QUARTERLY MARKET OVERVIEW – JANUARY 2020

"To expect the unexpected shows a thoroughly modern intellect"
– Oscar Wilde

I thought it might be fun to start by pulling out some of my thoughts from January 2019:

- Eurozone Crisis 2 – another Greek style crisis; there are no immediate signs of this happening

- Military action – we saw drone strikes by Iran on Saudi Arabia, and then the US against Iran (and vice versa). The markets haven't yet been overly concerned but there has been a spike in oil prices

- UK:
    - Election and Brexit – the thought was that Parliament would see logic which they didn't. The second comment was that Corbyn should fear an election with no clear policy on Brexit, this came to haunt him with Labour's worst election result since 1935
    - No deal – this is still on the table, there is a hard deadline for the end of 2020
    - Theresa May – we suggested she would not last the year, which was correct, but Boris was not the candidate we thought would replace her
    - Sport – England didn't win the UEFA Nations League but did win the Cricket World Cup

- Trump not to stand in presidential race – very unlikely, but there is still time!!!

In the summary I said to expect volatility, twists and turns and if history repeats then positive returns were more likely. We certainly got that in abundance!

What does this tell us? We read economists' who tell us what to expect; the reality is that even with all the data they have, their chances of getting things right are about the same as ours.

What we can learn from this is that in life, there are things that we can assume, but it is impossible to guess with certainty.

As with all reviews, I will extract some soundbites which give a flavour of what to expect, but remember to expect the unexpected! If I look at 2018 and 2019 the concerns centred around China, US, Brexit and a global recession. Those remain as we enter 2020, although some have eased and been replaced by others.

In 2018, the top ten most read articles were primarily about stock market weakness; the only other stories were about storms and China-US trade. In 2019, 6 of the top-ten focused on US-China trade. The negative headlines seemed to play out in 2018 and it is surprising with all the negative noise in 2019 we managed to get the returns we did.

As we enter a new decade, it is worth reflecting that we are coming out of a nameless era – some might call it the teens or tweenies, but nothing really stuck. An entire decade with no identity, slow growth, escalating populism and melting glaciers.

Often, we focus on the negative and although global growth will be constrained by geopolitical uncertainty, perhaps we are being overly pessimistic. If we were close to a recession, we would expect exuberance within the markets or overheating and higher interest rates. Instead, unemployment rates are at record lows and there is no sign of economic exuberance; neither consumer nor business spending are over the top. We also have the potential for the first phase of a US-China trade deal to be signed. The point being, that for all the negative stories and headlines it might not be as bad as what is often painted.

The last decade wasn't great; we came out of financial crisis battered and bruised, but low interest rates meant that governments had more opportunities to invest and spend. We can expect to see that certainly in the UK, going forward.

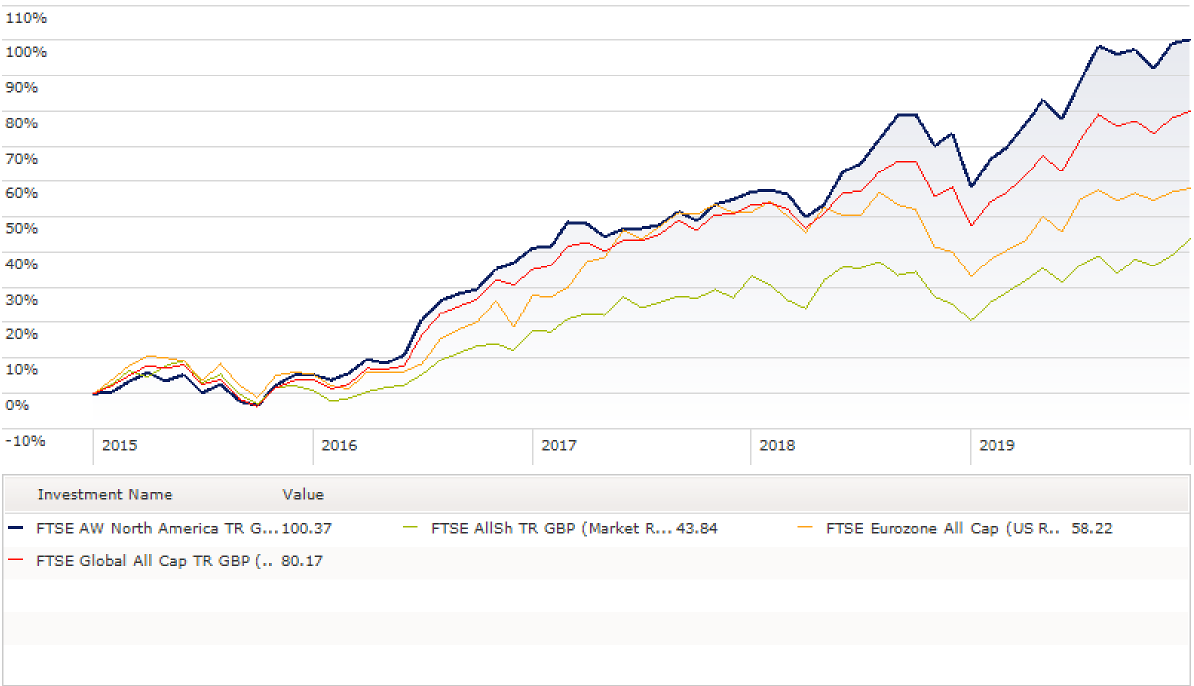
My message therefore coming into 2020 is that there are concerns, and we shouldn't underestimate the unexpected, but if US/China Trade calms down and there is some form of Brexit deal then we could see another positive year for markets. As ever expect volatility but this is not unusual.

George Ladds

George Ladds, Director, January 2020

US, EUROPE & UK

Five year returns 1 January 2015 – 31 December 2019



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Let’s start with the UK. In the last update, I indicated that there was a 32% chance of the Conservatives winning a majority. This shifted very quickly, with opinion polls consistently showing the Conservatives holding their ratings whilst Labour did not. There were two simple messages which Boris stuck to throughout the campaign: “Get Brexit Done” and “Stop Corbyn”.

This was a simple message which clearly appealed to many people; the biggest shift was traditional Labour heartlands moving to the Conservatives. Where we anticipated the battles between the Conservatives and Liberal Democrats this just didn’t happen, because the Liberals effectively removed the chance of a second referendum. Labour could have capitalised on this, but their message was confusing. Whatever Corbyn and Momentum say, this was their worst election result since 1935 and although Brexit had a part to play, the reality is that people just didn’t believe in Corbyn.

Labour have a long road to travel if they are going to get back into power. Although Kier Starmer is favourite to take over, we would not be surprised if he doesn’t win the leadership simply due to the power of Momentum within the party.

We start the Brexit withdrawal process at the end of January, and then we have all the trade discussions with a hard deadline of the end of the year. This has muted sterling strengthening, as there remains a possibility that we leave with no deal. Evidently, the Brexit train rumbles on.
In the bounce of 2019, the UK was one of the weakest returning markets, but it still garnered a healthy return of 19%. Domestic stocks led the gains and the FTSE 250 was up 29% with 10% coming in the 4th

quarter. The UK has undoubtedly suffered from three years of uncertainty which in turn means lost investment. The economy can only tread water for so long and the costs of this in terms of lower trade and foreign investment will be felt for some time.

The general view is that growth will remain weak and sentiment subdued. Risks are skewed to the downside. Inflation remains low and could drop further which is good for the consumer. Interest rates I thought might go up slightly this year, but it seems that this is unlikely and could come down.

Having said all of that, low interest rates are enormous cash windfalls for governments; the Conservatives have already declared that austerity is well and truly over. We can therefore expect them to spend on infrastructure; I think there are 40 hospitals to build! We will likely see more recruitment drives, especially in the police and health sector. Although this doesn't change the picture in terms of trade and foreign investment, it does provide some positives to the economy. You also have five years of a government with a sizeable majority, and currently no strong opposition.

The Eurozone growth was lacklustre in 2019. One surprise was that Germany was expected to drop into a technical recession but managed to pull out 0.1% of growth in the third quarter. This seems to have come from household and government consumption. Net trade improved, and corporates grew investment in construction.

Spain, the Netherlands and Belgium all achieved growth as did France and Italy. It shouldn't be forgotten that the Eurozone relies heavily on exports, and if the trade war tensions ease then this would lessen the drag and growth would improve. But Christine Lagarde, the President of the ECB, may find herself with little choice than to pursue negative interest rates if European activity and inflation fail to pick up.

Politically Italy saw a vote of no confidence which backfired with the Prime Minister forming a new coalition between the Five Star Movement, Democratic Party and Free and Equal. This was a relief for investors who were concerned about the League Party and their Eurosceptic views. In Spain, elections were held in April which produced a stalemate; another election was held in November with the same result. There will be a confidence vote, and nothing is certain.

The US markets were the strongest last year. It is worth reflecting that the last 8 instances where the S&P rallied over 20% in calendar year, the index rose the following year with a medium return of 15%. Furthermore, equity returns in January have historically been stronger than average and positive in 65% of cases over the last 90 years.

The main market influencers to watch are:

1. Impeachment
2. Democratic nomination
3. Election
4. China-US trade
5. Iran

On the impeachment trial, Trump must attend. However, his is conducted by the Senate which is 2/3rds controlled by Republicans so it is highly unlikely they will impeach their own president.

The big date for the diary is the presidential election on 3 November.

It is likely Trump will get the Republican nomination but for the Democrats it is less certain; Joe Biden (centrist candidate), Elizabeth Warren or Bernie Sanders (both from the left wing of the party). Biden and Warren are advocating some radical policy changes, including an overhaul to the health care system, breaking up big banks and tech firms, banning fracking and imposing wealth taxes and higher corporate taxes.

Nothing is certain in the race, so other candidates to watch are Pete Buttigieg, Kamala Harris and Michael Bloomberg. By the end of March, we should have a clearer picture as to who will stand for the Democrats. The debates take place in September and October so plenty of fun and games to come!

It is worth adding that ¾ of incumbent presidents have been re-elected going back to 1932. An incumbent president has never failed to win re-election unless a recession has occurred during their time in office, although Trump's approval ratings are lower than any other re-elected President.

So, it seems likely Trump will get re-elected, but it is unlikely he will regain the House of Representatives, and that the Senate shifts to a Democrat majority. Gridlock is not a bad thing as it is a restraint against more radical proposals on both sides.

Although we indicated the probability of a positive year for the S&P 500 it is worth adding it tends to be more volatile in the run up to the election, and then markets tend to respond more positively when a Republican president is elected.

In terms of trade, in theory Phase 1 will be signed in January and then we can move to Phase 2. At the time of writing, the text of a "Phase 1" deal between the US and China had been agreed by both sides. That included the US cancelling 15% tariffs on about $150bn of Chinese goods due on December 15th and halving the tariff rate to 7.5% on goods worth about $120bn. This came into effect in September while a tariff of 25% on around $250bn in Chinese imports remains in place. In exchange, the Chinese also cancelled tariffs that were due to be implemented on December 15th and agreed to substantially increase their imports of US agricultural, energy and other goods and services over the next two years, as well as tighten laws on technology transfer and intellectual property rights.

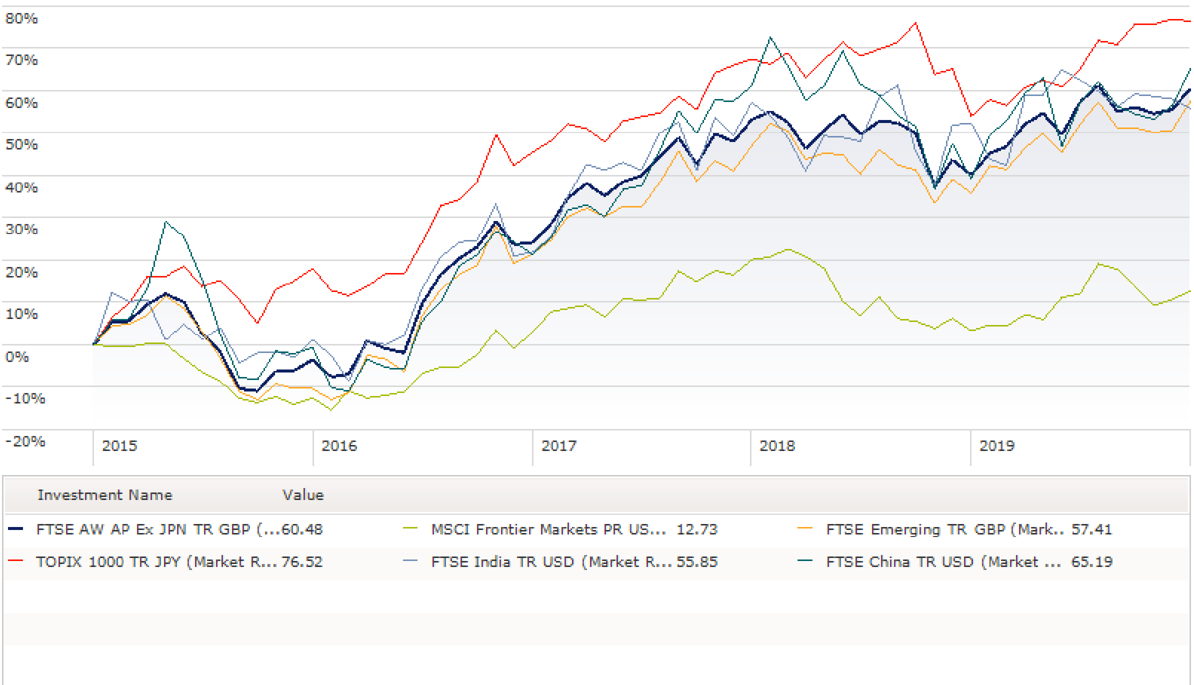
The last cold war between the US and Russia lasted decades; this is only the beginning and many areas will not be resolved quickly. But if this is signed it will ease concerns.

Perhaps more cynically, if the US-China spat eases, Trump needs a new target and Iran is perfect for that. As I am writing this, Iran has bombed US bases in Iraq; what happens next, we wait to see. The markets don't currently seem fazed, but oil prices are going up.

In conclusion, in the US, January is the 128th consecutive month of growth, which is on average 2.6% and unemployment now stands at the lowest level for 50 years. Interest rates have come back down. Most of the headlines will be around trade, Iran and the Presidential race. If history repeats, then we could see positive returns from the US in 2020. The UK is far from out of the water, but we have a government with a significant majority and a willingness to spend. In Europe they will welcome a lessening of the trade tensions.

EMERGING, ASIA AND FRONTIER MARKETS

Five year returns 1 January 2015 – 31 December 2019



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We have already covered the trade wars. The table from Barclays shows real returns from the UK and US.

Real Investment returns, average p.a	UK equities	US equities	UK gilt	US T bond	UK cash	US cash
10 Years	5.8	10.4	2.7	2.0	-2.5	-1.5
20 Years	2.0	3.6	2.5	3.8	-0.1	-0.4
30 Years	3.9	7.0	4.6	5.2	0.4	0.8
50 Years	4.7	5.3	3.2	3.7	1.1	0.5
90 Years	4.9	6.5	1.3	2.5	0.7	0.4
2019 (est)	12.0	25.4	5.5	5.4	-1.2	-0.5
Current nominal yield	5.0	1.9	0.8	1.8	0.75	1.75

The argument is that very few parts of the developed world have the capacity to deliver growth over 2% because of demographic headwinds. Therefore, investors will likely turn to emerging markets to bolster returns. These economies are not exempt from population pressures, but incomes are rising rapidly and increasing numbers reaching middle class status. More households are buying their first homes, cars, appliances and using financial services.

So, not only are investors potentially looking to these regions but any form of trade resolution could deliver significant upside.

Once again, the best performing equity market was Venezuela but with a more modest return of 4,604%. Unfortunately, when converted to US dollars that becomes -36%, making it the worst performing market, followed by Chile, Nigeria and Argentina. The best performing equity markets when measured in US dollars were Greece, Russia and Romania.

Taiwan elections

The incumbent President Tsai (Democratic Progressive Party) is likely to be re-elected in the Taiwanese January 11th presidential elections. Her party benefited from stronger economic data in recent months thanks to the US-China trade war, which redirected some manufacturing to the island.

Hong Kong

The Hong Kong protests have also helped the independence-leaning party to gain ground over rival and more China-friendly opposition party. In Hong Kong, the protests that started in June 2019 are due to continue in January as the pro-democracy protesters now have more political capital since the landslide victory at the Nov-19 local elections. The domestic issues, coupled with the US-China trade war, have had a sharp impact on economic activity and job losses. The Chinese authorities have so far been relatively quiet but that might change after the Taiwanese elections.

Turkey – US sanction risk

Turkey's purchase of the Russian S-400 missile defence system – together with the October military operation in Northern Syria – has increased significantly the risk of sanctions from the US Congress. These could come in the form of visa bans for officials and asset freezes for state-owned bank Halkbank (Iran-related sanctions). The US also threatened to close down two military bases in South-eastern Turkey. It remains unclear whether the US is willing to also implement broader financial sanctions on the banking sector as a whole, similar to what they did with Russia after the annexation of Crimea. Given Turkey's banking sector's huge need for short-term external funding, the latter option would bring material disruption to the Turkish economy. As a result this is less likely because an implosion of Turkey would not be good news for either the European Union (Syrian refugees agreement with Erdogan) or the US (Russia would likely increase its influence in the region). Policy mistakes are another key risk, such as an aggressive monetary and fiscal easing to achieve the government's unrealistic 5% growth target for next year. Bond spreads in Turkey, whether sovereign or corporates, have rallied hard in late 2019 and barely reflect either policy-making or US sanction risks. Asset prices leave little room for error in 2020.

India/Pakistan

India PM Modi's new Indian Citizenship Law passed in December 2019 and has incorporated religious criteria for refugees or communities seeking naturalisation. The law provides facilitated eligibility to become Indian citizenship to Hindu, Jain, Parsi, Sikh, Buddhist, and Christian minorities – but not Muslims – from Afghanistan, Pakistan and Bangladesh. Widely criticised, the new law has been the subject of mass protests across the country and in particular in majority-Muslim state territory Kashmir. Early 2019, the region again saw an Indo-Pakistan military standoff after a vehicle-borne suicide bomber killed over 40 Indian forces in February. On the economic front, Pakistan (credit rating B3/B-) is also under pressure after GDP fell sharply in 2019. The IMF programme requires aggressive fiscal and monetary targets which already have resulted in anti-government protests. Any escalation of geopolitical risk with India would not be welcome.

Russia/Ukraine

Will last year's good news carry on in 2020? The conflict between Ukraine and Russia which started in 2014 after Russia annexed Ukraine's Crimea peninsula – death toll of 13,000 to date – has considerably improved since the Paris Summit on 9th December. Presidents Putin and Zelenskiy agreed to fully implement an existing ceasefire and on 29th December a long-awaited prisoner exchange of 200 prisoners happened. Mid-December, after many months of negotiations Ukraine (through Naftogaz) finally signed a new gas transit contract with Russia (Gazprom). This should indirectly help Ukraine's budget as Naftogaz is a state-owned entity. The IMF programme and reform agenda of new President Zelenskiy are other positive factors.

Asia/Emerging Markets is not one country, there are many different economies with different opportunities. We will no doubt write more on China in the coming months but for now we want to wait to see the outcome of the trade talks. It is worth adding that the trade dispute has benefited other economies including Taiwan and Vietnam. Equally US firms have moved manufacturing bases to Asia to avoid tariffs, Tesla is one that has recently seen the first of its Chinese made cars coming out of the factory.

In Brazil, the pensions reforms should boost confidence and investment and the central bank has been cutting interest rates. Russia has insulated itself from the global economic cycle through fiscal prudence and foreign exchange intervention and seems happy with very modest growth.

In summary, a lot can change in a relatively short period of time in this region. An easing of the trade conflict could have significant upside benefits. If there is an easing of tensions in Hong Kong and Turkey, this could all be positive. These regions have lagged in terms of returns and if there is a feeling that developed economy returns will slow, then it seems natural these regions offer the greatest potential moving forward.

CASH

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We are in an environment where interest rates are staying lower for longer. It is likely the government will use this to invest in the UK economy. Rates might go up slightly, but the odds are very much towards them remaining as they are or evening reducing.

Even with inflation coming back a small amount, it is still a negative asset class. It is therefore becoming less of a justification to hold large sums of cash unless it is required for short-term needs.

The days of 6% interest on cash is gone for certainly the next 10 years and may be a lot longer….

CONCLUSION

The issues going into this year remain: China, US, Brexit and recession. If the deal is signed in January, then the trade war concerns will drop back slightly but there is still a long way to go.

That said, the onset of global recession seems to have abated. The usual indicators are absent, although the unemployment figures are at record lows, there is low inflation, low interest rates and certainly no market exuberance. It doesn't mean the markets don't have negative periods, we have seen big market selloffs in 2015, 2016 and 2018. The reality is that unless there is strong growth, market exuberance and rising rates, the chances of a near term recession are unlikely.

The UK has effectively come into 2020 with political stability, something it has not really seen for nearly a decade. It doesn't mean Brexit is done although the difficult discussions can now begin. The economy has suffered, and it will take time to recover but government spending shouldn't be ignored.

If China and the US become buddies then Trump needs a new enemy; enter Iran. How this escalates is difficult to say at this stage, but if Trump can go to the election with a trade deal and seeming to have dealt with Iran, this will be massively positive for his chances of getting back in.

We can see where there is potential for the market to react negatively, but we have to remember that it is the 'unexpected' that causes the most damage. The year has the potential to be positive but there are many factors in play, which will likely make the year volatile, with plenty of twists and turns. Whether these are enough to make this a negative year, only the next twelve months will tell!!

Source: Charts have been sourced from Morningstar. Other data sourced from First Trust, Invesco, M&G, Hermes, JP Morgan, 7IM, and Schroders. Any reference to a fund or share is not a recommendation to buy or sell that asset. Past performance is no guide to future performance and investments can fall as well as rise.