Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 15 May 2019

Tactical Positioning

When equity markets go down, it is worth looking at how 'risk-off' or perceived 'safety' assets such as gold, US Treasury bonds, the Japanese yen and the Swiss franc are moving to determine the severity of the situation, as these are normally rise when investors are selling out of equities. Over the last two weeks, the move up in this group has been muted despite the apparent impasse in the US-China trade talks which we discuss below. This suggests to us that it would be wrong to confuse the recent pick-up in market volatility with the beginning of something more sinister.

Market Moves

	Equities *(incl. Dividends)*						
15-May-19	World ($)	US ($)	Europe[1] (€)	UK (£)	Japan (¥)	EM ($)	Asia ($)
Last 2 Weeks	-3.3%	-3.1%	-3.2%	-1.5%	-4.3%	-5.3%	-4.4%
Year to Date	12.5%	14.3%	14.1%	10.4%	5.0%	6.7%	9.1%

	Commodities			Currencies *(vs. USD)*			Gov't
	COM[2] ($)	Gold ($)	WTI Oil ($)	EUR	GBP	JPY	UST 10Y[3]
Last 2 Weeks	-1.0%	1.0%	-3.0%	-0.1%	-1.4%	1.7%	-13 bps
Year to Date	4.8%	1.1%	36.6%	-2.3%	0.7%	0.0%	-31 bps

[1]Europe excluding UK
[2]Bloomberg Commodity Index
[3]US Treasury 10 Year Yield shows absolute, not percentage, change in yield
Source: Bloomberg

The old City adage "sell in May and go away" is haunting markets so far this month. More hawkish-than-expected Federal Reserve and Bank of England meetings initially unnerved investors, but it was President Trump's trade-related tweet on Sunday 5 May, stating that tariffs on $200bn of Chinese goods would increase to 25%, that led to a marked shift in sentiment. Since then, risk assets have fallen across the board and volatility has increased, reflected by the VIX index (a measure of the S&P 500's implied volatility) moving above 20, although, it is still well below the mid-30s seen at the end of 2018. While the US and China may step back from the brink and agree a trade deal, the outcome is hard to predict. Sentiment has also been hit by increased tension between the US and Iran, with National Security Advisor, John Bolton, announcing that the US is sending a carrier strike group and bomber task force to the Middle East, though so far, oil has taken its direction more from potential supply increases by Saudi Arabia and Russia. Government bonds, gold and the Japanese yen have only partly benefitted from weaker sentiment. Although, gold rose a little more forcefully on speculation it could receive some flows if China decides to reallocate some of its $1 trillion worth of US Treasuries.

US-China trade relationships have been the market's main centre of attention as negotiations become more challenging. The latest round of US tariffs on $200 billion of imports from China came into force, taking the rate from 10% to 25%. China then announced a new round of retaliatory tariffs on $60 billion of US goods with rates ranging from 5% to 25%. Trump continued to be unpredictable, as he went from praising President Xi and talking up the "beautiful letter" he received from him one minute, to decrying China's "ripping off" of the US the next. On 13 May, markets had their second-worst day since the start of the year as the trade issue came to a head, with companies most exposed to trade hit hardest (particularly technology names, such as Apple, whose supply chain is highly dependent on trade with China). At the end of the fortnight, markets are looking calmer given the apparent willingness of the two sides to keep talking – Trump intends to meet Xi at the G20 next month – and a lack of other negative catalysts of global significance. Meanwhile, the US is preparing the next round of tariffs covering another $300 billion of Chinese imports.

Turning to US monetary policy, interest rates were left unchanged at the Federal Reserve meeting on 1 May. The market was, however, rattled by the divergence between the official committee statement and Fed Chair Jerome Powell's comments at the press conference. Powell said that recent weak inflation appears "transient or idiosyncratic", and he appeared more optimistic on the US and global economies than expected. The official statement, by contrast, was more cautious as it included a new mention of the decline in inflation which was not included in the previous meeting's statement. Despite Powell's comment, the short-term US interest rate market has priced in an interest rate cut in 2019 and the yield on 10 year Treasury bonds briefly fell below the yield on 3 month Treasuries. Yield curve inversion (the yield on longer term bonds falling below that on shorter term bonds) has historically been a reasonable recession predictor, though it is, of course, not infallible and some market participants do not regard it as meaningful in this interest rate cycle.

Whilst the Bank of England meeting was a similar affair, in that monetary policy was left unchanged, Governor Mark Carney talked up the need for more interest rate rises in future than are currently reflected in market prices. UK politics continues to focus on Brexit with talks between the Conservatives and Labour achieving little thus far. The two main parties, particularly the Conservatives, were punished at the local elections over their failure to deliver Brexit, with the arch-remainer, second-referendum-supporting Liberal Democrats having a good night, albeit off a low base. The next signpost is the European Parliament elections on 23 May, with polls showing that around a third of the country intends to vote for Nigel Farage's newly formed Brexit Party, which may take first place.

Economic Updates

Economic data in the US was mixed. The monthly employment report saw non-farm payrolls coming in above market expectations and the lowest ever recorded unemployment. Elsewhere, consumer confidence data beat expectations, as did the Empire Manufacturing survey, job openings, factory orders and non-farm productivity. On the other hand, the manufacturing and services PMIs (Purchasing Manager Indices), industrial production, retail sales, inflation, house prices, consumer credit, jobless claims and wage growth disappointed.

In Europe, macroeconomic data generally came in above market expectations. Eurozone GDP, the manufacturing, services and composite PMIs, core inflation, industrial production, retail sales, unemployment, investor confidence, money supply and German trade data all beat consensus expectations.

UK macro data were mixed with industrial production, retail sales, trade balance, house prices, the construction PMI, and mortgage/general lending beating expectations, although some of this was exaggerated by economic activity being brought forward ahead of a potential hard Brexit and, hence, not necessarily reflective of underlying demand. On the downside, consumer confidence, the manufacturing PMI, mortgage approvals and consumer credit all missed forecasts.

In China, the trade dispute with the US weighed on economic data despite central bank and government policy easing measures, with industrial production, retail sales, fixed asset investment and new loans disappointing. The trade balance itself disappointed, with imports well above expectations but exports well below.

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15 May 2019

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