Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 29th February 2020

Tactical Positioning

Looking back over last week, one thing that stood out during the equity downturn was the impact of programme trading. On a number of occasions programmatic trading represented over 90% of equity market turnover in the US. This powerful market force has a significant momentum bias which exacerbates market trends. Last week, the trend was clearly on the downside and, as we saw at the turn of 2018/19, momentum can quickly pivot to the upside. Tactically, the market fall on the 28th February looked to us like investor 'capitulation' after a viciously negative week for risk assets. In the midst of this we added a modest amount of equities to some portfolios which were below their target equity exposure. Although there may be more unsettling news to come we expect, on balance, that equity markets will be higher by the end of the year.

Market Moves

	Equities (incl. Dividends)						
29-Feb-20	World ($)	US ($)	Europe[1] (€)	UK (£)	Japan (¥)	EM ($)	Asia ($)
Last 2 Weeks	-11.4%	-12.5%	-12.2%	-10.7%	-10.7%	-7.5%	-7.1%
February	-7.6%	-8.3%	-7.6%	-9.0%	-9.6%	-3.8%	-3.0%
Year to Date	-8.2%	-8.4%	-8.6%	-12.0%	-11.0%	-7.0%	-5.4%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	Gold ($)	WTI Oil ($)	EUR	GBP	JPY	UST 10Y[3]
Last 2 Weeks	-5.8%	0.0%	-14.0%	1.8%	-1.7%	1.5%	-44bps
February	-5.0%	0.0%	-13.2%	-0.6%	-2.9%	0.2%	-36bps
Year to Date	-12.0%	4.0%	-26.7%	-1.7%	-3.3%	0.5%	-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

The final week of February was the worst week for major developed equity markets since the Global Financial Crisis of 2008-2009, with the coronavirus the dominant catalyst. What really rattled markets was the increasing rate of new infections outside China (the epicentre of the virus with ~80,000 official cases and ~2,900 deaths, although the real figures could be considerably higher). Outside China there have now been ~9,000 cases and ~100 deaths, with South Korea and Italy particularly badly affected. Fearing that the cases seen so far are just the tip of the iceberg, investors started to price the economic impact of a global pandemic into asset prices with double digit percentage declines in developed market equities.

The VIX Index, a measure of the implied volatility of options on the S&P 500, rose to 49 on Friday, a level not seen since the Greek Sovereign Debt Crisis of 2011. Two weeks earlier it had been just 13.7. Lower credit quality (high yield) corporate bond spreads (the additional yield they offer over government bonds) increased from 3.68% to 5.06% in the US and rose 1.14% to 4.09% in Europe, with high credit quality (investment grade) corporate bond spreads increasing by around a quarter of one percent. Core sovereign bonds were the obvious winners with US yields reaching all-time lows. The yield on the benchmark 10-year Treasury closed 0.32% down at a record low of 1.15%, while the 30-year yield fell 0.24% to 1.68%, also a record low. The 30-year US Treasury bond rose 6.3% on the week. German government bonds also benefitted from the flight to safety with the 10-year yield down 0.18% to -0.61%, although it is still marginally above its all-time low of -

0.71%. The Japanese yen (another risk-off beneficiary) rose 3.98% against the US dollar, while gold surprised everyone by losing -3.51%, likely owing to leveraged investors selling gold to cover losses on equities.

Looking forward, government actions to stem the spread of the virus will now be crucial to future market moves. Clearly, limiting freedom of movement is harder in many countries than communist China, although the Italian government was quick to quarantine a whole region of Northern Italy. Turning to the macroeconomy, fiscal and monetary policy reactions have started. The People's Bank of China cut the 1-year loan prime rate by 0.1%, whilst the Hong Kong government announced it will hand out HKD 10,000 (~USD 1,285) to each adult resident, although this will be financed from tax revenues (so is effectively a tax cut) and is the fourth such handout. The next scheduled US Federal Reserve (Fed) monetary policy meeting is on 17-18 March*, and markets are already pricing in a rate cut. Fed Chair Jerome Powell supported markets on Friday when he indicated that rate cuts may be needed if financial conditions tighten and the US economy slows. Bank of Japan Governor Kuroda also committed to take the necessary action to provide liquidity and ensure financial stability.

US politics continue to be as divisive as ever with the coronavirus the latest issue at large. President Trump appointed Vice President Mike Pence as coronavirus chief, much to the surprise of many, given Pence's controversial handling of an HIV outbreak during his time as Indiana governor. The Democratic primaries rumbled on with Senator Bernie Sanders currently the frontrunner.

Economic Updates

Most economic data releases have yet to reflect the impact of COVID-19 and the market's attention has been on the spread of the virus itself. We did, however, see a glimpse of what is likely to proliferate, when China released their February Purchasing Manager Indices ("PMIs"). The manufacturing PMI collapsed to 35.7 from 50.0 (the market had been expecting 46.0). The non-manufacturing PMI was even worse, falling by almost half to 29.6 from 54.1. Both are record lows and the non-manufacturing PMI has never seen a reading below 50. Other Asian PMIs (in Japan and South Korea) fell to multi-year lows.

Economic data in the US was mixed and given recent events it could be argued that it was out of date even before it was published. The NY Empire State and Philadelphia Fed manufacturing indices, Michigan consumer sentiment, housing starts and new/existing/pending home sales beat expectations; while core PCE inflation, the services and manufacturing PMIs, house prices, consumer confidence and initial jobless claims disappointed.

In Europe, data was mixed with Eurozone consumer confidence, the German manufacturing and composite PMI and German employment outperforming expectations; whilst German GDP growth and the German services PMI underperformed.

UK macro data was promising overall with the manufacturing and composite PMIs, core CPI, core retail sales, consumer confidence and employment beating expectations; but wage growth disappointed.

JONATHAN BELL
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3rd March 2020

*The Federal Reserve has subsequently cut rates by 50bp.

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