# Stanhope Capital Fortnightly Bulletin

Period ending 15 March 2018

## Tactical Positioning

In recent days, we have started to see signals from markets to make us reconsider our equity positioning. Global growth looks solid and is synchronised for the first time in a decade but we are lacking any short term catalyst, in our view, that could lead valuations much higher. By contrast, our list of reasons to be more cautious has increased with the addition of trade tensions over tariffs, dismay at the high turnover in Trump's appointees and geo-political tensions resurfacing in areas like Iran. Alongside this, sits worries over higher inflation and the end of quantitative easing (QE): The unprecedented stimulus provided to global economies in the last decade is being dismantled and no one can predict the outcome. Our response is to consider cutting equity exposure for the first time in over a year. The world is in a much better place from an economic point of view and one of our most favoured asset classes remains equities but with increasing "fog on the road", a modicum of caution seems appropriate.

## Market Moves

| | Equities *(Local Currency, incl. Dividends)* | | | | | | |
|---|---|---|---|---|---|---|---|
| **15-Mar-18** | **World** | **US** | **Europe**[1] | **UK** | **Japan** | **GEM** | **Asia** |
| **Last 2 Weeks** | 0.8% | 1.3% | -0.3% | -1.0% | -1.5% | 1.8% | 1.6% |
| **Year to Date** | 1.2% | 3.1% | -1.7% | -6.3% | -3.9% | 4.5% | 3.4% |

| | **Commodities** | | | **Currencies** *(vs. USD)* | | | **Gov't** |
|---|---|---|---|---|---|---|---|
| | **BCOM** | **Gold** | **WTI Oil** | **EUR** | **GBP** | **JPY** | **UST 10Y**[2] |
| **Last 2 Weeks** | -0.9% | -0.2% | -0.7% | 0.9% | 1.3% | 0.3% | -3 bps |
| **Year to Date** | -0.6% | 1.0% | 1.3% | 2.5% | 3.1% | 6.0% | +42 bps |

[1] *Europe excluding UK*

[2] *US Treasury 10 Year Yield shows absolute, not percentage, change in yield*

*Source: Bloomberg*

Over the fortnight, Asia and the US generally recovered some of the ground lost in February and reacted positively to the Goldilocks economy in the US. Within the latest employment report, the impressive payroll number and softer than expected wage inflation resonated well with investors. The Nasdaq index closed higher for seven consecutive sessions, the longest winning streak since October 2017 and touched a record level. At the end of the fortnight, however, disappointing retail sales in the US put the brakes on this juggernaut.

Kim Jong Un's message that North Korea are open to abandoning their nuclear plans and the willingness of President Trump to meet his nemesis, temporarily calmed the explosive geopolitical situation in the Korean peninsula. To some observers, the dramatic U-turn alleviated a serious risk simmering beneath markets. In other circles, there was an undercurrent of scepticism, based on the belief that the *"little rocket man"* was seeking to buy himself a window of opportunity to progress his nuclear ambitions and remove some painful sanctions.

President Trump, similarly, took markets by surprise when he signed an executive order to raise tariffs on imported steel to 25% and aluminium to 10%. The trade deficit with China seemed to be very much in the crosshairs and the President also expressed a desire to investigate China's continued abuse of intellectual property rights. Trump's belligerent stance and conviction that *"trade wars are good, and easy to win"* stoked

fears that his anti-globalist policy agenda could derail the benign economic environment fostered by his tax reform programme. The resignation of the White House's economic advisor, Gary Cohn, and sacking of the now former Secretary of State, Rex Tillerson, added to the air of unease.

Never one to shy away from confrontation, the President of the European Commission, Jean-Claude Juncker, reacted to Trump's sabre rattling by suggesting that the EU would be prepared to target imports ranging from Harley-Davidson bikes to Bourbon whiskey. Wall Street, nevertheless, regained some composure when Trump softened his tone and explained his intention to be *"very flexible"*. Canada and Mexico, for example, were extended an olive branch, although only in return for a Trump-friendly NAFTA agreement being signed. US Treasury yields edged downwards as investors digested the impact of an increasingly protectionist state of global politics.

European equities struggled to make any headway, partly unnerved by the stream of data suggesting that the tide of economic momentum has perhaps turned and partly by the state of paralysis in Italian politics. The populists of the Five Star Movement and Northern League were the biggest winners of the general election, whilst the former Prime Minister, Matteo Renzi, resigned as leader of the Democratic Party and Silvio Berlusconi's Forza Italia finished in a dismal fourth place. Italy has now had around ninety governments since the turn of the twentieth century and it is noteworthy that markets have remained relatively calm in the face of a likely prolonged period of jostling to form a functioning coalition. On the other hand, the political stalemate in Germany ended after the SPD voted in favour of establishing a coalition government with Angela Merkel's CDU.

In the UK, Brexit negotiations rumbled on and Theresa May showed her hand by reiterating the desire for the UK to leave the single market and customs union and end the free movement of people. The UK's relationship with Russia deteriorated to a new low, following the apparent nerve agent attack on a former double agent in the market town of Salisbury in Wiltshire. The British Government retaliated by expelling 23 Russian "diplomats" and threatening to freeze Russian state assets.

Out of the larger emerging markets, China was the standout performer and investors were unperturbed by the presidential term limit being repealed, which gives President Xi the opportunity to hold onto power indefinitely. Echoing the path trodden by Mao Zedong, President Xi's political theory was enshrined in the constitution. Turning to commodity markets, the price of crude oil experienced a volatile period, but ultimately fell with reports that US inventories are on the rise.

## Economic Updates

As mentioned above, there was a sharp increase in the number of new jobs in the US, with the reading coming in at 313,000 vs. 205,000 expected. At a more granular level, there was also a rise in the prime age participation rate to the highest mark since 2010. However, the average hourly earnings data, which caused a significant sell-off in equities and bonds at the beginning of February, came in lower than expected at 0.14% vs. 0.20% month-on-month. Importantly, there were no signs of inflation growing at a faster rate than expected, with the Consumer Price Index in line with expectations at +0.2% month-on-month. In his testimony to the Senate, as new chair of the Federal Reserve, Jerome Powell reiterated the need to gradually increase rates but added that *"there's no evidence the economy is currently overheating"*.

Elsewhere in the US, the National Federation of Independent Business Small Businesses Optimism Index came in at 107.6 vs 107.1 expected, marking the highest reading since 1983 and the Manufacturing Institute of Supply Management Index delivered the strongest recording since May 2004 (and the third strongest since April 1984). This encouraging picture was partially blemished by retail sales which fell for the third successive month, down 0.1% month-on-month vs. an expected rise of 0.3%. What is more, the January trade deficit widened to the highest level since October 2008, at $56.6 billion vs. $55.0 billion expected.

Economic data on this side of the Atlantic generally fell back over the period from its elevated highs. The Eurozone's industrial production fell 1.0% vs. an expected 0.5% fall and the composite Purchasing Managers Index (PMI) came in lower than foreseen at 57.1 vs. 57.5 expected. Germany's January trade surplus came in lower than expected at €17.4 billion vs. €18.1 billion, hampered by weaker exporters, whilst factory orders fell 3.9% month-on-month vs. an expected fall of 1.8%. The renewed strength of sterling possibly weighed down on exports in the UK, with the IHS Markit/CIPS Manufacturing PMI down to 55.2 from 55.3, the lowest reading since the Brexit vote in June 2016.

Although, the latest Chinese manufacturing production reading was the weakest since July 2016, industrial production rose to 7.2% year-on year vs. 6.2% expected, the highest rate of growth since 2014. As a side note, the output from industrial robots in China rose 25% year-on-year, an unsettling statistic to those concerned about artificial intelligence replacing humans in the workplace.

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**15 March 2018**

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