Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 15th February 2020

Tactical Positioning

As we discuss below, being bearish about equity markets over the last few weeks has caught out many investors. Whilst the monetary 'spigot' is open, risk assets continue to attract support just as they have during previous waves of monetary stimuli since 2009. We are happy to stick with our exposure to equity markets, though we always keep an eye on valuations, which although historically high in many areas, can be generally justified given the very low cost of capital… a prop to markets which may persist for some time to come.

Market Moves

	Equities *(incl. Dividends)*						
15-Feb-20	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Month to Date	4.3%	4.9%	5.2%	1.9%	1.3%	4.0%	4.4%
Year to Date	3.7%	4.8%	4.1%	-1.5%	-0.4%	0.5%	1.8%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Month to Date	0.8%	0.0%	1.0%	-2.4%	-1.2%	-1.3%	8bps
Year to Date	-6.6%	4.0%	-14.8%	-3.4%	-1.6%	-1.0%	-33bps

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 powered forward over the fortnight, with US and European indices reaching fresh highs. Economic concerns about the impact of the coronavirus outbreak on the Chinese and global economy were trumped by strong corporate earnings releases on Wall Street and positive economic data coming out of the US. Investors seem to be taking the crisis in their stride, confident that central banks will step in to support markets if required. Indeed, the People's Bank of China left little to the imagination, injecting billions of dollars into money markets and halting the night-time trading of futures, in order to stabilise markets and prevent irrational behaviour. These capital injections included $57 billion being added to the banking system during a single trading session, the highest since January 2019.

The human cost of the epidemic has been high, at the end of the fortnight standing at 1,665 deaths and 68,500 infections in China, far in excess of the SARS crisis in 2003. Although it is too early to forecast the long-term economic cost, it is widely expected that there has been major damage caused to supply chains and economies. There are reports that Chinese oil demand has fallen by 20% as a result of the outbreak and BP, the oil and gas major, has ominously warned that up to one-third of global oil demand could be vulnerable to disruption. Amongst other possible consequences, the fallout from the epidemic threatens to hurt China's property market, as developers are forced to close sales centres and as buyers delay their search for new homes. According to Citi, China's GDP growth over the first quarter could fall to just 3.6% annualised.

The picture was less gloomy in the US as investors celebrated an impressive earnings season, with over 70% of companies surpassing expectations and management teams' general confidence reflected in their forward guidance. Spirits were buoyed as several blue-chip companies including Apple, Microsoft, Alphabet and Amazon delivered results that were significantly better than expected. Elsewhere, Tesla captured headlines and became the world's largest car manufacturer by market capitalisation, rising 91% since the New Year and a remarkable 347% since its lows in June 2019.

Turning to US politics, the impeachment of President Trump abruptly came to an end, as the Republican controlled Senate voted to acquit him. Perhaps the only surprise was that Mitt Romney, the former presidential candidate, broke ranks and become the first Senator in US constitutional history to vote down his own party leader. A recent survey by Deutsche Bank points to over 95% of market participants now expecting President Trump to be re-elected in November, at odds with pollsters and bookmakers who suggest that the race with the Democrats is too close to call.

One of the main lessons from the start of the Democratic primaries is that the election of their presidential candidate is likely to be unpredictable. Faulty voter technology laid the foundations for a chaotic Iowa caucus, where for a period all candidates claimed success in various forms, before Pete Buttigieg marginally came out ahead of Bernie Saunders, leaving the early front runner Joe Biden languishing in fourth place. In New Hampshire, Saunders and Buttigieg finished first and second respectively, with Biden coming in at fifth, raising serious question marks about the viability of his campaign. The confirmation that Michael Bloomberg, the former mayor of New York and eighth richest man in the world, will be on the ballot papers for Super Tuesday on 3rd March, the date when the greatest number of states hold primaries, may once again turn the Democrat primaries on their head.

The advent of the UK leaving the European Union failed to mark an improvement in political discourse. A sense of déjà vu resonated when EU negotiators demanded that the UK sign up to a "level playing field" in areas including environmental standards, state aid, the environment and competition policy, as precursor to a free trade agreement. Emboldened by his large parliamentary majority, Boris Johnson unsurprisingly rejected the notion of the UK agreeing to alignment on any of these policies, increasing the risk of no deal at the end of the transition period and putting downward pressure on sterling.

Economic Update

Economic data in the US was overwhelmingly positive and markedly different to the anaemic conditions weighing down Europe, contributing to a strengthening US dollar against the euro and most other major currencies. One of the highlights in the US was the Institute of Supply Management Manufacturing Purchasing Managers Index (PMI) which came in at a six-month high of 50.9 against 48.5 expected, with the new orders component surprising on the upside. Notably, the pick-up in data was not confined to the manufacturing sector, as the Institute of Supply Management Non-Manufacturing PMI Index came in at 55.5 against 55.1 expected. Significantly, the US/China trade dispute appeared to be bearing fruit, evidenced by the US annual trade deficit narrowing 1.7% to $617 billion, the first decline since 2013. In the fine print, the import of goods from China fell nearly 18%, slowing to $345.6 billion in 2019, albeit from a record $419.5 billion in 2018.

This side of the Atlantic, fourth quarter GDP growth in the Eurozone came in at 0.1%, the joint worst reading since the debt crisis seven years ago, whilst industrial production shrunk by 4.1% against expectations of a 2.3% decline. Many of the problems seemed to rest with Germany, the engine room of Europe, as fourth quarter GDP growth flatlined and factory orders declined 2.1%. Nonetheless, Germany's current account surplus remained the largest in the world over 2019 at $293 billion, helped by stronger exports to the US as a result of a weakening euro as well as a modest recovery of exports to the UK. This healthy current account position didn't escape the attention of President Trump, who declared his intention to address the US's trade deficit with Europe in a similar manner to his dealing with China. Its remains to be seen whether this is simply the President showboating ahead of the US presidential election or the next chapter in his America First policy.

JONATHAN BELL, IVO COULSON, HARRY COOKE
17 February 2020

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