Equities market perspective

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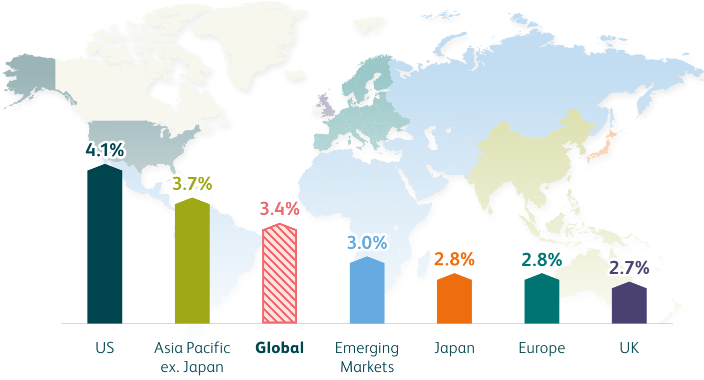
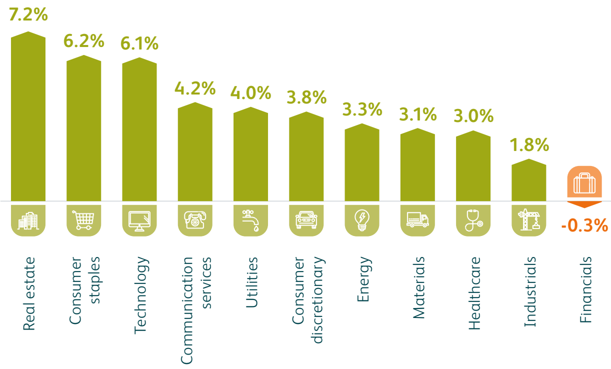
M&G INVESTMENTS

Market summary

Regional performance – March 2019



Global sector performance – March 2019



Global equities: The MSCI AC World index continued its rally in March, making the first quarter the second strongest quarter on record. On a regional basis, the US was the best performer in the month and continues to lead the bounce in equity markets this year, whilst China was the best performing country, helped by policy stimulus. Improved prospects of a resolution in the US-China trade negotiations helped propel returns in the tech sector, whilst a flatter yield curve weighed on financials. Value underperformed across all regions except Latin America.

UK: FTSE 100 posted its third straight month of gains as miners benefited from the progress in the latest round of China-US trade talks, which helped to offset the latest Brexit setbacks.

Europe: Poor March PMI numbers for Germany and France left returns for the region relatively modest in the month. The ECB confirmed it would not raise rates for the rest of the year and announced cuts to its growth and inflation forecasts. External factors such as Brexit and protectionism continue to weigh on the region.

US: The S&P 500 had its best start to a year since 1998. The Fed announced it did not expect to raise interest rates for the rest of the year.

EM/Asia ex Japan: During the month, policy stimulus helped China outperform the global index; China remains the best performing country YTD.

Other: The US 10y-3m yield curve inverted for the first time since 2007. This is often considered a warning of future recessions. Brent crude continued its rally and has returned 27% (in USD) year to date.

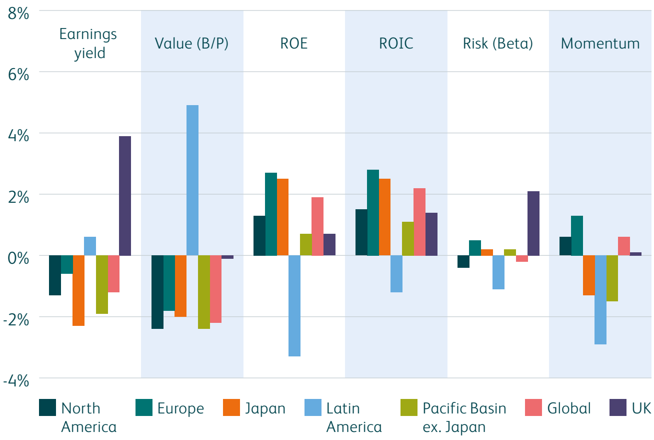
Market data

Total returns (%)	MSCI AC World		FTSE All-Share		S&P 500		MSCI Europe		MSCI Asia Pac x Jap		MSCI EM	
	Mar	YTD	Mar	YTD	Mar	YTD	Mar	YTD	Mar	YTD	Mar	YTD
GBP	3.4	9.8	2.7	9.4	4.1	11.1	2.8	8.5	3.7	9.0	3.0	7.5
EUR	2.8	14.4	2.0	13.7	3.4	15.7	2.1	13.0	3.0	13.5	2.3	11.9
USD	1.3	12.3	0.6	11.9	1.9	13.6	0.7	11.0	1.6	11.5	0.9	10.0

	MSCI AC World	FTSE All-Share	S&P 500	MSCI Europe	MSCI Asia Pac x Jap	MSCI EM
Valuation (P/B)	2.3x	1.6x	3.3x	1.8x	1.7x	1.7x
(P/E)	16.9x	14.8x	20.0x	16.0x	13.6x	12.6x
(P/E FY1)	15.3x	12.9x	17.2x	13.7x	13.9x	12.5x

Source: Datastream & Factset, MSCI indices, S&P indices for the US, as at 29 March 2019. Total returns in GBP.

Style update: what's in vogue? Q1



Source: UBS Global Quantitative Research, 29 March 2019. All returns are relative to the relevant Dow Jones Global Indices regional index.

Currencies: percentage change over month and YTD (Majors vs GBP)

	Aus. Dollar	Yen	Swiss franc	Euro	US Dollar
Mar	1.9%	1.5%	2.1%	0.6%	2.1%
YTD	-1.4%	-2.8%	-3.2%	-3.9%	-2.0%

Source: Datastream, 29 March 2019.

Theme of the month: Share buybacks – the good, the bad or the ugly?

Key points

- US companies announced a record $1.0 trillion in stock buybacks in 2018
- The 'buyback wave', fuelled by corporate tax cuts, has attracted growing criticism
- Do buybacks only benefit company executives, or do they create long-term value and reward shareholders?
- Could greater oversight help to align the priorities of company executives, authorities and shareholders alike?

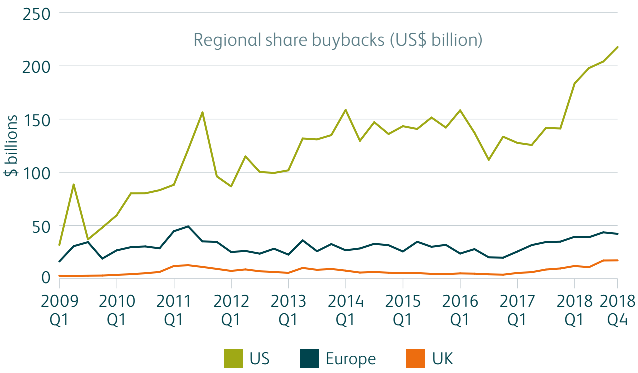
US companies announced a record $1.0 trillion in stock buybacks in 2018, thanks to the boost from cash repatriation and corporate tax cuts; corporate buybacks have continued to hit the headlines in 2019. While the debate around the virtue of listed companies buying back their own shares is nothing new, growing criticism in academia and, more recently, from US politicians has brought the topic into sharp relief.

In the US, the debate was reignited by the recent 'buyback wave', fuelled by Trump's corporate tax overhaul in late 2017. This has **prompted a number of politicians to take aim at these companies** – pledging to increase taxes and regulations to curb the practice and make the US economy fairer and more productive.

The accusation levelled at firms implementing share buybacks is that **the exercise only serves to benefit company executives, who are compensated for increasing earnings-per-share over the shorter term** while at the same time artificially inflating share prices and diverting cash that could otherwise be reinvested for growth, returned to shareholders through dividends, or shared with employees. **In recent years, companies have also been borrowing heavily to fund buybacks,** depleting equity and increasing their leverage – hence, raising the risk shouldered by investors.

Interestingly, when comparing the uptick in buyback activity in the US with other regions, there is a noticeable divergence.

Trump's tax stimulus fuels 'buyback wave' in the US



Source: Bloomberg, March 2019. S&P500 Index, Stoxx Europe 600 Index, FTSE All Share Index .

This is likely a result of Trump's tax relief policies, combined with comparatively lower regulatory hurdles in the US. **Company boards and executives face conflicting incentives when authorising share buybacks.** To combat their misuse, the EU regulates share buybacks under the Market Abuse Directive while, in the UK, the Investment Association produces guidelines for companies to only carry out share buybacks if they are in the best interests of shareholders. **Greater regulatory alignment globally could see this regional divergence narrow.** We would also expect to see a moderation in US buybacks in 2019 as the impact of Trump's tax cuts begins to fade.

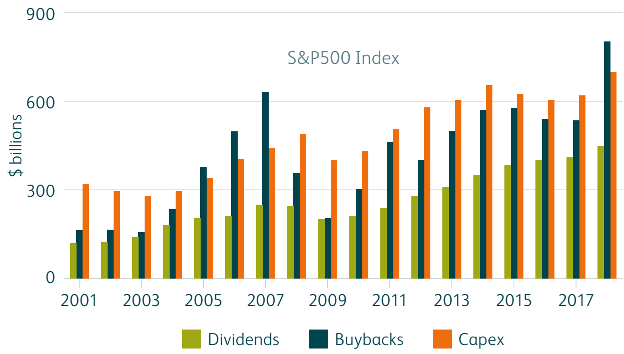
While sceptics have garnered a greater share of the limelight of late, there is also a wealth of evidence to suggest that **buybacks can have a positive impact on a company's long-term prospects and share price performance**. Depending on the underlying health of the company, buybacks are generally well received by markets.

Indeed, investors can often penalise companies for 'hoarding cash' and not reinvesting it in the business or returning it to shareholders in the form of dividends or buybacks. Lack of visibility about management's intentions can create uncertainty and lead to the stock being undervalued.

While a company can deploy cash in a number of ways, **using excess cash to buy back its own shares could signal that management believes the stock is being undervalued** by the market. It could also signal management's **confidence in the stability of the company** and its future profits. Much like dividend distributions, many believe that share buybacks are a responsible way of returning money to shareholders, which can then be deployed elsewhere by investors.

Buybacks, in the US at least, have risen at a faster pace than capital spending in 2018. **It's the first time since 2007 that buybacks have topped capital expenditure.**

US share buybacks exceed capital expenditure in 2018



Source: Bloomberg, Citi Research, March 2019.

The use of share buybacks continues to attract mixed reviews given the potential for their misuse by company executives to boost earnings-per-share over the short term, particularly given slower projected earnings expansion this year. However, given the potential for buybacks to also create value over the longer term, **the solution may not be to crack down on buybacks altogether but rather, to address the conflicts of interest and introduce greater oversight,** to ensure that a company's long-term prospects, and its shareholders, are at the heart of decision-making by company management.