Stanhope Capital Fortnightly Bulletin

Period ending 31st August 2020

Tactical Positioning

Equity markets continued in a bullish vein through August, dominated by the same stocks that have led the recovery since April. Tempting though it was to reduce risk, the 'sugar rush' of global liquidity programmes remains a powerful force and this would have been a mistake. Whilst it is realistic to expect a pull-back in the coming weeks, we have seen that each time the market falls it has flushed out more buyers who have been waiting to 'buy the dip' and the recovery is swift. We remain alert to risks coming from the US election, trade disputes and a potential blowout in some of the market leaders but, for now, we continue to maintain our current equity positioning.

Market Moves

	Equities *(incl. Dividends)*						
31-Aug-20	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Last 2 Weeks	2.4%	3.8%	-0.3%	-1.9%	-0.3%	0.6%	1.0%
August	5.8%	7.1%	3.1%	1.8%	7.9%	2.2%	3.1%
Year to Date	4.1%	9.3%	-7.2%	-19.0%	-4.0%	4.4%	4.9%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Last 2 Weeks	3.5%	1.2%	1.4%	0.8%	2.2%	0.7%	0bps
August	6.8%	-0.4%	5.8%	1.3%	2.2%	-0.1%	18bps
Year to Date	-9.0%	29.7%	-30.2%	6.4%	0.9%	2.6%	-121bps

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

Against a backdrop of mixed economic data, the congressional stalemate on the relief bill (the fifth such aid package designed to alleviate economic and health-care crisis) and the increase in China-US tensions, the market's summer romance with equities continued to flourish over the fortnight. We are now officially in a new bull market (the S&P 500 has risen by over 50% since the 23rd March) and it is only the fifth time in history that such a feat has occurred during a recession. Anchored by investors' unwavering belief in unlimited central bank stimulus, the period witnessed the S&P 500's fastest recovery from a bear market on record, closing at a new all-time high on the 18th August. The 126 trading days it took for the S&P 500 to reclaim its February peak was over 10 times as fast as the index's average historical rebound (1,542 trading days). This positive mood continued into month-end with the S&P 500 rising to new highs and producing its best August performance since 1986, with a return of +7.1%.

Focusing on these headline-making milestones, however, can be misleading given the big divergence between the stock market's winners and losers. In fact, most companies in the index remain below the price levels they achieved at the previous market peak in February. During the month, higher-valuation growth stocks outperformed lower-priced value companies, extending the 2020 trend. Large companies easily outpaced small companies, as large technology companies or technology-enabled disrupters continued to drive the

market's upward momentum. Meanwhile, bank and energy stocks have underperformed on the back of rock bottom interest rates and a weak oil price. Apple, Amazon, Microsoft, Facebook and Alphabet have accounted for 25% of the total market recovery since March and now make up 22% of the total market value of the S&P 500. As a result, their strong performance more than offsets the poor performance of hundreds of other companies in the index. In such an environment, many actively managed funds, focused on these growing companies, have been able to outperform the index by a large margin.

The disconnect between financial market performance and economic reality is reflected in many forward-looking volatility measures. Both the Chicago Board Options Exchange (CBOE) VIX and CBOE NASDAQ-100 (VXN) volatility indices increased meaningfully over the fortnight. Typically, these two measures act as fear indicators and move in the opposite direction to equity markets: when stocks rise, volatility normally falls and vice versa. Occasionally this relationship can invert, leading to a simultaneous increase in both equity index prices and equity volatility measures. This reversal can reflect excessive optimism which in turn has typically pre-empted declines in equity markets. Perhaps the options market is sending a message that turbulence in the later stages of 2020 will be greater than the equity markets currently anticipate.

The world's central bankers and economists virtually convened for the annual Jackson Hole Economic Policy Symposium – the Glastonbury festival of the monetary policy world. Jerome Powell, Chair of the US Federal Reserve (Fed) took centre stage and highlighted the decision to move to ”average inflation targeting”; instead of raising interest rates as soon as inflation exceeds 2%, the Fed will allow periods of overshooting the 2% level to make up for past undershoots. This equates to a more dovish policy of lower interest rates for longer and reinforces the market's expectation that the Fed will retain its zero-interest-rate policy through to 2023. Powell also announced a policy tweak that changes the approach to employment; in future, the Fed will not set a specific goal for the unemployment rate but rather will allow conditions to dictate what it considers 'full employment'.

Following Powell's speech, the US dollar continued its descent to a two-year low, versus a trade-weighted basket of major currencies, as it fell for a fifth consecutive month. The dollar's weakness meant that the euro strengthened above $1.19 for the first time in over two years, while sterling rose 2.2% against the greenback. Elsewhere, the yield on the US 10-year Treasury note increased by 17bps from 0.53% to 0.70% in August, the biggest monthly gain since September 2018. As represented by the spread between the ten and two-year yields, the Treasury curve steepened by 14 basis points to 0.57%, as lengthier bond maturities fell in anticipation of potentially higher inflation.

Economic Updates

Corporate and economic fundamentals have yet to reflect a sustained recovery from COVID-19-related damage. The fall in the US consumer confidence index, from July's 91.7 to August's 84.8, was sharper than the consensus forecast. The 'expectations' component of the index fell to its lowest level since 2016 as households are worrying about the persistence of unemployment and other income losses.

The US initial jobless claims number also disappointed. The 1.11 million figure was well above the consensus expectation of 920,000, although the 14.8 million continuing jobless claims was better than the 15 million expected.

JONATHAN BELL
IVO COULSON
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31 August 2020

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