Stanhope Capital Fortnightly Bulletin

Period ending 30th April 2019

Tactical Positioning

As 2018 ended, markets looked bleak as fears the world economy was falling back into recession snowballed into a market rout. Four months on and the story is very different, the Federal Reserve has paused its policy of raising rates, a trade deal between the US and China may be imminent and the latest US GDP growth report surprised to the upside, demonstrating once again that recession concerns late last year were overblown. The result: global equity markets are now up 16.3% for the year in dollar terms (14.2% in sterling and 18.7% in euros) and portfolios have of course partly benefited from this rise in markets.

As mentioned in our last bulletin we have not increased our overall equity allocation rather we have rebalanced our equity exposure within portfolios by reducing Europe in favour of other markets.

Market Moves

	Equities *(incl. Dividends)*						
30-Apr-19	World ($)	US ($)	Europe[1] (€)	UK (£)	Japan (¥)	EM ($)	Asia ($)
Last 2 Weeks	1.0%	1.4%	1.7%	-0.1%	-0.3%	0.3%	0.1%
April	3.6%	4.0%	4.8%	2.3%	2.0%	2.6%	2.4%
Year to Date	16.3%	18.0%	17.8%	12.0%	9.8%	12.7%	14.1%

	Commodities			Currencies *(vs. USD)*			Gov't
	COM[2] ($)	Gold ($)	WTI Oil ($)	EUR	GBP	JPY	UST 10Y[3]
Last 2 Weeks	-2.0%	-0.3%	0.8%	-0.8%	-0.5%	0.5%	-5 bps
April	-0.4%	-0.7%	6.3%	0.0%	0.0%	-0.5%	+10 bps
Year to Date	5.9%	0.1%	40.7%	-2.2%	2.2%	-1.6%	-18 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 fortnight got off to a slow start as volatility hit a new low for the year during a holiday-shortened trading week. Despite this, most markets ended the period in positive territory, with Europe leading the pack buoyed by positive Chinese data and a six-month extension to the Brexit deadline. Macroeconomic concerns remain, however, with the euro falling to a near two year low against the dollar amid worries about the health of the eurozone economy.

In the US, the S&P 500 broke above its previous all-time high reached in September 2018, helped by news of positive earnings surprises early in the reporting season. The technology-heavy Nasdaq Composite Index outperformed as Amazon and Microsoft reported strong quarterly earnings, the latter pushing its market capitalisation above $1 trillion for the first time. Thus far, roughly half of US companies have reported earnings, with 77% of them beating expectations, however, according to Factset earnings are expected to be slightly negative for the quarter and with corporate taxes, the cost of capital and wage growth at historic lows (and likely to rise from here), shrinking profit margins pose a threat to the equity market. Factset expect full year corporate US earnings growth of 3.6% significantly lower than the 24.3% recorded in 2018.

Chinese equities posted their biggest weekly declines since October as investors became worried that the government would dial back fiscal and monetary support following a better than expected quarterly growth number. The Shanghai Composite Index and the large-cap CSI 300 each shed 5.6% although China still has one of the better performing markets for the year, up over 20% since the end of December. Elsewhere, market moves were muted with Japanese equities slightly negative for the period as non-domestic investors took profits ahead of the 10-day public holiday to mark the ascension of the new emperor. Meanwhile Emerging Markets rose marginally, with weakness in Turkey due to political uncertainty and inflation concerns offset by progress on pension reform in Brazil.

Oil prices rose early in the fortnight, as the US revoked the waivers allowing eight countries to import crude from Iran, before falling sharply after data showed US crude oil inventories had reached their highest levels in 18 months. Energy stocks suffered as earnings disappointed.

Economic Updates

It was a quiet period for economic data, with two major exceptions. The United States first quarter GDP surprised to the upside, growing at an annualised rate of 3.2% (vs. 2.3% expected). Whilst clearly a positive, the GDP report was weaker than the headline figure suggests, as volatile components such as net exports, inventories, and government spending drove a good portion of the increase and will likely unwind in the coming quarters. If stripped of these outsized contributions, there are some more concerning figures from the private sector. 'Final sales to private domestic purchasers', a good measure of private demand, increased at 1.3% annualised, half the rate of the previous quarter and personal consumption expenditure slowed from 2.5% to 1.2%. Considering consumers account for the majority of GDP, it is concerning that they only contributed one quarter of the 3.2% growth rate. The picture is mixed; the benefits of tax cuts and increased government spending are waning, although the poorer than expected personal consumption numbers were probably hit by the government shutdown at the beginning of the year.

Chinese GDP also grew faster than expected in the first quarter, allaying fears that the trade tensions with the US are weighing on its economy. GDP rose 6.4% year-on-year as industrial production surged and fixed asset investment and retail sales posted solid growth. While widely taken as positive news, the Organisation for Economic Co-operation and Development (OECD) issued a report, warning against the prolonged government stimulus deployed to help the economy achieve this growth rate. The report warned that such stimulus could "lead to a further build-up of imbalances and capital misallocation, and thereby weaker growth in the medium term" and highlighted that debt in state-owned enterprises has reached "unsustainable" levels.

Data coming out of Europe continued to disappoint as weaker-than-expected Purchasing Managers' Index (PMI) data showed that the French and German manufacturing sectors remained in contraction. Germany's manufacturing sector has now contracted for four months in a row according to IHS Market PMI, with the April reading coming in at 44.5 (below 50 indicating a decline). Labour productivity growth across the Eurozone has also been slowing and is now negative in Germany and Italy. Also, Italian wage growth came in at just 1.4% year-on-year compared with 2.2% a year ago.

Finally, Japan's Finance Ministry reported that Japanese exports declined 2.4% year-on-year in March owing to weakening demand from China. This marks the fourth straight month of declines and Japan's overall trade surplus has now dropped by roughly a third over the last 12 months.

JONATHAN BELL
IVO COULSON
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30th April 2019

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