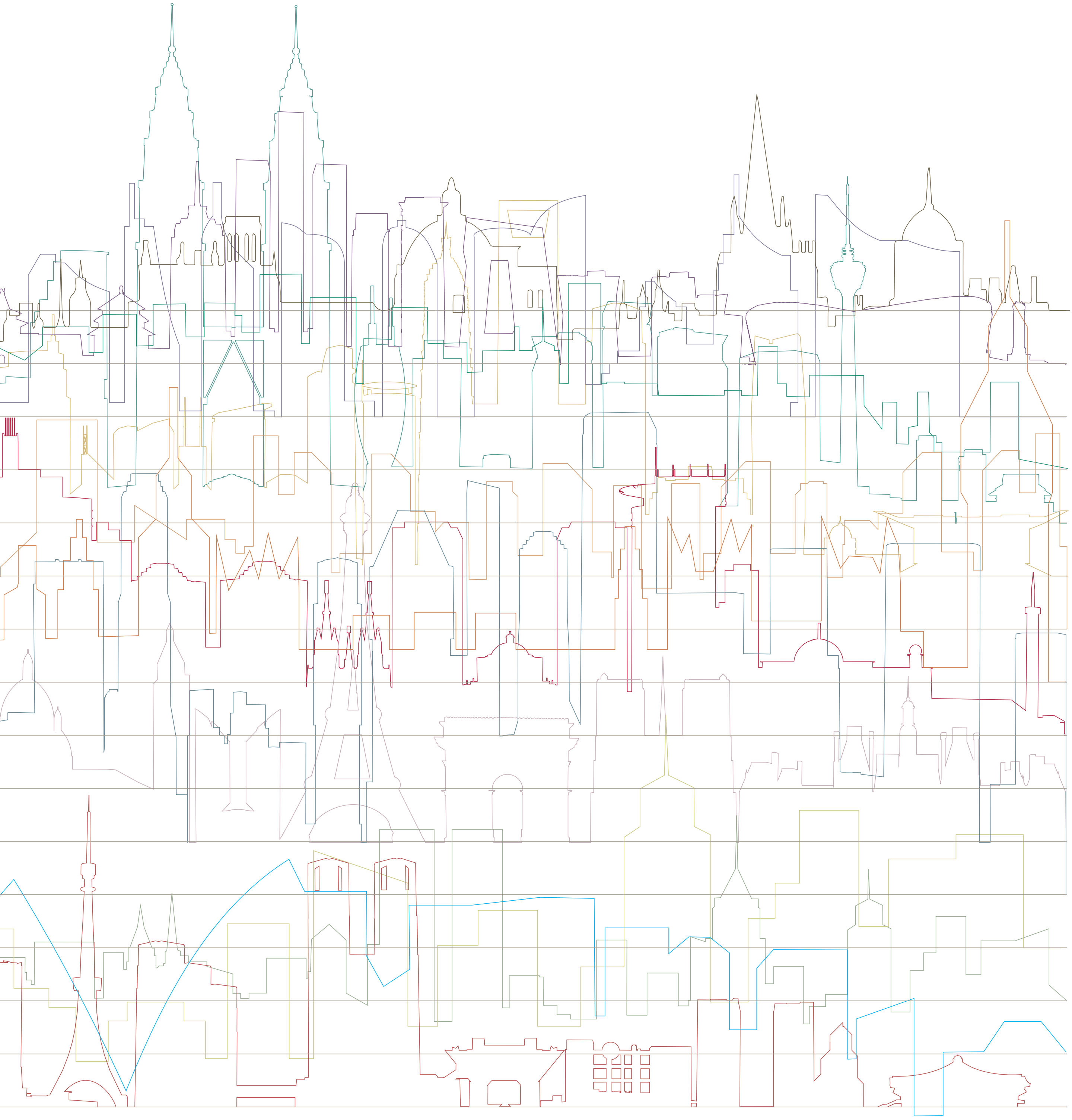
WORLD EQUITY MARKETS END THE DECADE ON A HIGH



OM

We are delighted to present the first *International Equity Review* of the new decade. It reports the performance of fifty major world equity markets in 2019, setting it in the context of performance during the past decade.

Key conclusions:

1. In 2019 world equity markets turned in their best performance of the decade: 24% in dollar terms
2. Brexit worries notwithstanding, the UK leapt to 4th place in the 2019 annual rankings, nudging the buoyant US aside and delivering an impressive 30.11 % increase in dollar terms. Over the decade, it maintained its place in the top ten while the Eurozone economies continued to languish at the bottom of the rankings
3. Although emerging markets gained ground in 2019, over the decade they underperformed significantly relative to the US. 80% of all markets fell below the *MSCI ACWI* average and many failed to generate a positive real return in dollar terms.
4. The prime cause was the dollar's increasing strength against local currencies. This issue is likely to have a continuing impact
5. Currency hedging should therefore be a regular feature of international investment in future combined with avoidance of over-weighting in domestic markets and the pursuit of active stock picking strategies.

The global picture

The *MSCI All Country World Index* (*MSCI ACWI*) for 2019 reported an overall performance of 24% in dollar terms - by far the best annual return of the decade and a considerable improvement on the miserable 2.4% return during the noughties (see Table 2 below).

Overall, global equities returned 78.3% during the 2010s. Clearly the decade benefited from the low world equity prices at the start of the period in the wake of the financial crisis of 2008. Global equities were further boosted by the quantitative easing programmes adopted in response to the crisis by most central banks throughout the decade.

However, in comparison to the performance of the last five decades (as shown below in Table 2) it must be admitted that the first two decades of the third millennium have not represented much of a bull run. In fact, they are the only two in the previous five that returned less than 100% over the decade. The strengthening US dollar has been a prime factor in this. Portfolio flows have diverted cash from the emerging markets to the US. The dollar debt burden in these markets has dampened prospects and, in addition, where the dollar has been the reporting numeraire, local returns have been further discounted.

The UK recovers while the Eurozone lags

Despite three and of half years of Brexit uncertainty and the indignity of being relegated to a place in the bottom five of world markets in the Brexit referendum year 2016, the UK leapt back to fourth place in the 2019 equity performance rankings, even nudging the buoyant US market into fifth position (see Figure 1 below).

As shown in Figure 1 below, which reports the performance for the five largest equity markets in 2019 in dollar terms, the UK has delivered an impressive 30.11% return in contrast to a US return of 28.88%. Germany, China and Japan underperformed the *MSCI ACWI* return of 24.05%.

UK performance in 2019 was undoubtedly boosted by an approximate 4% increase in the value of sterling, thanks to the general election bounce there in December. But in addition the UK held on to its top ten ranking throughout the decade, taking the number eight slot ahead of Japan and Ireland (see Figure 3 below). The UK's performance is all the more impressive when one considers that the value of pound depreciated against the US dollar by more than 17% during the decade, in the process subjecting international investors in the UK a sizeable 'haircut' on their invested capital.

While the media commentariat has largely - and negatively - focused on the prospects of Brexit for the UK, significantly less consideration has been given to the state of affairs in the Eurozone countries. Surprisingly, only one Eurozone market outperformed the UK in dollar terms in 2019, and that was Finland, which was ranked one place above the UK in seventh place. No less than six slots in the bottom ten were occupied by Eurozone countries, with Greece getting the wooden spoon and Portugal its runner-up. Outside the top ten, the only respectable European performer was Germany, which came in twelfth overall for the decade. Moreover, while the decline of the pound over the decade (17.87%) has received much press attention, the Euro has fared worse with a depreciation of nearly 22% over the same period. Whereas the pound appreciated during 2019, the Euro lost around 2% against the dollar. On balance, markets appear to be expressing more optimism in the UK than in the Eurozone countries.

Rumours of the demise of Japan's equity performance have also been greatly exaggerated. Japan generated nearly 20% per annum over the decade despite a currency depreciation of more than 15%. The top slot, incidentally, for performance over the decade went to New Zealand with a return of 12.7% per annum, slightly ahead of the US with 11.22% per annum. Although ranked last for the decade as a whole, Greece also performed extremely well in 2019 and secured the second rank in the top 50 despite the underlying weakness of the Euro.

Emerging markets end on a rise

Emerging markets performed much better in 2019 than they had done in the previous years of the decade, generating a healthy 15.42%. Albeit below the *MSCI Ex US* average, this was an encouraging note on which to close the decade. The BRICS fared even better than the rest of the emerging markets in 2019 with a return close to 20%. Their rise was fuelled by a spectacular performance from Russia which topped the overall table for 2019 on a staggering return of 43.2% boosted by a recovery in the Rouble (see Table 1 below). Brazil also made the top 10 for the second year in a row at the ninth slot delivering an impressive return of 26.9%. China too outperformed the average of non-US markets, however South Africa and India , albeit positive, were well below the 2019 average.

But a mixed picture overall

Three disquieting trends emerge from the performance data: 80% of the markets underperformed the *MSCI ACWI*, with many failing to generate a positive real return in dollar terms. Volatility increased massively, and currencies had a much greater influence on returns than previously. Individually or together, these trends will have major investment implications if they continue.

TRUMP'S EXIT FROM WHITE HOUSE THE MAJOR RISK FOR EQUITIES IN 2020

The US, and to a lesser extent the UK and Japanese equity markets, were the markets largely responsible for lifting the *MSCI* performance. The US market largely dominated performance for the decade, as shown in Figure 2 below, outperforming the *MSCI ACWI* by an extraordinary 440 base points per annum.

Since the US contributes a weight of more than 50% to the index, a more appropriate performance benchmark than the *MSCI ACWI* is the *MSCI Ex US*. On this comparison the US outperforms by a massive 909 base points per annum. The main culprits dragging down returns were the emerging markets and the BRICS and in particular the Eurozone markets. The emerging markets were well below at 1.2% the US dollar inflation rate of 2% and the BRICS were only slightly positive (0.23%) in nominal terms. India and China turned in a lacklustre performance for the decade, but at least they were positive in real terms. The major culprits damaging the BRICS' overall performance were Russia (-1.89%) and Brazil (-3.08%).

In total twenty-three markets, nearly half of those reported in Table 1, generated negative real returns in dollar terms over the decade. Since US inflation is running at around 2%, a nominal dollar return less than that represents an erosion of capital in real terms for the international investor. In essence, over the last decade the rest of the world has delivered zero real returns to dollar-based investors. So much for the benefits of international diversification! In fact gold provided a better return to US investors than the non-US markets both in 2019 and the decade overall.

Damage inflicted by the rising dollar

This situation has undoubtedly been significantly exacerbated by local currencies' depreciation against the dollar. Table 1 below reports that only five of the fifty markets enjoyed a currency appreciation against the dollar. In many cases the depreciation was significant and indeed was in excess of 20% for thirty-two of the fifty markets. Five experienced a depreciation of greater than 50%, and fourteen lost more than 30%. The dollar's continual rise has several implications for international investing whether or not from a dollar numeraire. The strengthening dollar imposes a considerable increase in the cost of capital for the emerging markets which undermines the potentially mitigating effects of competitive pricing in terms of trade.

The outlook - CoronaVirus looms

The new decade opens with heightened tensions ranging from trade wars to relatively high asset prices, zero inflation, low to negative interest rates, and seriously swollen central bank balance sheets. After a strong start in equities for the new decade the spectre of the CoronaVirus has dampened markets considerably - the effects could be significant. As global investors we are told that we face a decade of stagnant growth and insignificant investment returns. A bleak prospect indeed but not one we entirely accept. After all, trouble represents opportunity, as the great investment guru Sir John Templeton often commented.

Looking ahead, equity markets will continue to press into uncharted waters with respect to geo-political factors, and the effects could result in a major repricing in 2020. Three major risks in particular could severely disrupt equity markets in 2020. The first is the outcome of the US election. If President Trump fails to be re-elected, interest rates and taxes are likely to increase and cause US growth to slow down. In such circumstances equity markets everywhere are likely to be adversely affected. Secondly, a break-down in the trade discussions between the US and China could also disrupt markets. Finally, the play-out of Brexit is likely to sharpen focus on existing internal issues within the European Union. Without further full financial integration the Euro is likely to continue to depreciate.

Investment implications

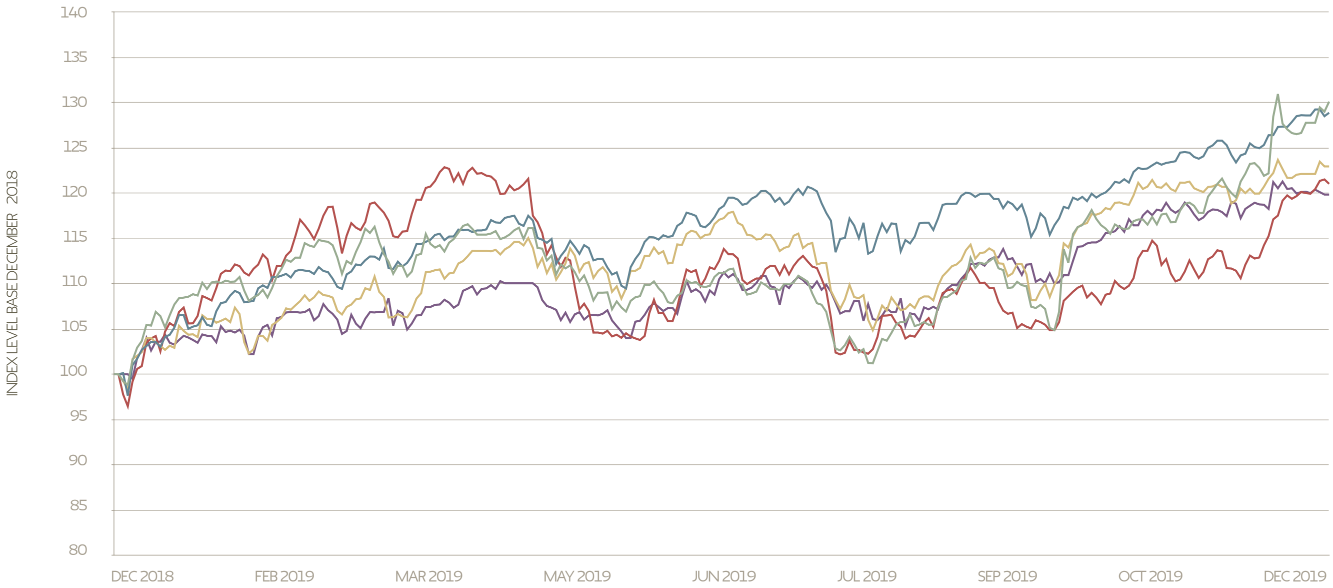
Three overriding lessons for international investors emerge from this review:

1. Avoid domestic bias. Many investors outside the US have suffered from overweighting their home markets and underweighting the US dollar. This has been costly in the last decade, not only because returns have been typically low in local currency terms but because most currencies have lost ground to the dollar. European and Asian investors have suffered significant cost by overweighting their local equities. These policies are even more worthy of review in a post-Brexit world.

2. Actively manage currency risks. Given the increasing influence of currency fluctuations on equity returns, international investors should consider adopting a definite hedging strategy. Although the policy of diversification counters currency risks to some extent, active and passive investors alike should consider adopting a deliberate hedging policy. Especially where forward rates are at a premium, there seems little reason not do so. Hedging is likely to become a standard feature of equities investing, as it already is in fixed income investing. This should inform hedging policy both for index investors and for stock pickers.

3. Perhaps concentrate on focussed stock picking. The increased volatility witnessed since 2018, together with directionless returns overall, makes passive investing a lot less attractive. Careful stock selection combined with active currency hedging could prove an eminently worthwhile strategy.

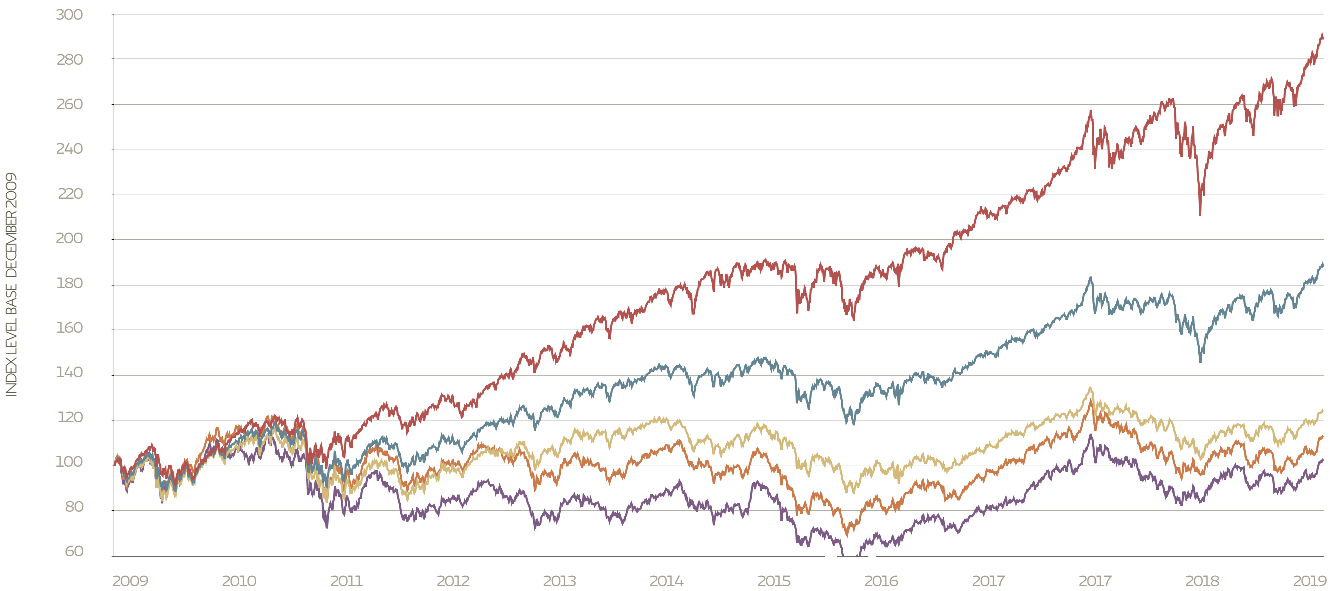
FIGURE 1. Major equity markets' performance for 2019 ($ returns) SOURCE: Oxford Metrica.



EQUITY MARKET PERFORMANCE FOR THE YEAR ENDING 31 DECEMBER 2019

— UK — USA — GERMANY — CHINA — JAPAN

FIGURE 2. The US versus the rest of the world and emerging markets ($ returns) SOURCE: Oxford Metrica.



EQUITY MARKET PERFORMANCE FOR THE DECADE ENDING 31 DECEMBER 2019

— S&P500 — MSCI ACWI — MSCI EX US — MSCI EM — MSCI BRICS

FIGURE 3. Major equity markets' performance for decade ($ returns) SOURCE: Oxford Metrica.

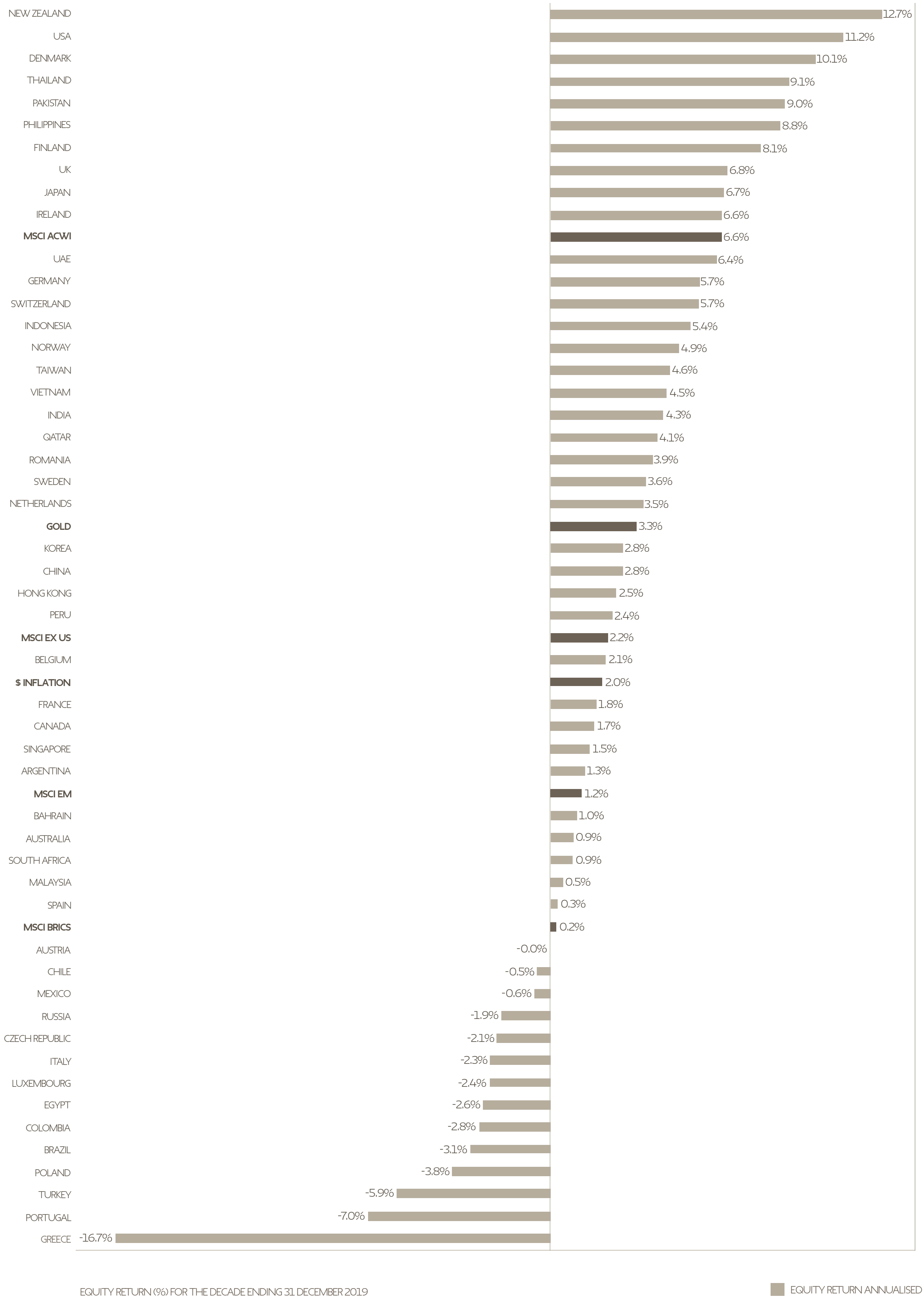


TABLE 1. International equity markets' performance ranking

SOURCE: Oxford Metrica

Rank 2019	Country	Return 2019	Decade Return[1]	Rank Decade	Currency 2019	Currency Decade
1	Russia	43.23%	-1.89%	40	12.21%	-51.55%
2	Greece	40.09%	-16.74%	50	-1.95%	-21.65%
3	New Zealand	31.06%	12.70%	1	0.49%	-7.11%
4	UK	30.11%	6.80%	8	4.06%	-17.87%
5	USA	28.88%	11.22%	2	0.00%	0.00%
6	Romania	28.64%	3.87%	20	-4.80%	-31.26%
7	Ireland	28.54%	6.58%	10	-1.95%	-21.65%
8	Switzerland	28.10%	5.67%	13	1.70%	7.06%
9	Brazil	26.91%	-3.08%	46	-3.55%	-56.62%
10	Taiwan	25.93%	4.59%	16	2.11%	6.93%
11	Italy	25.70%	-2.32%	42	-2.01%	-21.81%
12	Canada	25.06%	1.69%	29	4.98%	-18.62%
13	Denmark	24.79%	10.14%	3	-2.04%	-22.11%
14	Colombia	24.14%	-2.75%	45	-0.99%	-37.79%
	MSCI ACWI	**24.05%**	**6.56%**			
15	France	23.91%	1.75%	28	-1.95%	-21.65%
16	Germany	22.95%	5.69%	12	-2.01%	-21.81%
17	Netherlands	21.51%	3.52%	22	-1.95%	-21.65%
18	China	21.03%	2.77%	24	0.55%	-0.46%
19	Sweden	20.93%	3.64%	21	-3.85%	-23.18%
20	Bahrain	20.38%	1.00%	32	-0.03%	-0.01%
21	Japan	19.85%	6.65%	9	1.40%	-15.16%
	MSCI BRICS	19.79%	0.23%			
22	Belgium	19.58%	2.13%	27	-1.95%	-21.65%
23	Egypt	19.52%	-2.60%	44	11.59%	-65.82%
24	Australia	18.82%	0.87%	33	-0.27%	-21.76%
	Gold	**18.31%**	**3.30%**			
	MSCI EX US	**18.11%**	**2.19%**			
25	Finland	18.02%	8.06%	7	-2.01%	-21.81%
	MSCI EM	**15.42%**	**1.20%**			
26	Austria	13.73%	-0.02%	37	-2.01%	-21.81%
27	Norway	13.48%	4.94%	15	-0.81%	-34.09%
28	Czech Republic	12.20%	-2.06%	41	-0.78%	-18.70%
29	Turkey	11.48%	-5.91%	48	-11.08%	-74.90%
30	South Africa	11.38%	0.86%	34	2.90%	-47.20%
31	Thailand	9.74%	9.13%	4	8.63%	11.42%
32	Hong Kong	9.67%	2.52%	25	0.55%	-0.46%
33	India	9.61%	4.33%	18	-2.15%	-34.67%
34	Mexico	8.92%	-0.63%	39	4.16%	-30.71%
35	Philippines	8.16%	8.81%	6	3.32%	-9.16%
36	Peru	8.13%	2.37%	26	1.93%	-12.78%
37	Portugal	8.06%	-7.02%	49	-1.95%	-21.65%
38	Vietnam	7.74%	4.47%	17	0.07%	-20.24%
39	Singapore	6.46%	1.51%	30	1.37%	4.48%
40	Spain	6.27%	0.28%	36	-1.95%	-21.69%
41	Indonesia	6.13%	5.35%	14	4.36%	-32.23%
42	Korea	3.78%	2.77%	23	-3.62%	0.63%
43	UAE	3.26%	6.35%	11	-0.01%	0.00%
44	Luxembourg	2.63%	-2.36%	43	-1.95%	-21.65%

Rank 2019	Country	Return 2019	Decade Return[1]	Rank Decade	Currency 2019	Currency Decade
	$ Inflation	**2.10%**	**2.00%**			
45	Qatar	1.14%	4.08%	19	-0.09%	-0.47%
46	Pakistan	-1.51%	8.99%	5	-10.38%	-45.50%
47	Malaysia	-5.02%	0.48%	35	1.06%	-15.93%
48	Poland	-6.37%	-3.79%	47	-0.86%	-24.52%
49	Argentina	-13.47%	1.32%	31	-37.10%	-93.65%
50	Chile	-16.83%	-0.52%	38	-7.74%	-32.53%

[1] Annualised

TABLE 2. MSCI ACWI returns for five decades

Period	1970's		1980's		1990's		2000's		2010's	
Decade	101.7%		515.3%		209.5%		2.4%		78.3%	
Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Annual	10.42%	-9.42%	13.44%	20.25%	2.1%	-4.26%	5.63%	21.62%	11.18%	24.05%

OXFORD
METRICA

Oxford Metrica is a strategic advisory firm, offering informed counsel to boards. Our advisory services are anchored on evidence-based research in risk and financial performance. Our work includes statistical analysis and index construction for banks and insurers, risk and performance analytics for asset managers, due diligence support in mergers and highly customised services for corporate boards.

Dr Rory Knight, is Chairman of Oxford Metrica and a member of the Board of the Templeton Foundations. He was formerly Dean of Templeton, Oxford University's business college. Prior to that Dr Knight was the vize-direktor at the Schweizerische Nationalbank (SNB) the Swiss central bank.

oxfordmetrica.com

OM