Stanhope Capital Fortnightly Bulletin

Period ending 31 March 2018

Tactical Positioning

In our mid-March Bulletin we mentioned that we were considering a cut in equity exposure. We followed through with this shortly afterwards and now sit with the lowest equity exposure in portfolios for four years. The tariff issue is turning out to be a major distraction for investors and the eventual outcome is highly unpredictable. Whilst we suspect that we will not see a full-scale trade war and markets will calm down, we prefer to view things from the perspective of having some liquidity in hand which both reduces portfolio volatility but also provides optionality should a good buying opportunity arise.

Market Moves

	Equities *(Local Currency, incl. Dividends)*						
31-Mar-18	**World**	**US**	**Europe[1]**	**UK**	**Japan**	**GEM**	**Asia**
Last 2 Weeks	-3.0%	-3.8%	-1.5%	-1.0%	-0.9%	-3.6%	-3.7%
March 2018	-2.3%	-2.6%	-1.9%	-2.0%	-2.4%	-1.9%	-2.2%
Year to Date	-1.9%	-0.9%	-3.2%	-7.2%	-4.8%	0.7%	-0.4%

	Commodities			Currencies *(vs. USD)*			Gov't
	BCOM	**Gold**	**WTI Oil**	**EUR**	**GBP**	**JPY**	**UST 10Y[2]**
Last 2 Weeks	0.2%	0.7%	6.1%	0.2%	0.6%	0.1%	-9 bps
March 2018	-0.6%	0.5%	5.4%	1.1%	1.9%	0.4%	-12 bps
Year to Date	-0.4%	1.7%	7.5%	2.7%	3.7%	6.0%	+33 bps

[1]*Europe excluding UK*

[2]*US Treasury 10 Year Yield shows absolute, not percentage, change in yield*

Source: Bloomberg

It has been a perfect storm for risk assets. Escalating trade tensions, further revolutions of the White House door, a tech tantrum spurred on by Facebook data concerns and signs of abating global growth all saw equities end the period lower. US stocks were hit hardest, declining 3.8% over the fortnight and ending the quarter in negative territory for the first time since 2015. As is generally the case with storms, it was somewhat of a rocky ride. Over the course of the month, the benchmark US index swung either down or up by at least 1% on eight days, following on from twelve occasions in February. To put this in perspective, in the thirteen months to end of January there were only ten days when that happened. As we have expressed in previous bulletins this year, we expect heightened levels of volatility to persist.

Asian and Emerging Market equities were particularly rattled by President Trump's announcements on trade tariffs as China has emerged as his clear adversary. While his plan to impose tariffs on $60 billion of imports from China would not, on its own, have significant economic consequences, the risk of tit-for-tat escalation that results in a broad-based global trade war has risen. We expect it to be a drawn-out process of negotiations from here. In addition, he plans to restrict direct investment by China in the US and Treasury Secretary, Steve Mnuchin, has until 21st May to come up with a proposal. Although the US President's approach may be designed to achieve a fairer trade deal, we are concerned that his tweeted assurance that "trade wars are good, and easy to win" may be misguided. His focus on reducing the trade deficit risks sparking a damaging trade war, at a time when the stimulus he is adding to the economy through tax cuts is likely to result in greater demand for imports.

As mentioned above, the other big focus for the market was the technology sector. The sector fell 6.2% over the fortnight, as measured by the MSCI World Information Technology Sector Index. The sell-off emanated from the scandal surrounding Facebook's privacy practices but was exacerbated by calls in Europe and the US to increase regulation and revamp the way technology companies are taxed. Increasingly, the EU are putting forward plans to tax digital media companies on the basis of where they generate revenue rather than where headquarters are based. This could have a significant impact on the big tech names, such as Amazon, who have headquarters in countries with favourable tax treatment. In addition, Tesla's share price came under pressure (-18.3% over the fortnight) as news emerged that they are undergoing another investigation related to a crash last year in a self-driving car. A downgrade from Moody's on the back of Model 3 production delays also stoked funding fears.

In bonds, the risk-off environment saw the yield on the 10-year US Treasury tighten 9 basis points over the fortnight to 2.74%. At the short end of the curve, yields rose however, as the Federal Reserve took another gradual step towards normalising monetary policy with a hike in the fed funds rate of 25 basis points. This led to a flattening of the yield curve, with the spread between the yields on 2-year and 10-year US bonds ending the period at a decade low of 47 basis points. This caused some concern as an inversion of the curve is usually a harbinger for recession.

Oil was the standout performer over the fortnight, with prices benefiting from concern that the appointments of Mike Pompeo and John Bolton, long-standing critics of the Iran nuclear deal, could spell trouble for the arrangement. Ever since his election, Trump has had his sights on the "worst deal ever", signed in 2015 to restrict Iran's nuclear programme. As has become customary, Trump has sought to bolster his position by dismissing those with opposing views (Tillerson repeatedly advised against abandoning the deal) and appointing senior officials with views more sympathetic to his own. Before the deal was signed in July 2015, Mr. Bolton declared: "The inconvenient truth is that only military action…can accomplish what is required", suggesting air strikes on Iran's nuclear facilities. He has tempered his tone, particularly since appointment, but the likelihood of the European parties to the deal (Britain, France and Germany) finding a way of appeasing Mr Trump's demands before May 12th, when the current waiver expires, have reduced. Bolton has also, as recently as February, advocated a pre-emptive military strike on North Korea.

Economic Updates

Concerns that the recent strong and synchronised acceleration of growth is moderating have recently surfaced. Citigroup's surprise index for Europe, which is based on whether actual numbers turn out to be better or worse than forecast, is hovering at its lowest level since March 2016, which contrasts with the same measure in the US which is just off its December 2017 highs. Indeed, there has been a widespread fall in the survey data in Europe and also some negative surprises in the hard data. The Markit Purchasing Manager Indices (PMIs) for manufacturing and services both came in considerably below expectations, suggesting the speed of economic expansion is decelerating. In addition, investor confidence slid as concerns rose that a global trade war could hit European exports. We are not overly concerned by this moderation in economic data as the readings have fallen from extraordinarily high levels and still signal a respectable and stable growth rate for the region.

Meanwhile, as was widely expected, the US Federal Open Market Committee raised interest rates by a quarter percentage point this month. This is the sixth rate hike since they began raising rates off near-zero levels in December 2015. Looking forward, they anticipate two further rate hikes this year, though nearly half of the committee (seven of the fifteen) thought three may be warranted. They also lifted their GDP forecasts and lowered their unemployment rate projections over the coming years due in large part to increased fiscal stimulus. Meanwhile, with the job market on a solid footing, household confidence remains sky-high as evidenced by the latest surveys complied by the Conference Board and University of Michigan (both survey readings are hovering at multi-year highs).

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IVO COULSON
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31 March 2018

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