Stanhope Capital

Stanhope Capital Fortnightly Bulletin

Period ending 15 May 2020

Tactical Positioning

As we discuss below, some of the 'sugar rush' in equity markets seen in April has evaporated over the last couple of weeks. Sensing that this might be a possibility, we reduced our equity exposure in the first week of May to 'bank' some of the recovery. This does not mean that we have changed our generally positive stance towards equity markets but simply reflects a degree of prudence. Undoubtedly, short term volatility relating to the perceived level of success resulting from the easing of lockdown restrictions will be with us for the next few weeks and US utterances about China's initial alleged 'cover-up' of COVID-19 are hardly helping global harmony.

Market Moves

	Equities *(incl. Dividends)*						
15-May-20	World ($)	US ($)	Europe[1] (€)	UK (£)	Japan (¥)	EM ($)	Asia ($)
Month to Date	-1.6%	-1.6%	-3.2%	-1.4%	-0.9%	-1.9%	-1.9%
Year to Date	-13.2%	-10.9%	-18.9%	-22.0%	-14.5%	-13.6%	-12.4%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	Gold ($)	WTI Oil ($)	EUR	GBP	JPY	UST 10Y[3]
Month to Date	1.3%	3.4%	56.2%	-1.2%	-3.8%	0.1%	0bps
Year to Date	-23.5%	14.9%	-51.8%	-3.5%	-8.6%	1.5%	-127bps

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

After the resurgent bull market in April, with the S&P 500 having its best month since 1987 (+12.8%), the first half of May saw a small reversal in most major equity markets. The 'risk-off' move boosted safe haven assets such as gold (which hit its highest level since 2012) and the US dollar, whilst gains for core government bonds were limited by significant new issuance. That said, the S&P 500 traded in a narrow range compared with that seen in March/April, and the VIX index of implied volatility fell to 26.3 (the lowest since late February and well below the all-time high of 82.7 hit in March), although it did pick up in the second half of the fortnight as stocks fell. A notable exception to the rout in equities this year was the technology-heavy NASDAQ which continued its march upwards and incredibly (given events) the index has now generated a modest positive year-to-date return (+0.47%). The surge reflects a shift to a more digital economy with companies like Amazon among the biggest beneficiaries. Amazon, with its market capitalisation of $1.2 trillion, is worth more than all the bonds in the leading US high yield bond index.

The fall in equity indices reflects a souring relationship between the US and China, including the threat of economic sanctions, as well as investor anxiety about easing lockdowns and the potential for a further wave of COVID-19 infections. In Germany, all shops and restaurants have been allowed to reopen. In Italy, bars, restaurants, hairdressers and beauticians were given the green light to reopen, whilst in Spain, various restrictions were eased outside of Madrid and Barcelona. In France, 'deconfinement' rules have enabled most firms to reopen, and individuals no longer need permission to leave home, although the country has been divided into regions according to risk level. There has been some evidence of an increase in infections as a result of the easing of lockdown restrictions.

Turning to US-China relations, both countries have roundly criticised each other's approach to COVID-19. One third of Americans believe China created the virus, and the US ordered the Federal Retirement Thrift Investment Board to stop investing in Chinese stocks. Sanctions have even been threatened. This is one issue which unites Republicans and Democrats, with Joe Biden also saying he plans to be tough on China. The rise in Chinese imports

of US goods may help keep the Phase One trade deal intact but the relationship looks set to remain very difficult ahead of this year's elections.

On monetary policy, two of the top four central banks, the European Central Bank and the Bank of Japan, now have negative interest rates and there has been market speculation over whether the Bank of England (BoE) and even the Federal Reserve (Fed) could follow suit. The BoE base rate looks increasingly likely to go negative given that the economy has been plunged into a deep slump: the BoE has forecast a Q2 GDP contraction of -25%. However, BoE Governor Andrew Bailey downplayed the chances of negative rates becoming a reality. Meanwhile, in the US, Fed Chair Jerome Powell has made clear he does not see it as an appropriate tool for the US economy and he would look to deploy other tools (such as enlarging existing programmes and forward guidance) first.

Fiscal policy continued its expansionary tilt with the US Treasury expected to issue an astonishing $3 trillion of government debt in Q2 2020 alone. This is almost as much as it collected in tax receipts in the whole of 2019. On this side of the Atlantic, the UK Job Retention scheme was extended until October – the government is funding the wages of 27% of the workforce and the scheme is now estimated to cost upwards of £80 billion. France and Germany have similar schemes although theirs are more flexible and allow part-time working, reducing the cost to finance ministries.

Economic Updates

Economic data continued to reflect the impact of the COVID-19 pandemic and although it highlights the poor state of the world economy, it adds very little to the crucial issue of when and how fast the recovery will be. Many economic data releases beat expectations over the period, but only because expectations had already collapsed to ultra-low levels. In the first quarter of the year Eurozone GDP fell by 3.8% quarter-on-quarter, with Germany 2.2% lower. The lockdown will have a greater impact on Q2's numbers, so we should expect a more significant impact when this quarter's GDP numbers are released.

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15 May 2020

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