Stanhope Capital Fortnightly Bulletin

Period ending 31st December 2019

Tactical Positioning

2019 was a very good year for financial markets. The US equity market topped the list of major markets again, with a 30.7% total return for the S&P 500 index, whilst the MSCI All-Country World Index returned 26.2% (in USD). Asia Pacific Ex Japan and Emerging Markets lagged the performance of the US and Europe but still returned 19.0% and 18.0%. Bond markets also rose over the year with yields falling. We made no major tactical moves during the fortnight; we remain principally invested in risk assets whilst maintaining an element in defensive assets in case the investing environment deteriorates.

Market Moves

	Equities *(incl. Dividends)*						
31-Dec-19	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Last 2 Weeks	1.5%	2.0%	0.8%	2.7%	-1.0%	2.1%	1.3%
December	2.7%	3.0%	1.3%	2.8%	1.3%	5.7%	4.3%
2019	26.2%	30.7%	26.4%	17.3%	18.5%	18.0%	19.0%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Last 2 Weeks	1.9%	3.3%	1.6%	0.8%	-0.6%	0.6%	9bps
December	5.0%	4.0%	10.7%	1.8%	2.6%	0.8%	14bps
2019	7.7%	18.8%	34.5%	-2.2%	3.9%	0.9%	-77bps

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

Tactics for a new decade?

During this century's first decade (to 31/12/2009) equity returns were weak. The total return from the S&P 500 index averaged close to -1% per year. European equites did marginally better at +2.4% (in USD). Better returns came from Emerging Market equities (+10% p.a.) and bonds, with US Investment Grade corporate bonds generating an annualised return of 6.6%.

Supported by low interest rates and quantitative easing, the second decade of the 21st century was kinder to equity investors. The S&P 500 index rose by an average of 13.3% per year. Other markets also went up, but by less. European equities rose 5.4% p.a. on average and Emerging Markets just over 3.3% p.a. Bonds generated good absolute returns, albeit not as strong as US equities. US Investment Grade corporate bonds again returned an annualised average of around 6.6%.

So, what about the coming decade? Interest rates and bond yields look likely to remain low for some years. The 10-year German Bund offers a negative yield, whilst 10-year US Treasuries offer just 1.9% per annum. With yields starting at such low levels, it is difficult to see how bond investments can have another good decade.

Equity valuations are generally high compared to long-term averages. At the end of the year, the forward price-to-earnings multiple on the S&P 500 index was 19.8x and for Europe 16x. However, equity valuations can remain high relative to history if interest rates and bond yields remain low. Global economic growth is forecast to be around 3% p.a. over the coming decade whilst OECD growth, constrained by continued slow productivity growth and low population growth, may grow by only half as much. Corporate profit margins could eventually be squeezed by higher wages and consequently company earnings growth may only match nominal GDP growth. Using these forecasts, assuming no change in valuation multiples and considering the dividend yield on equities, of close to 2.5%, the resulting annual average total return for equity markets would be around 5% above inflation. This is similar to long term historic equity real returns.

Recent pessimism surrounding European and Emerging Market equities may be overdone and as a result these markets may see a relative recovery. But both regions have structural issues of a magnitude that does not exist in the US and lack the US's long list of fast growing globally dominant companies. Consequently, equity portfolios be kept diversified across all three areas.

In the short term, there are, as always, reasons to be cautious, but there is no way of predicting if or when the market might fall. As a result, based on the expectations for the decade, investors should remain invested in equities for now, whilst keeping an element of 'dry powder' in case a market setback provides a better buying opportunity.

Economic Updates

The main news in the final fortnight of the year was the highly anticipated and well-received announcement that China and the US have finally agreed to a 'Phase One' trade deal, details of which are due to be released when the agreement is signed on the 15th of January. The deal is expected to contain a clause on dropping plans for new US tariffs on Chinese imports, Chinese agreement to buying more US farming products and fresh Chinese commitments to improve intellectual property protections. This adds another success to Donald Trump's presidency, with 'Phase Two' negotiations expected to start shortly and most likely to be concluded in time for the 2020 November election in the US.

The news elevated markets across the globe, with the primary beneficiaries being the US and Emerging Markets, the latter being up 5.7% for the month of December whilst commodities also enjoyed a strong year-end. The NASDAQ index broke through the 9,000-point barrier for the first time, notably thanks to market giant Amazon, having reported record holiday sales. In the meantime, Trump's impeachment proceedings continue, although it has been made abundantly clear by politicians and the media that there is close to a 0% chance that he is found guilty by the Republican-controlled Senate. We see no effect on markets from this game of political charades.

In the UK, the Conservative Party is riding high on their new majority in the wake of the recent General Election and UK equities are enjoyed strong post-election returns on the back of reduced political uncertainty. By contrast, sterling has given up the initial gains following the election result, as the Prime Minister committed to negotiating a trade deal with the EU before the end of 2020 rather than taking advantage of a proposed extension on the negotiation period to the end of 2022. Meanwhile, it has been announced that Andrew Bailey, previously CEO of the Financial Conduct Authority, will replace Mark Carney as Governor of the Bank of England on 7th March this year.

Happy New Year.

JONATHAN BELL
IVO COULSON
STEFAN KUTZNER

3rd January 2020

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