Stanhope Capital Fortnightly Bulletin

Period ending 15th October 2018

Tactical Positioning

Despite short-term market turbulence we continue to take a broadly positive stance towards markets. Pull-backs are a healthy way for investors to gain perspective and assess risk and reward. The recent volatility reflects an adjustment by investors to a world that just might be tinged with higher inflation than experienced in the last 10 years. Whilst we believe that inflation is unlikely to behave like a forest fire, it is not as supine as some investors have been thinking and, for this reason, we remain cautious on long term bonds. We may well have further 'whipsaw' days in equity markets in the coming weeks, but we believe it is unwise to sell out of risk assets at a time when there are reasonable valuations in a number of markets and a robust US economy is providing positive momentum.

Market Moves

	Equities *(Local Currency, incl. Dividends)*						
15-Oct-18	**World**	**US**	**Europe[1]**	**UK**	**Japan**	**GEM**	**Asia**
Last 2 Weeks	-6.0%	-5.6%	-6.1%	-6.2%	-7.7%	-6.8%	-7.9%
Year to Date	-0.8%	4.0%	-5.6%	-5.3%	-5.4%	-9.5%	-9.8%

	Commodities			**Currencies** *(vs. USD)*			**Gov't**
	BCOM	**Gold**	**WTI Oil**	**EUR**	**GBP**	**JPY**	**UST 10Y[2]**
Last 2 Weeks	2.4%	2.9%	-2.0%	-0.2%	0.9%	1.7%	+9 bps
Year to Date	0.3%	-5.8%	18.8%	-3.5%	-2.7%	0.8%	+75 bps

[1]*Europe excluding UK*

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

Source: Bloomberg

Although equities started positively on the back of the United States-Mexico-Canada Agreement ("USMCA") trade deal a number of factors drove markets sharply lower over the fortnight with many indices entering correction territory (defined as a drop of at least 10% from a recent peak). It is hard to identify any one reason for the correction, but factors included: strong economic data leading to a sharp sell-off in US bonds, concerns about a potential higher interest rate hiking path being set by the Federal Reserve, increased geopolitical tensions between the US and China, slowing global and Chinese growth, potential earnings volatility due to tariffs, and the strong US dollar. Despite this, we should note that October, especially in US mid-term election years, is historically a volatile month.

Markets were not immediately impacted by the International Monetary Fund (IMF) cutting global economic growth forecasts at the start of the period; the IMF cited trade war risks and tighter credit conditions as factors in their decision. However, strong September US non-farm employment payrolls and a bumper Institute for Supply Management (ISM) number led to the largest sell-off in US 10-year Treasuries since November 2016 (after the US election) and the highest Treasury yields in seven years. Initially, equities reacted positively to the strong economic news in the US, but subsequently the strong uptick in bond yields led to pressure on global risk assets as the market began pricing the potential for faster interest rate hikes by the US Federal Reserve. This, the market surmised, may lead to an even stronger US dollar which would in turn impact corporate earnings, as well as exacerbating the current pressure on emerging market countries. US Federal Reserve Chair, Jerome Powell, added

to the bond sell-off with a bullish speech confirming his view of continued gradual rate hikes, saying interest rates were getting closer to a neutral footing and could even go “past neutral”.

Elsewhere, most developed and emerging market country equity indices are now negative for the year. The Peoples Bank of China (PBoC) tried to alleviate concerns of slowing economic momentum by loosening monetary policy through lowering the reserve requirement ratio (RRR) for the third time in 2018. However, Chinese equities still hit four-year lows over the period. Geopolitical tensions with the US were also high as Bloomberg reported that Chinese entities hacked thirty US companies and US Vice President, Mike Pence, said that there was no doubt that “China is meddling in America’s democracy”. However, on a more positive note, President Trump and Chinese leader Xi Jinping have reportedly agreed to meet at next month’s G-20 summit which has increased hopes of resolving the trade conflict.

Meanwhile, European risk assets also had to contend with continued geopolitical risk in Italy. A meeting of EU finance ministers in Luxembourg criticised Italy’s budget stance while Jean-Claude Juncker, the European Commission President, warned of needing to do everything to “avoid a new Greek crisis”. Italy’s Deputy Premiers, Luigi Di Maio and Matteo Salvini, defended their plan to increase the country’s budget deficit, with the latter even calling the leaders of the European Commission (EC) the “enemies of Europe”. By contrast, the Finance Minister, Giovanni Tria, said Italy was committed to “ensuring a constant reduction of the debt toward the objective agreed with the EU”. Despite this, Italian 10-year yields are at their highest levels since 2014 and the spread between Italian and German borrowing costs is at its widest since 2013.

In the UK, sterling was up over the period despite mixed Brexit headlines while equities traded down in line with other global markets. Prime Minister Theresa May delivered a confident speech at the Conservative Party conference which reduces the risk of an imminent leadership battle and it was initially reported that she was preparing to compromise on the Irish border situation by considering allowing regulatory checks on goods to take place between Northern Ireland and the UK mainland. In return for this concession, Theresa May appears to be aiming for the whole of the UK to remain within the EU’s customs union as the backstop agreement. However, members of Mrs May's governing coalition partner, the DUP, spoke out against the proposal, with the the party’s leader, Arlene Foster, saying she opposes "any form" of border in the Irish sea and that post-Brexit checks on goods between Northern Ireland and the rest of the UK would be the “worst of one world” rather than the “best of both worlds.” Brexit Secretary Dominic Raab communicated on Sunday that Mrs May could not sign up to what is currently being offered by the EU while the EU’s chief Brexit negotiator, Michel Barnier, tweeted that “despite intense efforts, some key issues are still open, including the backstop for IE/NI to avoid a hard border.”

Within commodities, crude oil initially spiked to new four-year highs but soon fell back on signs of rising supply and general market unease. Gold and the Japanese yen, which are considered safe-haven assets, were some of the better performers in the risk-off environment.

Economic Updates

Economic data released over the period was mixed. The IMF reduced global growth forecasts for both 2018 and 2019 to 3.7% from 3.9%. The US, however, continued to show robust growth (2.9% in 2018 and 2.5% in 2019). The September ISM manufacturing index fell from 61.3 to 59.8 versus 60.0 expected but was still the third highest reading this year, while the ISM non-manufacturing survey index rose to the highest reading since August 1997, at 61.6 versus 58.0. Employment data was strong, with the Automatic Data Processing Institute nonfarm payrolls for September coming in at 230k versus expectations of 184k, while initial jobless claims fell to 207k, close to the five-year low. The September new jobs report missed expectations at 134k versus 185k expected but the prior two months were revised up to a net 87k and the unemployment rate also fell to 3.7%.

The final September manufacturing PMI revision for the Eurozone fell from 54.6 to 53.2 versus the 53.3 flash print while the services PMI was confirmed at 54.1. Similar to the line taken by the IMF, Germany’s economy ministry also trimmed the growth forecast for 2018 to +1.8% from +2.3%, and for 2019 to +1.8% from +2.1%, citing “protectionist tendencies” and “international trade conflicts” as the key reasons for the cuts. Germany’s industrial production report disappointed with August activity -0.3% month-on-month versus expectations of +0.3%, while German exports also declined for the second month in a row.

In the UK, the final September manufacturing PMI surprised to the upside (53.8 vs. 52.5 expected) while August GDP growth was flat as against consensus of +0.1%.

JONATHAN BELL
IVO COULSON
GEORGE EGAN
16th October 2018

Important Information

The information contained herein (the "Information") has been prepared by the Stanhope Group. The Stanhope Group comprises Stanhope Capital (Switzerland) SA and its subsidiaries, including Stanhope Capital LLP, Stanhope Capital (Cayman) Limited, Stanhope Capital (Jersey) Limited and Stanhope Capital Limited. Stanhope Capital LLP is a limited liability partnership incorporated in England and Wales authorised and regulated by the Financial Conduct Authority (FCA). Stanhope Capital (Switzerland) SA is a company incorporated in Switzerland and a member of the Swiss Association of Asset Managers (SAAM), a Self-Regulating Body approved by the Swiss Financial Market Supervisory Authority (FINMA). Stanhope Capital (Jersey) Limited is a limited liability company incorporated in Jersey and regulated by the Jersey Financial Services Commission (JFSC). Stanhope Capital (Cayman) Limited is incorporated in the Cayman Islands and is registered with the Cayman Islands Monetary Authority. Acceptance of delivery of any part of this Information constitutes acceptance to the conditions of this legal disclaimer.

The Information attached is being disclosed by the member of the Stanhope Group indicated in the Information and exclusively to the intended recipient (the "Recipient").

The Information does not constitute an offer to sell or a solicitation of an offer to buy any investment fund or other financial products. The Information does not constitute investment advice or advice with respect to the suitability of any investment.

Restrictions

The Information is private and confidential and provided for information purposes only. No part of the Information is to be distributed, copied or disseminated directly or indirectly to anyone other than the Recipient and its professional advisers (for the sole purposes of obtaining advice). The Information should not be relied upon for tax, auditing or other purposes. The Information is not intended for any person in any jurisdiction (by way of nationality, residence, domicile or otherwise) where the publication or availability of it would be in contravention of any applicable law or regulation.

Opinions, estimates and statements contained in the Information constitute judgments of the Stanhope Group at the time of their preparation and are subject to change without notice.

The value of investments can fall as well as rise; potential income or profits are accompanied by the possibility of loss. The Recipient may not receive back the original amount invested. Past performance is not a reliable indication of future results. Performance figures included in the Information are unaudited except where indicated. Please refer to the risk warning notes provided next to any performance figures included in the Information. In certain circumstances prices stated may be historic because of the delay in obtaining prices and/or valuations from third parties. Valuations are based on either market prices available at the time of the preparation of the Information or on the Stanhope Group's reasonable estimates thereof at the time made. Valuations based upon other models or assumptions or calculated as of another date or time may result in different values. The valuation or returns on investments in currencies other than the base currency of a client's account may increase or decrease as a result of currency fluctuations.

The Stanhope Group may recommend or make investments for its clients in illiquid or volatile instruments or funds which may carry a high degree of default risk or in funds which utilise leverage/gearing which can exaggerate performance and may lead to large falls in value.

Any description of any investment process or investment management process described in the Information may change from time to time at the discretion of the Stanhope Group or otherwise.

While reasonable skill, care and diligence have been taken to ensure that the Information was accurate as at the date of writing, the Stanhope Group has not verified and accepts no legal responsibility for any third-party Information. In addition, the Stanhope Group makes no representation, warranty, undertaking or guarantee, express or implied, as to the accuracy or completeness of the Information and opinions therein. No members of the Stanhope Group shall be responsible for or have any liability to any Recipient or third party for losses or damages (whether consequential, incidental or otherwise) arising (i) out of errors, omissions or changes in market factors, conditions or circumstances or (ii) from making any use of the Information.
The Information does not replace, supplement or amend the contractual documentation entered between the relevant member of the Stanhope Group and the Recipient, including but not limited to (i) the required qualifications of the Recipient in order for such Recipient to receive the Information and (ii) the disclaimers and limitation of liability contained in such contractual documentation. Further, the Information does not replace, supplement or amend the documentation applicable to any investment fund or other financial products referred to in the Information.

United Kingdom

To the extent that the Information is aimed at residents of the United Kingdom, the Information has been approved for issue in the United Kingdom by Stanhope Capital LLP. Stanhope Capital LLP's advice is categorised by the Financial Conduct Authority as "restricted" because it advises on investment funds, which are only one type of "retail investment product". Stanhope Capital LLP does not provide investment advice on other retail investment products, such as life insurance, stakeholder pensions or personal pension schemes.

Jersey

The advice Stanhope Capital (Jersey) Limited offers under our advisory service is restricted as we advise on investment funds, which is only one type of investment product. Stanhope Capital (Jersey) Limited does not provide investment advice on retail investment products, such as life insurance, stakeholder pensions or personal pension schemes.

United States

The Information is not intended for residents of the United States or for any U.S. Person. The Information is not an offer to sell any securities to or for the benefit of United States persons or the solicitation of any offer to buy securities on the part of or for the benefit of any such United States persons. For the avoidance of doubt a U.S. Person does not include a U.S. Citizen resident outside the U.S.