Stanhope Capital Fortnightly Bulletin

Period ending 15th July 2019

Tactical Positioning

Despite England being knocked out of the semi-final of the FIFA Women's World Cup, the first two weeks of July were kind to sports fans in the UK, particularly so over the weekend, with a Lewis Hamilton win at Silverstone, the longest Wimbledon men's final, and an extraordinary and nail-biting final between England and New Zealand in the Cricket World Cup. For investors, markets were equally kind, with another strong fortnight for equities following the rise already seen this year.

By contrast, company profits growth has been subdued and while valuations in most markets still look reasonable, there are question marks over how long the current rally can continue. So far this year, it has been right to stick with risk positions in portfolios and we continue to do so, but like the sports men and women over the weekend, we cannot relax because of what has happened so far this year. We maintain our balance in portfolios and continue to look out in case the environment changes.

Market Moves

	Equities *(incl. Dividends)*						
15 -Jul -19	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Last 2 Weeks	1.8%	2.5%	0.6%	1.5%	1.5%	0.5%	0.4%
Year to Date	18.0%	21.2%	18.0%	14.8%	7.4%	10.6%	12.9%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Last 2 Weeks	1.2%	0.3%	1.9%	-1.0%	-1.4%	0.0%	+8 bps
Year to Date	6.4%	10.3%	31.2%	-1.8%	-1.9%	1.6%	-60 bps

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

Wall Street saw the best performing equity market over the fortnight, boosted by dovish policy statements from the US Federal Reserve ("Fed"), a softer US dollar and seemingly constructive trade talks between the US and China. The S&P 500 Index closed above 3000 for the first time ever, whilst the Nasdaq and Dow Jones Industrial Average also marked record highs. Global equities are now up 18% for the year. Bond markets have risen this year, although over the fortnight US bonds came off slightly as analysts modestly trimmed their expectations of the extent of the likely interest rate cuts. In the eurozone, some of the higher risk bond markets have performed particularly well. Italian 10-year bond yields continued to move sharply downwards over the fortnight, benefiting from the European Commission's ruling that there will be no disciplinary action over Italy's budget. Moreover, the yield on euro denominated Greek 10-year bonds made history by briefly dropping below 2.00%, remarkably almost reaching parity with US dollar denominated US Treasuries.

Equity markets welcomed the testimony of Fed Chair, Jerome Powell, before Congress, which suggested a strong preference for an interest rate cut later this month with apparent support from most Fed board members. His statement that the 'case for a somewhat more accommodative monetary policy had strengthened' gave little room for misinterpretation. Powell cited the US/China trade dispute, slowing global growth and anaemic inflation as major issues facing the economy, and noted that unwanted 'crosscurrents have re-emerged'. Just as importantly, Powell appeared to brush over the temporary trade truce agreed by President Trump and President Xi at the G20 Osaka Summit and played down the surprisingly strong June jobs report.

On the trade front, representatives of the US and China opened a formal dialogue to implement the consensus reached at Osaka. Larry Kudlow, Director of the National Economic Council, reiterated the plan for the US to ease its stranglehold on Huawei by relaxing licensing restrictions and for China to increase their purchases of US agricultural products. Yet, it was not all plain sailing, with the US Commerce Department announcing its intention to apply duties of between 30% and 177% on Chinese imports of fabricated structural steel, arguing that the Chinese government has been unfairly subsidising production. The US State Department's decision to approve Raytheon's $2.2 billion sale of Abrams tanks, Stinger missiles and other military equipment to Taiwan, similarly vexed Chinese authorities.

European Union ("EU") policy makers are considering how to respond after the US published a list of goods worth up to $4bn, including Scotch whisky and Italian cheese, which are set to be hit with punitive duties later in the year. US grievances were focused on the subsidies Airbus and other European companies have been receiving from the EU, which the World Trade Organisation ruled violates international trade rules and the US Trade Representative estimates costs the US economy $11 billion per annum. Never afraid to turn the screw, President Trump ordered an investigation into the legality of France's planned 3% digital services tax, which he claims unfairly targets large US technology companies. It is likely that trade discussions with the US will be high on the agenda of the new cohort of European leaders starting in November, including Ursula von der Leyen as President of the European Commission, Charles Michel as European Council President and Josep Borrell as the EU's foreign policy chief. Current Chairwoman of the International Monetary Fund, Christine Lagarde, has been appointed the new president of the ECB, also from November.

Geopolitical tensions simmered in the Middle East, in the aftermath of Britain's seizure, off the coast of Gibraltar, of an Iranian oil tanker bound for Syria. In response, Iran accused Britain of an act of piracy and attempted to prevent a British oil tanker passing through the Strait of Hormuz, the waterway through which one third of the world's seaborne oil passes. This confrontation and a large drawdown in US stockpiles drove the price of crude oil higher.

Economic Update

Economic data was mixed in the US. Nonfarm payrolls caught investors off guard at 224,000 against 160,000 expected, easily surpassing the 72,000 recorded in May. Likewise, US CPI inflation came in higher than expectations, at 0.3% month-on-month compared to 0.2% anticipated. Both these readings point to a healthy, rather than depressed, economy and reduce the likelihood of the Fed opting for a full 50-basis point cut later this month. However, in contrast to the strong jobs report and inflation data, the ISM Manufacturing Purchasing Managers Index ("PMI") fell to 55.1, the lowest reading since June 2017, and the ISM Non-Manufacturing PMI fell to 51.7, the lowest since October 2016.

This side of the Atlantic, the IHS Markit/CIPS UK Construction PMI was particularly poor, coming in at 43.1 against 49.2. This is, by some distance, the worst reading since the Global Financial Crisis, highlighting the fragile state of the UK economy. In the fine print, exports declined, and domestic demand fell, possibly the result of a reversal of the stockpiling which took place in the run up to 31st March 2019, when the UK was expected to leave the EU. The gloomy picture was not improved by the Services PMI which came in at 50.2 against 51.0 expected and the Composite PMI at 49.7, the first reading below 50 since July 2016. Mark Carney, the Governor of the Bank of England, laid the foundations for the Monetary Policy Committee to cut interest rates in August, explaining that the 'intensification of trade tensions has increased the downside risks to global and UK growth' and that it is therefore 'unsurprising' that markets have priced in lower interest rates.

In China, the protracted trade dispute with the US looks to be biting, with second quarter GDP rising by 6.2%, meeting expectations but down from 6.4% in the first quarter and ominously, the slowest growth rate since 1992, when quarterly data was first released. Nonetheless, stimulus measures give the impression that they are supporting domestic consumption. Industrial production, for example, came in at 6.3% year-on-year against 5.2% expected, and retail sales at 9.8% year-on-year against 8.5% expected.

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15 July 2019

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