Stanhope Capital Fortnightly Bulletin

Period ending 15th June 2018

Tactical Positioning

We have not made any major tactical changes in portfolios over the last two weeks and remain slightly underweight equities versus our targets. We can see a time when we might add to equities, but trade wars are damaging to sentiment and having some 'dry powder' in the short term provides useful optionality. With the quieter summer months ahead, which tend to bring lower trading volumes, markets may be particularly vulnerable to changing newsflow and this could produce interesting investment opportunities against a background of global growth.

Market Moves

	Equities (Local Currency, incl. Dividends)						
15-Jun-18	**World**	**US**	**Europe[1]**	**UK**	**Japan**	**GEM**	**Asia**
Last 2 Weeks	2.2%	2.8%	2.3%	-0.4%	2.5%	0.6%	0.8%
Year to Date	3.0%	4.6%	1.4%	1.5%	-0.6%	0.3%	1.7%

	Commodities			Currencies (vs. USD)			Gov't
	BCOM	**Gold**	**WTI Oil**	**EUR**	**GBP**	**JPY**	**UST 10Y[2]**
Last 2 Weeks	-3.2%	-1.5%	-3.0%	-0.7%	-0.2%	-1.7%	+6 bps
Year to Date	0.3%	-1.8%	7.7%	-3.3%	-1.7%	1.8%	+52 bps

[1] Europe excluding UK

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

Source: Bloomberg

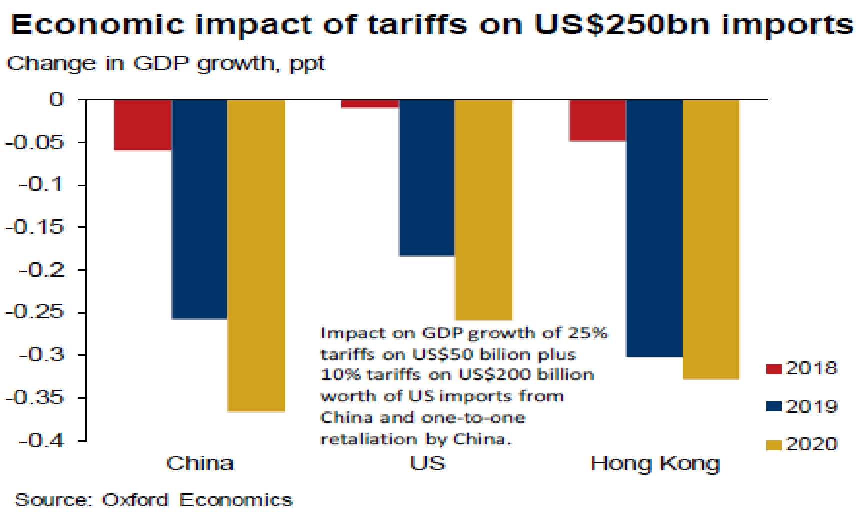
Global equity markets rose 2.2% seemingly unfazed by the numerous political events over the period such as; the G7 meeting, the Trump/Kim summit, the ongoing Italian political situation and US, European and Japanese Central Bank meetings. Commodities, by contrast, were broadly weaker, with the oil price down 2.7% on Friday as speculators began to anticipate that an increase in oil production might be announced by the two countries that opened the football World Cup (Russia and Saudi Arabia). OPEC is meeting later this week.

European equities performed well over the fortnight following a more dovish meeting of the European Central Bank (ECB). The announcement pushed back the date for a rate rise, suggesting that "the key ECB interest rates are to remain at their present levels at least through the summer of 2019 and, in any case, for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations". Perhaps the biggest shock was the inclusion of calendar-based guidance on rates which is a first for the ECB. The bank intends to reduce asset purchases from €30bn to €15bn in September this year and to stop them by the end of December, however, they indicated that the plan to taper was very much conditional on "incoming data confirming the Governing Council's medium-term outlook". In reaction the euro fell 1.89% (the largest fall since the Brexit vote), bond yields fell across the eurozone, and equities as measured by the Euro Stoxx index rose 1.23%. This good performance was pared back recently, as rumours of disagreements in Angela Merkel's government collided with trade war fears.

The US market was the best performing market in the period, up 2.8%, despite the FOMC (Federal Reserve Open Markets Committee) raising rates by 25bps. Their message was more hawkish than expected as the median dot in the Fed's "dot-plot" survey of individual policymaker's rate expectations moved from three rate rises to four expected in 2018. Forward guidance was changed to omit the comment, indicating the fed funds rate would remain below longer-run levels "for some time", while the language on inflation was also upgraded to remove the words "carefully monitoring". Market reaction was not huge with the most significant move at the short end of the yield curve (the 2yr finishing 2.9bps higher at 2.569%) pushing the difference between the yield on 10 year bonds, minus the yield on 2 year bonds, to below 40bps for the first time since 2007 - a narrow spread is normally seen as an indicator that growth is likely to slow.

It was a dizzying two days at the G7 Summit, during which President Trump arrived late, suggested that Russia could be re-admitted to the group and went on to criticise US trade partners, before describing his relationship with each of the other leaders as a "10 out of 10". The summit ended with the US President leaving early and pulling out of the joint communique usually made by the group at the end of the meeting. It is little wonder that markets didn't know how to react, and most major indices were unchanged when markets opened on Monday. There was a similarly benign response to the meeting of President Trump and North Korea's leader Kim Jong Un. The first meeting of the two countries' leaders, on the surface, appeared a success, although anyone who watched the President's press conference after the meeting will have noticed that little of significance was decided.

Global markets sold off 0.2% on Friday, and the US market initially fell 0.7% following confirmation that Trump has signed off on tariffs covering $50bn worth of Chinese goods imported into the US each year. China responded saying they would impose 'same scale' tariffs on US goods immediately but this did not prevent the Shanghai Composite Index from falling to its lowest level since September 2016 and completing its fourth straight week of declines. Since the end of the period under review, Trump has threatened tariffs of 10% on a further $200bn of Chinese exports to the US. The bar chart below gives Oxford Economics' forecast of the impact on US and Chinese GDP of this level of tariffs.



A resurgent dollar, rising US interest rates and lower investor appetite for risk is affecting EM currencies with the Argentinian peso, South African rand and Turkish lira in particular, badly hit by the Fed announcement on Wednesday, owing to their large current account deficits and high inflation. In response, Central Bankers are reacting fast by raising rates and intervening in currency markets to try to cut off any crises that may result. On Friday last week the Brazilian real saw its biggest one day gain (c.6%) since 2015, when the Central Bank said it would flood the market with currency swaps to protect against a further decline.

Elsewhere, Japanese equities performed well, up 2.5%, aided by the Bank of Japan maintaining its accommodative stance and softening its view on core inflation from 1% expected growth, to "growth in a range of 0.5%-1%".

Economic Updates

By and large, economic data was positive over the fortnight. The change in US nonfarm payrolls in May was above market expectations at 223k and employment in the service sector rose the most since February (up 171k), while solid gains were also recorded in other sectors. Average hourly earnings growth was 2.7% yoy (year-on-year), just below the January high of 2.8% and the May unemployment rate edged down to 3.8%. Alongside April 2000 this is now the lowest US unemployment rate since 1969. The US Consumer Price Index (CPI) report on Tuesday was the most anticipated data point last week and core CPI was in line with expectations up 2.2% yoy, the highest since February 2017. It seems that while inflation has risen back to the Fed's target, there are no signs of it taking off just yet.

Despite the ongoing confusions over Brexit, UK core retail sales in May were stronger than expected at +4.4% yoy whilst core CPI was +2.1% yoy.

In Europe, the final reading of Germany and France's May CPI was confirmed at +2.2% yoy and +2.3% yoy respectively. Unfortunately for Germany, the country's April factory orders fell for the fourth consecutive month and were much weaker than expected (-2.5% mom vs. +0.8% expected), weighed down by slower domestic orders (-4.8% mom).

The data releases from China were generally softer. May retail sales expanded at a slower than expected 8.5% yoy, a fall from the previous month's release of +9.4%. Meanwhile, industrial production rose 6.8% yoy and fixed asset investment posted the slowest increase since 1999 (+6.1% yoy).

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15th June 2018

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