INVESTMENT REVIEW – February 2020

VINTAGE ASSET MANAGEMENT

Investor confidence was rattled in January first by events in the Gulf and then by the new coronavirus outbreak even as the US signed a compromise agreement on their trade dispute with China and as corporate earnings generally met expectations. Equity markets mostly started the year well but then faltered, while fixed interest holdings rallied as bond yields again contracted.

Early in the month the US assassination of the Iranian general Qassem Suleimani raised concerns that the dispute in the region would escalate, although the reprisal for now was relatively subdued from the Iranian regime, which also faced protests over its downing of an Ukrainian Airlines jet which killed all 176 on board. The price of oil rose sharply then subsided, before coming under pressure as did wider markets on concerns over the potential impact on the global economy of the coronavirus that emanated in China from Wuhan, a city of 11m of whom a reported 5m had left for the new-year holidays or fled before the imposition of a quarantine.

China was a feature not just in the origin of this latest virus, in an illegal market with a wide variety of wild animals, but also for a population that is increasingly mobile and a government that is still mostly authoritarian. It imposed the largest quarantine in history while also being a little more forthcoming in announcing the apparent risks, in identifying the pathogen and in sharing its genetic code. The draconian measures will restrict economic growth, already down to an annual rate of 6% so barely half the rate it was in 2003 when a previous strain of coronavirus, the severe acute respiratory syndrome or SARS, led to a sharp contraction in quarterly growth (if followed by a swift recovery). Then China accounted for some 4% of global GDP whereas in 2019 this had risen to 16%. The SARS outbreak caused 774 deaths, similar to those arising from another variant in 2013 in the Middle East respiratory syndrome; the Ebola virus always seemed more ominous but with less impact. Much will depend on how widespread this new virus turns out to be and its fatality rate, which some have reported to be at 3% similar to the devastating influenza epidemic that followed the First World War. There is some genuine concern given the uncertainty but also scope for bouts of panic in which a sense of perspective is lost: a bad flu season in the US in 2017-18 caused 60,000 deaths, for example. For now the issues have impacted markets, which were vulnerable to a correction after a strong run.

Meanwhile the UK left the European Union forty-seven years after joining the Common Market, with not much of a bang and hardly a bong but some celebration. The country is for now in a sort of limbo period in the eleven months to 31st December by when it should aim to sign a trade agreement. In parallel the government of Boris Johnson will be looking to reach a deal with other countries including the US, although the special relationship has been under pressure over plans for a tax on digital services, which would impact US technology giants, and the decision to allow the purchase of 5G telecoms equipment from Huawei, seen by the Americans as a security risk. There may be a range of challenges: in particular, while farming and fisheries may make up less than 1% of GDP combined they are symbolically important sectors. The Bank of England opted to keep interest rates unchanged although its Monetary Policy Committee said it was ready to cut them if the post-election bounce in confidence loses momentum. The rate of inflation fell to its lowest level in three years in December at 1.3%, and retail sales declined again, in now the longest period of falls since records started in 1957.

The US economy has been robust but growing at 2% rather than the 3% targeted by Donald Trump, for whom the impeachment proceedings will be replaced by a focus on the first caucuses in the build-up to the election in November and on dealings with China after the first-phase agreement. The Chinese economy grew in 2019 at its slowest rate since 1990 at 6.1% with barely 6% in the last quarter; the country has been facing longer-term issues in lower secular growth and a declining birth rate, which reached a record low ratio of 1.05, about half the rate needed for a population to remain stable. India saw a day of protests at stagnating living conditions as well as continued unrest over its new citizenship law, which has antagonised Muslims; the inflation rate reached 7.3% in December, the highest level in over five years (a three-fold rise in onion prices accounting for almost a quarter of that). In Continental Europe GDP fell in the fourth quarter in both France and Italy; inflation has increased if still standing some way off the target rate of 2% for the European Central Bank, which is expected to provide a further stimulus, potentially with a focus on the environment.

In the UK the FTSE 100 fell by 3.4% over January to end at a level of 7286, a return that also reflected the resilience of Sterling as interest rates were not cut. The mid-sized companies in the FTSE 250 index also fell 3.4% in the month although the FTSE SmallCap index was more resilient with a decline of 0.9% as was the FTSE AIM All-Share at -0.8%. The FTSE All-Share return was -3.3% in the period.

In the US the S&P 500 faded to end January with a decline of 0.2%, helped by the large technology shares which contributed to a rise of 2% in the NASDAQ index although at a closing level of 3,226 it was short of the 3,498 at which the current bull phase (defined as a period without a fall of a fifth) would surpass the 1990s for the largest rise as well as the longest. The Dow Jones Industrial index lost 1% and smaller companies, as represented by the Russell 2000 index, fell 3.3%.

In Europe the EURO STOXX 50 fell by 2.8% in the month, with the French market weakest, while the Euromoney index of smaller companies fell 1.5%. In Japan the Nikkei 225 lost 1.9%.

The MSCI Emerging Markets index in US$ struggled in the month and lost 4.7% given the issues in China, whose mainland markets remained closed at the month-end but opened sharply lower this week. The Hang Seng index in Hong Kong fell 6.7%. The MSCI Frontier Markets index was flat in the month although the Vietnamese index was down by 2.5%.

In the bond markets the UK 10-year gilt yield fell back in the period from 0.82% to 0.52% and the total return for the FTSE Gilts All Stocks index was a robust 3.5% in the month. In the US the 10-year yield also fell, from 1.92% to 1.51%, and it is again lower than the 3-month yield, while in Germany they turned more negative again at a level of -0.43%. The month saw positive returns from government and corporate bonds although the riskier high-yield and emerging market debt indices declined.

Sterling was stronger in the latter part of the month but in all was down 0.4% against the US$ to close at a rate of $1.32:£ and up 0.7% against the euro at €1.19:£. The price of gold rose by a further 5% in the month to end at $1589 per troy ounce helped by the global uncertainty if also by the fall in US real yields and the shift to negative bond yields; central banks bought 650 tonnes of gold in 2019, their second-highest amount in fifty years. The price of Brent oil was 15% lower over the month at $56 per barrel given concerns over a slow-down in growth. The bellwether copper price was down 10% although palladium was higher as was rhodium, also in demand for its use in catalytic converters. The main agricultural commodities were mixed in January. The Vix index gauge of expected volatility in the US market rose by a little over a third.

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