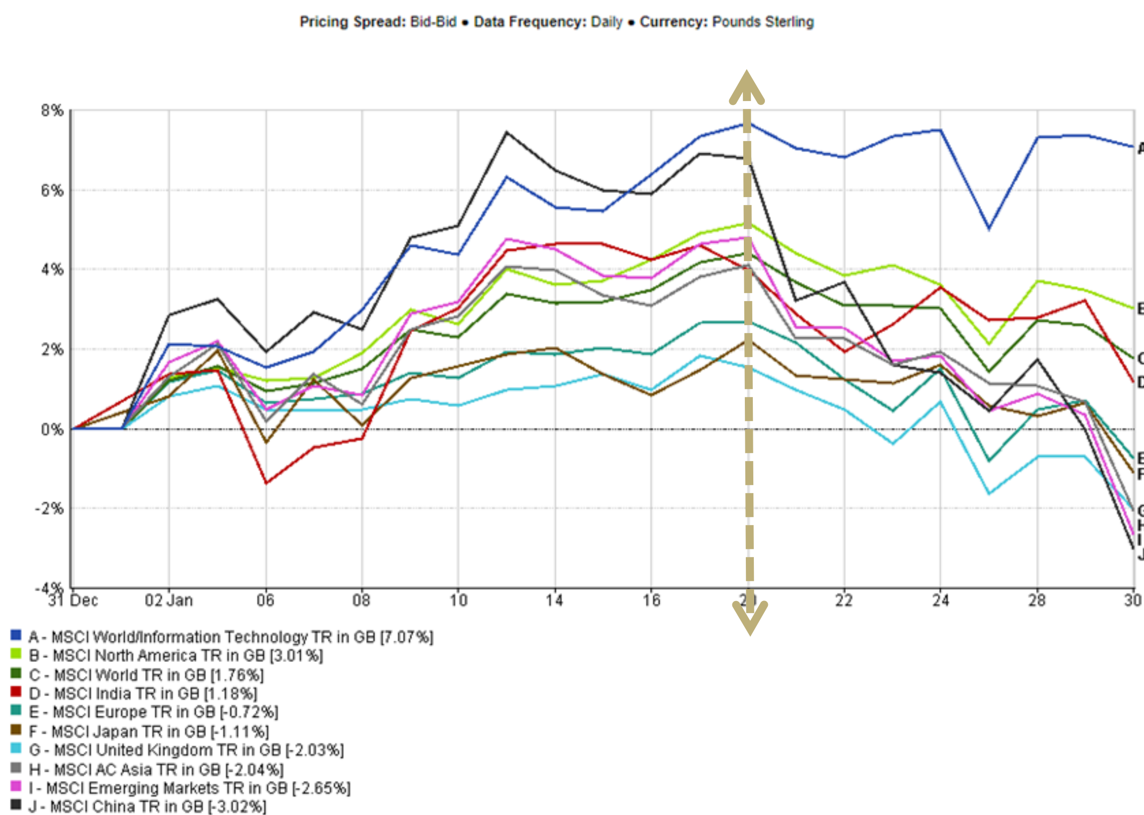
MARKET UPDATE

FEBRUARY 2020 MPU

Shortest ever war?

At the time of writing our last monthly update all eyes were focussed on the, apparently, impending war between the US and Iran following the assassination of an Iranian general. The shortest recorded war was apparently between the British Empire Vs. Zanzibar in 1896 but the latest US - Iranian conflict doesn't appear to have lasted much longer. The media, spearheaded by Twitter and other social media, were awash with apocryphal end of the world scenarios. It turned out that much of the tit-for-tat retaliations were apparently telegraphed ahead and so casualties were kept to a minimum. It just didn't seem like either side was up for it. By the end of the second week of January, the global markets had completely shrugged off any impending fears of Armageddon and were on fire led by Global Technology and Chinese equities. The central reason markets had been going up for much of the previous 12 years was back in play; easy monetary policy with no 'tightening' clouds on the horizon.

MSCI Global Markets January 2020 (fig1)



The Forgotten War… at least for now

Until the Americans took out the Iranian general, the big concern for markets was the economic trade war which was principally between the Trump administration and China. It's currently hard to find any reference to it in the media, but the main issues haven't been resolved and the sticking plaster (phase one) is certainly not a proper and lasting solution. It may be because Trump has had the sometimes-farcical impeachment process to deal with, but that charade appears to be at an end. Back in the day, impeachment enquiries moved markets but that is all so last century.

The Coronavirus – the economic consequences of a human tragedy

On the 31st of December, China announced an outbreak of a new coronavirus in the city of Wuhan, involving 27 cases. However, it wasn't until the third week in January (indicated by the gold arrow in fig1) that it really started to hit the world media headlines and impact the equity and bond markets.

Mainland-listed Chinese stocks ceased trading on January 23rd which was two days before the start of the Lunar New Year. Even by then, the benchmark Shanghai Composite had fallen approximately 4.5% since the highs of mid-January. Once they re-opened on Monday, albeit with a short selling ban in place, China indices were down circa 7.5% with many stocks 'limit down' 10% in the session. The Chinese government reduced their reverse repo agreements by 10bps and injected 1.2 trillion yuan via reverse bond purchase agreements, which helped stem these losses.

The economic fallout from the virus is impossible to quantify but if the number of cases fell next week, which looks incredibly unlikely, there is already damage to the Chinese economy and this must feed through to economic numbers in relatively short order. If the extrapolations from the impact start to be more positive however, or at least better than worst case scenarios, we could quickly to revert to the liquidity fuelled stock market melt up.

Hong Kong - another blow on the bruise

The outbreak of this virus is already being felt keenly in the Chinese administrative region of Hong Kong. The area was already living with the consequences of the ongoing pro-democracy protests which have badly affected the market for consumer goods and the hotel and leisure industries amongst many others. Tourism numbers have fallen off a cliff and a resolution between the people's movement and the Chinese authorities looks as far away as ever.

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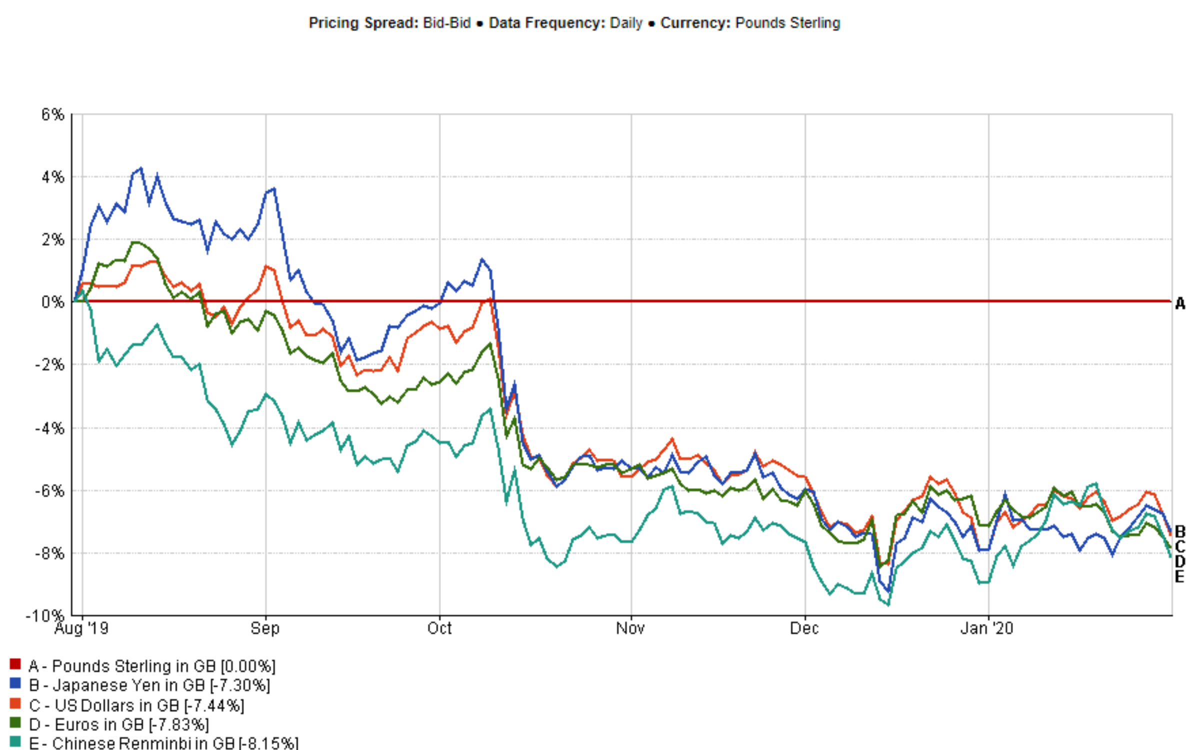
I knew you were trouble

On the 31st January 2020 the UK withdrew from the EU and began a transition period which will run to 31st December 2020. This eleven-month period will see the two parties negotiate their future relationship. Although all these points are factually correct, the relationship will change and develop for at least as long as the EU does. Just like the US-China trade war, both parties will evolve their positions. In the case of the European Union, many aspects of its current construct are far from the finished article. We have been bullish on the outlook for the UK for some time and we remain so. Although we will no doubt have to endure some of the negotiations being played out on the public stage, it's in both sides interests to get the job done as quickly and efficiently as possible. If you are having an operation, let's say heart surgery, you just want it to be over as soon and successfully as possible. You probably wouldn't benefit from being awake and watching the process and that's how the next eleven months might well feel. If I am a German car maker or a French wine producer, the last thing I want is petty point scoring or political posturing, I just want to trade; simple as that. As has been the case since the original vote, we all need to be wary of currency effects on investment returns for UK investors. The Pound continues to strengthen, which is diminishing the gains of overseas equities, at least for now.

POUNDS STERLING Vs. WORLD CURRENCIES (fig2)



31/07/2019 - 31/01/2020 Data from FE fundinfo2020

Fundamentally speaking

With the virus front and centre of investors' minds, the beneficiaries of the uncertainty are the usual suspects - gold, treasuries, the Dollar and the Yen. Once again at the start of the year, there were many commentators and investment banks calling for a treasury sell off (yields to rise). We never subscribed to this school of thought. The main reason global yields are so low is the debt bingeing and super-easy monetary policy which can't be reversed to any real extent. The US tried that in Q4 2018 and lost nearly 20% of their equity market value for their trouble; they won't be trying that again anytime soon and especially not in an election year. As it is an election year, the Fed will be reluctant to look overtly political in any interest rate moves, even if the economic circumstances indicated they should do. This is another cap on Treasury yields in our opinion. Gold continues to prove its diversification benefits and now there is nearly $14 trillion in negative yielding debt, the opportunity cost has once again evaporated.

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