario analysis sees UK GDP at +1.75% ABOVE their latest November Inflation Report forecast for UK growth over the next five years i.e. an upgrade. You will not have read that in many articles.

Above: Alice Avis, Non-executive Director of iPulse, winner of N+1 Singer's 'Best Use of IP' award at the Tech Track Awards 2018.

Our advice for 2019: Dust off the files and be ready for action! It looks likely the ride will remain volatile, certainly more than we have been used to for the last decade. Volatility by its very nature offers opportunity. With the US continuing to deliver above 3% GDP growth as we end 2018, it would be a major surprise if 2019 were to see it enter a recession. As uncertainty unwinds, as it must with time with equity valuations, particularly those in the UK at attractive trends, we would suggest that the outlook is more rosy than many commentators would suggest.

FT: Europe's Fastest Growing Companies 2017

Top 3 AIM Stockbroker & Adviser 2018

LSE: 1000 Companies to inspire Britain 2016

'NOMAD of the Year' Award Winner 2018