Animal spirits stir

Sweeping aside negative business surveys and weak consumer trends, the stock market hit an all-time high of 7,859 in the third week of May – up almost 1,000 points from the year's low of 6,866 at the end of March. So much for the old stock-market adage, 'Sell in May and go away, don't come back 'till St Leger's Day'.

GDP growth of just 0.1% in Q1, the weakest in five years, pushed back expectations of a May interest-rate hike. Economists blamed the 'Beast from the East' and a fall in construction activity because of extreme wintry weather. Sterling dropped and the dollar rallied by 7%, from $1.44/£1 in late April to $1.34/£1 by early May. With 70% of FTSE profits dollar-denominated, the market duly rose alongside the world's reserve currency.

The market was also buoyed by a rising oil price, which lifted leading FTSE companies BP and Shell. The oil price hit $80 a barrel in the third week of May, the highest level in four years. With Saudi Arabia due to launch state-owned oil company Aramco on the stock market in 2019 (at a rumoured $2tn valuation), it is unlikely to fall back far.

It was not the mighty greenback and the higher oil majors alone that propelled the market inexorably forward. The 'animal spirits' also stirred, in John Maynard Keynes' famous term used to explain financial and buying decisions in conditions of uncertainty.

Geopolitical uncertainty abounds domestically – with fears of a hard Brexit or a Marxist Corbyn government – and internationally, with US threats of trade wars and tariffs, an ever changing position toward North Korea, political uncertainty in Italy, and the risk of a crisis in Turkey.

The synchronised global economic recovery enjoyed in 2017 has stalled, with growth in Europe slowing down markedly. At home, economic signals are mixed and confused: on the one hand, employment hit an all-time high of 75.6% in Q1, pay growth was 2.9% and inflation fell for the second consecutive month, from 2.5% in March to 2.4% in April; on the other, the GfK consumer confidence barometer fell to -9 in April against -7 in March, gross mortgage lending was down -2.3% in March, with total approvals 15% lower, and Visa spending down -2%.

"We are in the matrimonial phase of the cycle"

Against this backdrop, bond yields have risen over the past year, with a positive impact on FTSE 100 pension funds. These have swung back into the black for the first time since the financial crash of 2007, with a £4bn surplus in 2017 reversing a £31bn deficit in 2016. The surplus has continued to grow and stood at £20bn by April 2018. Healthy company contributions, strong investment growth, and changes in the approach to longevity and discount-rate assumptions – which largely offset the impact of worsening financial conditions – helped improve things. In contrast – and not surprisingly, given the £60bn of unsecured consumer debt (50% on zero-rate credit cards) – the household savings ratio fell from 7.0% in 2016 to 4.9%, the lowest in more than 50 years.

This goes some way to explaining why, for example, the total profits of the UK's top 100 restaurant groups fell by 64%, from £345m to £125m, in the past year. Rising wages, food inflation, intense competition and over-supply of casual dining restaurants are also partly to blame.

Similarly, the high street has fallen prey to a perfect storm of squeezed consumers compounded by discount sellers at one end and online retailers at the other, with rising business rates, national minimum wage costs and rising foreign exchange in the middle. Which brings us back to those 'animal spirits' that have lifted the market in times of uncertainty.

Just as every Shakespearean comedy culminates in a wedding, so do bull markets. We are now in the matrimonial phase of the cycle, with merger mania sweeping the market. Not a day seems to pass without another union, deal or mooted marriage. Four were announced on a single day in mid-May – the takeover of ZPG (formerly Zoopla) by Silver Lake; Virgin Money by CYBG; Shire by Takeda; and Vodafone's acquisition of Liberty Global's European cable networks – along with three private equity approaches to IWG (formerly Regus), the world's largest serviced office provider. This was followed by Ocado sealing a deal with US supermarket chain Kroger.

Not until the ensuing bear market will a Shakespearean tragedy unfold, and the flawed hero take centre stage. As the old saying goes, tragedy is comedy plus time.

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