Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 31st August 2019

Tactical Positioning

We made no major tactical changes in the last two weeks but are looking at a number of themes that could be included in portfolios in the coming months. With borrowing rates at generationally low levels, some countries (including the US) are considering issuing very long dated bonds (30, 50 or even 100 years). Germany, for instance, has just issued a 30-year bond with no coupon. In other words, free money. Our sense is that governments may take the opportunity to invest in popular policies that are visible and attract voter support, such as infrastructure spending. Although infrastructure stocks have not been particularly good performers in recent years, we are investigating whether there are any opportunities we should consider now.

Market Moves

	Equities *(incl. Dividends)*						
31 -Aug -19	World ($)	US ($)	Europe[1] (€)	UK (£)	Japan (¥)	EM ($)	Asia ($)
Last 2 Weeks	2.4%	2.8%	3.6%	2.4%	0.5%	1.4%	1.3%
August	-2.4%	-1.7%	-1.5%	-3.8%	-4.5%	-3.7%	-4.1%
Year to Date	14.1%	17.8%	15.7%	11.3%	2.0%	5.0%	7.1%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	Gold ($)	WTI Oil ($)	EUR	GBP	JPY	UST 10Y[3]
Last 2 Weeks	1.1%	0.2%	4.1%	-0.6%	0.8%	-0.3%	-1 bps
August	-1.8%	7.9%	-3.2%	-0.3%	0.2%	2.2%	- 49 bps
Year to Date	2.5%	19.0%	24.9%	-3.7%	-4.5%	3.0%	-116 bps

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

The second half of August saw a rebound in risk assets following a roller coaster of announcements about the prospects for trade talks between the US and China. Macroeconomic data in the major economies was generally weaker and as a result, bond yields fell, providing additional support to equity markets. Concerns remain around yield curve inversion (specifically the 10-year US Treasury bond yield closing below the 2-year yield for the first time since 2007), which has historically preceded US recessions. Monetary policy continued to hold investors' attention as comments by the US Federal Reserve ("Fed") Chair, Jerome Powell, seemed to endorse the market's expectation of more interest rate cuts.

European politics was also a source of tension; the UK faces the very real possibility of a hard Brexit at the end of October, whilst political upheaval in Italy led to the centre-left Democratic Party agreeing to form a coalition government with the anti-establishment Five Star Movement.

Markets continue to be buffeted by the trade tussle between the US and China. For example, on Friday 23rd August risk assets initially fell after China announced new retaliatory tariffs on US imports (5-10% on $75bn). Jerome Powell then made dovish comments supporting the chances of an interest rate cut (more on which below) helping markets regain composure. President Trump, never one to be over-shadowed, went on Twitter, asking "who is our bigger enemy, Jay Powell or Chairman Xi?" and tweeting that the US "would be far better off without [China]". He also stated, "our great American companies are hereby ordered to immediately start looking for an alternative to China" and followed this with an increase in tariffs on Chinese imports, from 25% to 30%, on around $250 billion of goods, and from 10% to 15% on around $300 billion of goods. As a result, markets sold off again. Subsequently the tone became more conciliatory (and markets partly recovered) as China apparently asked the US to come back to the negotiating table.

Turning to US monetary policy, the annual Jackson Hole Economic Symposium took place on 22-24 August and the highlight was Powell's speech in which he moved towards endorsing expectations of further interest rate cuts as implied by market pricing. His comments were perceived as "dovish" as he flagged "significant risks" to the US economy arising from weaker global growth, uncertainty over trade policy and weak inflation. The market was quick to spot that Powell avoided reference to the recent interest rate cut being a "mid-cycle adjustment" which made the market think the Fed may be about to cut rates more than previously expected. The market is now pricing two to three interest cuts by year-end.

Turning to European monetary policy, the incoming European Central Bank ("ECB") President, Christine Lagarde, made her first comments on the topic since being selected. She agrees with the Bank's accommodative stance and stated that Eurozone interest rates could move lower than the current level of minus 0.40%. So, more of the same at the ECB. At the same time, Lagarde is aware of the damage caused by negative interest rates on Eurozone banks so we may see more support for the sector, potentially in the form of deposit tiering (i.e. reducing the amount of commercial bank deposits with the Central Bank on which the negative rate charge applies).

In the UK, domestic politics predictably dominated newsflow and Brexit-related uncertainty continues. The Government is seeking a revised deal with the EU ahead of the Halloween exit date, by which Prime Minister Johnson has committed to leave "come what may". The main event of the fortnight was the Government obtaining Her Majesty's permission to prorogue (suspend) Parliament from 10 September to 14 October. The official reason is that the Prime Minister wishes to set out a new legislative agenda in a Queen's speech, however this has the effect of reducing the amount of time available to dissenting Members of Parliament to attempt to block a no-deal exit.

Italian politics proved equally unpredictable. The collapse of the 66th government since 1945 (the populist coalition of the hard right Northern League and the anti-establishment 5 Star Movement), caused by Deputy Prime Minister and Northern League leader Matteo Salvini withdrawing his party's support (he had hoped for fresh elections), threw the country into political crisis. However, the 67th government is now being formed as a surprise deal was agreed between 5 Star and the centre-left Democratic Party. This caused a rally in Italian bonds with the 10-year yield falling below 1% for the first time ever, although Italian bonds had lagged other peripheral European government bonds due to the political uncertainty. For comparison, the Greek 7-10 year government bond index has returned a stunning 26% year-to-date with the 10-year yield falling from 4.4% to 1.6%.

Economic Updates

Economic data in the US appears to be turning weaker with the Manufacturing and Services Purchasing Managers Indices ("PMI"), home sales, house prices, core durable goods orders and personal income all coming in below market expectations. The Manufacturing PMI is worth highlighting as it fell below 50 (indicating contraction) for the first time since 2009. On the other hand, existing home sales, headline durable goods orders, consumer confidence and personal spending beat expectations.

In Europe, macroeconomic data was similarly disappointing. Eurozone, and particularly German, exporters are highly sensitive to global trade dynamics and specifically Chinese consumption which has been hit by the US-China trade battle. It was therefore no surprise that Eurozone and German inflation, Eurozone consumer confidence, German retail sales and business climate/expectations surveys disappointed. Germany's GDP growth for Q2 came in negative at an expected -0.1%.

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31 August 2019

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