Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 30th September

Tactical Positioning

The Japanese equity market was the best performing major stock market over the last month, which may have been reflective of attractive valuations and a weaker yen. Overall, we have a broadly neutral view on this market, whereas we speak to many investors who have dismissed Japanese equities as unworthy of investment in the last few years, ignoring the fact that valuations are close to a 30 year low. Although we are maintaining our neutral view we have been reviewing our managers and are considering some changes. Elsewhere in Asia, we have a relatively high exposure, driven by growth in consumer demand in the region and attractive valuations. Although global trade growth is slowing, we believe that a compromise agreement will eventually emerge between the US and China and this will be particularly important for Asian equity markets. President Trump took a similarly explosive stance to his trade dispute with China over NAFTA (North American Free Trade Agreement) when he came to power in 2017 labelling it 'the worst trade deal' ever negotiated by the US. However, by September 2018 a new deal was quietly negotiated and a compromise reached. We believe that the current China - US trade war might also end up being gently defused.

Market Moves

	Equities *(incl. Dividends)*						
30-Sep-19	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Last 2 Weeks	-0.8%	-1.0%	0.1%	0.6%	-0.8%	-1.6%	-2.0%
September	2.2%	1.8%	3.1%	3.0%	5.9%	1.5%	1.4%
Year to Date	17.2%	20.0%	20.1%	14.3%	9.5%	7.8%	9.8%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Last 2 Weeks	-1.1%	-1.1%	-1.4%	-1.6%	-1.7%	0.0%	-23bps
September	1.2%	-3.2%	-1.9%	-0.8%	1.1%	-1.7%	17bps
Year to Date	3.1%	14.8%	19.1%	-5.0%	-3.6%	1.4%	-102bps

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

Equity markets rose in September, despite a partial setback in the second half of the month. The oil price response to the Saudi attacks remained muted, Treasury bond yields rose slightly for the month and the US dollar continued to strengthen.

Performance across equity markets was mixed over the fortnight, driven primarily by political newsflow. US equities reversed some of their earlier gains in the month, falling 1.0%. This was provoked in part by reports that President Trump is considering imposing controls on capital passing between the US and China, a potential departure from the US's normal free-market orthodoxy. If enacted, this could result in the delisting of Chinese companies from US exchanges, limiting US pension funds' Chinese exposure and even curbing US private equity firms' access to China. The effect was naturally felt more acutely across Asian and Emerging Markets which fell 2.0% and 1.6% respectively over the fortnight, with large index constituents such as Alibaba falling especially sharply (-5.2%) in the day following the stories in the media. Although no formal announcement has been made, some short-term reassurance was provided over the weekend as a US Treasury spokesperson stated by email that 'the administration is not contemplating blocking Chinese companies from listing on US exchanges at this time'. Overall, it is worth noting that market participants are not overly concerned by such news reports, with US equities remaining close to all-time highs.

The UK was the best performing market over the fortnight, rising by 0.6% which was partly in response to a fall in sterling. Despite initially rising, after the UK Supreme Court unanimously ruled PM Boris Johnson's decision to suspend Parliament to be unlawful, sterling's gains proved short-lived after chief EU negotiator Michel Barnier described the UK's current deal proposals as 'unacceptable'. The dollar strengthened versus sterling and the euro, hitting its highest level in more than two years in response to the heightening trade war rhetoric. Government bond yields fell over the past two weeks, in the US and Europe. In the case of Europe, this was in response to some weak industrial data. Despite the political rhetoric affecting markets, volatility remained low, and market weakness was not reflected by an increase in the gold price, which fell 1.1% over the fortnight.

It is worth noting that, the low-risk overnight interest rate US banks effectively charge each other ("the repo rate") spiked to 10% intraday on the 16th September and the New York Federal Reserve had to step in to calm the market. However, this was due to a technical rather than fundamental reasons and should not have longer term implications. The next big market event is the Federal Reserve meeting at the end of October. The market is pricing in a 60% implied probability of an interest rate cut (of 25 basis points).

Economic Update

In an interview with the Financial Times over the weekend, the Chairman of the European Central Bank, Mario Draghi, re-iterated the need for further measures to stimulate growth in Europe, stating that 'fiscal policy is a necessary complement to monetary policy and…the need is urgent'. Draghi's comments came as yet more data revealed economic weakness in the Eurozone. Manufacturing activity, as measured by the Purchasing Managers' Index (''PMI'') fell to an 83-month low of 45.6 in September, down from 47.0 in August. The German PMI, by far the most important component of the index, fell to 41.4 from 43.5 the previous month, marking the worst reading in more than a decade. In addition, the services component of the broader Eurozone index fell to an eight-month low of 52.0 from 53.5 in August, below market forecasts of 53.2. The Chief Economist of IHS Markit, which compiles the survey, stated that 'the Eurozone economy is close to stalling as a deep manufacturing downturn shows further signs of spreading to the services sector'. On the positive side, the index remains above the 50 level, signifying growth.

In the US, economic data was mixed over the fortnight. New home sales for August jumped to a 12-month high, rising 7.1% for the month versus expectations of 3.8%. Housing is the most sensitive sector to interest rates and the rise is part of an ongoing rebound in response to a sharp drop in mortgage rates following the Federal Reserve's renewed dovishness. By contrast, the US Services PMI was weaker than expected in September with a reading of 50.9 versus expectations of 51.4. In addition, the Chicago PMI came in at an anaemic 47.1 for September, significantly undershooting expectations of 50.0 and marking a 3.3 point decline from August's reading and a 10-year low. Although this sharp decline partly reflected the strike at General Motors, the survey exposed broad weakness in all underlying components, including a marked fall in the backlog of orders and inventories. Falling business conditions in the Chicago region continue to reflect the nationwide trend in manufacturing weakness, hampered by a slowing global economy and uncertainty over the trade dispute between China and the US. The OECD revised down forecasts for overall global growth in 2019 to 2.9% from 3.2% and for 2020 to 3.0 from 3.4%. If realised, this would mark the first year of below 3.0% global growth since 2009.

Elsewhere, in China manufacturing data for September surprised on the upside, coming in at 49.8 versus expectations of 49.6 driven by an improvement in underlying new orders and, surprisingly, exports. Despite beating expectations, this nevertheless marked the fifth consecutive month of contraction for manufacturing. The services component of the index was better, coming in just shy of forecasts at 53.7 (versus 53.9 expected).

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IVO COULSON
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2nd October 2019

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