Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 31st August 2018

Tactical Positioning

As we move towards the last quarter of the year, we are starting to focus on some of the more positive aspects underpinning markets. The first of these is the strong progress in U.S corporate earnings in 2018 where we expect growth to come in at 20% with a further 10% in 2019. Furthermore, we believe that interest rates in the U.S will rise at a much slower pace in 2019 (though two more rate rises in 2018 seems likely). Slow interest rate rises should not present too much of a problem to the US economy, assuming current economic conditions prevail. Outside the US it is worth noting that equity markets in Asia including Japan, Europe and Emerging Markets have not had a good year although there has been earnings growth in each of these regions. This leaves share valuations at reasonable levels. Even US valuations can be justified given the earnings growth expectations. Overall, we feel that problems in countries such as Turkey, Italy, Argentina and Venezuela are not going to stop the world economy in its tracks nor will the mid-term elections in the US be a gamechanger for the US economy. With these factors in mind, we feel that we should consider adding to equity exposure in our portfolios, moving from an underweight to equal weight stance. There are a few short-term factors that will affect our timing, if we proceed with this move, but the main message is that we feel markets could enjoy some further progress in the coming months.

Market Moves

	Equities *(Local Currency, incl. Dividends)*						
31-Aug-18	**World**	**US**	**Europe**[1]	**UK**	**Japan**	**GEM**	**Asia**
Last 2 Weeks	2.4%	3.0%	1.5%	-0.6%	2.2%	3.4%	2.6%
Year to Date	5.0%	9.5%	0.7%	-0.2%	-3.0%	-1.7%	-0.7%

	Commodities			**Currencies** *(vs. USD)*			**Gov't**
	BCOM	**Gold**	**WTI Oil**	**EUR**	**GBP**	**JPY**	**UST 10Y**[2]
Last 2 Weeks	2.0%	2.3%	7.4%	2.3%	2.1%	-0.3%	-0 bps
Year to Date	-3.9%	-7.8%	15.5%	-3.4%	-4.1%	1.5%	+46 bps

[1] Europe excluding UK

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

Source: Bloomberg

August was a month of ‘two halves’ as risk assets rebounded in the second half of August, with only the UK posting a negative return. The US market was buoyed by a weaker dollar as well as continued strength in earnings and some positive economic releases (more on which below). Dollar weakness over the fortnight was in part a response to Federal Reserve Chair Powell’s comments that he ‘saw no clear sign of an acceleration’ in inflation and subsequently does not feel there is an ‘elevated risk of overheating’. Although ‘trade war’ disputes and the potential economic effect of tariffs continue to dominate the headlines, the weaker dollar supported Asian and Emerging markets which rose by 3.4% and 2.4% respectively. Meanwhile, currency volatility continued, most notably for Turkey and Argentina but also for other members of the ‘fragile 5’ - India, South Africa and Indonesia. In addition, the market reacted positively to news that the People’s Bank of China would re-introduce the ‘counter cyclical buffer’ in its daily formulation of yuan exchange rate fixing. The buffer allows the central bank to use more discretion when setting the currency level and therefore enables them to lean against a sharp move in the currency.

Oil was the strongest performing asset class over the period, with West Texas Intermediate Oil index rallying by 7.4%, bringing it to within touching distance of its high for the year of $80 a barrel. Oil price volatility is likely to remain elevated whilst the market tries to discount the impact on Iranian supply of the sanctions due to come into effect in November, as well as the reduced output from Venezuela owing to the political crises and slowing output from the US, as capacity in infrastructure limits are reached. The broader commodity index rebounded by 2.0% in tandem with the modest rebound in Emerging Market equities and gold rose by 2.3%. There was little movement in bond prices in most developed countries with the US 10 year Treasury yield unmoved over the period.

Economic Update

Economic data during the fortnight continued to paint a picture of positive economic momentum. US Consumer Confidence in August beat expectations, posting a reading of 133.4 versus expectations of 126.6, marking the highest reading since October 2000. The report revealed that a greater share of respondents anticipated purchasing big ticket items including cars and household appliances within six months, which clearly bodes well for the overall outlook for consumption. In addition, whilst a smaller share of respondents said they expected employment to rise in the coming months, participants were more optimistic about pay gains. This rosy outlook for the US consumer was mirrored by the University of Michigan Consumer Sentiment Index, which fell less than expected in August. Whilst the survey revealed optimistic income expectations and job certainty, the report simultaneously revealed rising inflation expectations, which reached the highest level since 2014. Aside from consumer sentiment indicators, the August Richmond Fed Index (which measures industrial activity across the central Atlantic region) rose to 24 in August versus 20 in July, led by growth in shipments, the volume of new orders and employment. US second quarter GDP was revised up to a seasonally adjusted annual rate of 4.2% with an improvement in capital spending and net exports.

A report from the European Commission revealed consumer optimism weakened in August, dragging down a wider gauge of economic sentiment, whilst business confidence stabilised. Rising fears of unemployment amongst households was the main cause for the fall in the index, although, the survey also revealed stability in expectations for the wider economy. Moreover, in Europe, M3 money supply growth for July was weaker than expected, decelerating from 4.5% to 4.0%.

In Japan, July retail sales rose for the ninth straight month, beating forecasts. However, the pace of gains slowed sharply, suggesting consumption may not be strong enough to spur economic growth in the current quarter.

JONATHAN BELL
IVO COULSON
IMOGEN HERVEY-BATHURST

31 August 2018

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