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Newsflash

A new month and the 154th issue of Viewpoint from **Imperium Capital**.

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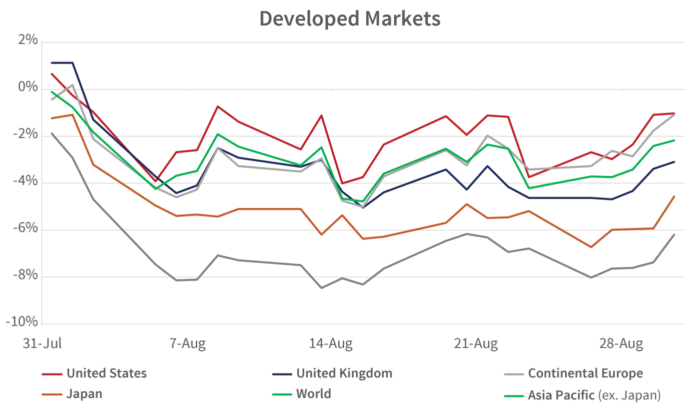
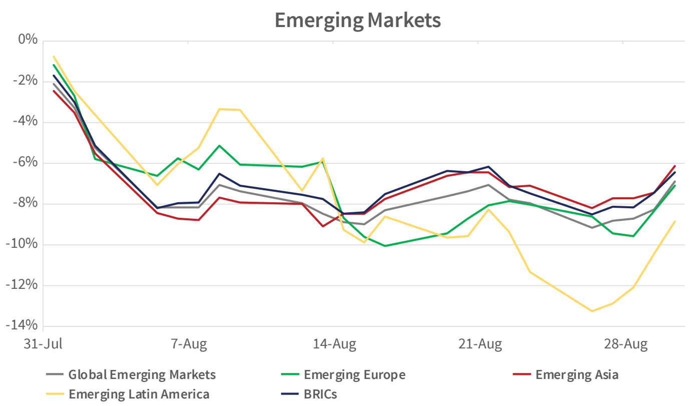
Market Commentary

The nervousness which had been creeping into markets during July intensified in August, with growing fears of a more broadly based global economic slowdown than the manufacturing contraction evidenced in the past 9 months. Equities fell sharply across the board, with the largest falls in the most economically exposed sectors and financials, the latter suffering from the dramatic shift down in interest rate expectations in recent weeks. In contrast, safe-haven government bond markets rose sharply, taking yields in many cases to new all-time lows. In the same vein, industrial commodity prices fell sharply, with the key iron ore price falling by 24% in the month, whereas precious metals rose; gold was up 7.5% in August, taking its rise this year to 19%, while silver did some catching up with gold, rising 13% in the month, bringing its rise this year in line with gold.

A similar pattern was evident in currency markets. The safe-haven yen rose 2.4% in the month, whereas those countries most economically exposed to a global slowdown suffered sharp currency falls: emerging currencies were down by 4% with by far the most important, the Chinese RMB, down by 3.6%, below the politically sensitive 7 to the US dollar and its lowest since before the financial crisis. The subsequent branding of China by the US as a currency manipulator represented another material escalation of the trade war in a month when the mood over the US-China trade wars turned much uglier.

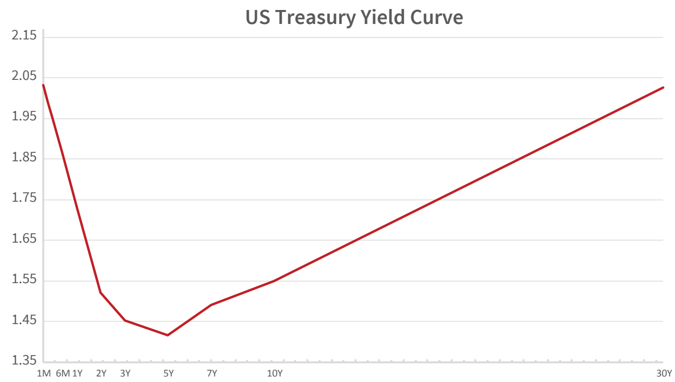
Unsurprisingly in a month when the economic news was almost universally gloomy, with further evidence of the global manufacturing recession and continuing weak forward-looking indicators, emerging markets led the falls. Whereas the developed world equity index, MSCI World, fell by 2%, emerging markets were down by 5%, leaving them up only 4% year to date compared with a 15% rise in developed markets. In bonds, emerging markets were one of the very few sectors to fall in the month, with a return of -2.7%, compared to a 3.6% positive return from US Treasuries.





It was in fixed income that the most remarkable moves took place. Worries about recession and continuing low inflation, together with the change in interest rate expectations and shift to easier monetary policy across the world led to extraordinary moves in bond yields. The yield on the 10 year US Treasury bond fell by 50bps in the month to 1.5%, very close to its all-time low of 1.36%. The 30 year Treasury yield fell below 2% for the first time as investors stretched for yield, and the yield curve inverted across most of the curve, including the widely watched 2 year-10 year, which is often seen as a reliable indicator of a forthcoming recession. Elsewhere yields fell to new all-time lows, and even more extraordinarily, the amount of negative-yielding debt in the world reached $17tn with several countries, including Germany, Switzerland and the Netherlands, now having no positive yielding government bonds. Reflecting this, Germany issued its first-ever zero coupon 30 year bond, yielding -0.1%. There are now only 5 developed countries, the US, UK, Canada, Australia and New Zealand, which do not have negative-yielding bonds anywhere along the curve.

To say that this is not normal is an understatement, and it raises considerable questions about the longer-term unintended consequences of central bank policy. The negative impact of extremely low and falling interest rates on profitability of banks and insurers resulted in sharp falls in financial stocks, which were among the weakest sectors in August; this is giving rise to wider misgivings and uncertainty about the extent to which monetary policy can be eased further, especially in the Eurozone and Japan where the problems are most acute. But for the time being there is no doubt that the course is set for easing by the major central banks as well as many others around the world that have already reacted to weaker growth by cutting rates.



The next policy shift which is likely is some easing of fiscal policy to support growth; with interest rates at all-time lows the case for borrowing to spend is becoming more appealing to governments, including even Germany, where politicians have reacted to the fall in GDP in Q2 and their deep manufacturing recession by discussing the possibility of a significant fiscal injection. The UK government has also called an end to austerity and is planning to lift spending materially in real terms in the coming year. Other countries could well follow in due course.

The escalation in the US-China trade war was a major factor in undermining markets in August. Increased tariffs, retaliation and counter-retaliation were a feature of the month as the rhetoric deteriorated, and talks floundered. The impact of the tariffs now in place, as well as the uncertainty generated by the failure to reach a compromise, is undoubtedly holding back trade, business investment and confidence, but it remains the case that both parties need to reach an agreement and a likely resumption of talks helped to support markets at the end of August.

Other factors that had damaged markets during August also showed signs of easing as the month drew to a close. The messy Italian political situation appeared to be moving towards a new coalition government which would keep out the far right, at least for the time being, while the democracy protests in Hong Kong, which have seriously damaged the economy and the stock market, are leading to concessions by the government, including scrapping altogether the deeply unpopular extradition law which triggered the protests, as well as opening the door to broader discussions about protesters' concerns.

Less clear is how the ongoing issue of Brexit is ultimately resolved. The political situation in the UK is so fluid that predicting what might happen tomorrow, let alone the outcome, is near impossible. However, it appears certain that the only way to resolve the impasse, now that the UK has a minority government with little prospect of enacting its policy objectives concerning either Brexit or domestic matters, is for a general election within the next few weeks. With Boris and the Tories currently well ahead of Corbyn and the Labour party in the polls, the likelihood of a Corbyn led government has diminished but the political situation has changed so dramatically post the referendum that nothing can be ruled out. UK markets, as a result, have remained under a cloud of uncertainty and seem set to continue to underperform the rest of the world until some clarity finally begins to emerge.

We have pointed to the need for greater caution in our recent commentaries and that caution remains warranted. The economic backdrop has deteriorated, corporate earnings are under pressure especially in sectors most exposed to manufacturing, and markets are largely discounting sizeable policy easing by central banks in coming months. But the extent of the global slowdown needs to be kept in perspective; trade and manufacturing are contracting but the service sector continues to grow, albeit more slowly, employment remains strong and the consumer is generally in good shape. There are no signs of systemic financial problems nor capacity shortages, inflation and a sudden tightening of policy. With inflation subdued central banks have considerable flexibility in keeping policy ultra-loose for much longer, thereby extending this extraordinary cycle.

The dramatic falls in bond yields this year, as well as the prospect of policy easing by central banks, provide a strong underpinning to equities and other risk assets, offsetting the more challenging conditions faced by the corporate sector. Against a backdrop of heightened uncertainty, some consolidation in markets has been overdue, but we believe that the cycle has further to run and while heightened volatility in this environment must be expected any further falls in markets will give rise to opportunities to add to risk assets.

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 August 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Developed markets equities						
United States	S&P 500 NR	**USD**	-1.7%	6.7%	17.9%	2.3%
United Kingdom	MSCI UK NR	**GBP**	-4.2%	1.7%	10.5%	1.2%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-0.6%	4.6%	16.9%	3.2%
Japan	Topix TR	**JPY**	-3.4%	0.2%	2.6%*	-10.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-4.4%	0.3%	5.9%	-4.8%
Global	MSCI World NR	**USD**	-2.0%	4.9%	15.2%	0.3%
Emerging Market Equities						
Emerging Europe	MSCI EM Europe NR	**USD**	-6.0%	1.4%	13.3%	13.7%
Emerging Asia	MSCI EM Asia NR	**USD**	-3.8%	0.7%	3.9%	-7.3%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-8.1%	-2.4%	3.6%	8.9%
BRICs	MSCI BRIC NR	**USD**	-4.8%	0.4%	7.4%	0.5%
Global emerging markets	MSCI Emerging Markets NR	**USD**	-4.9%	-0.2%	3.9%	-4.4%
Bonds						
US Treasuries	JP Morgan United States Government Bond TR	**USD**	3.6%	4.5%	9.1%	10.9%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	**USD**	2.6%	3.8%	9.6%	7.8%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	**USD**	3.1%	6.3%	13.9%	13.3%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	**USD**	0.4%	3.3%	11.0%	6.6%
UK Gilts	JP Morgan UK Government Bond TR	**GBP**	3.8%	6.3%	11.5%	11.9%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	**GBP**	1.5%	4.8%	10.1%	9.2%
Euro Government Bonds	ICE BofAML Euro Government TR	**EUR**	2.5%	6.6%	10.5%	12.0%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	**EUR**	0.6%	3.7%	7.6%	6.6%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	**EUR**	0.8%	4.0%	9.5%	5.8%
Japanese Government	JP Morgan Japan Government Bond TR	**JPY**	1.7%	2.6%	4.8%	6.2%
Australian Government	JP Morgan Australia GBI TR	**AUD**	2.1%	4.3%	11.2%	13.7%
Global Government Bonds	JP Morgan Global GBI	**USD**	3.0%	4.7%	8.0%	8.9%
Global Bonds	ICE BofAML Global Broad Market	**USD**	2.3%	4.2%	7.8%	8.2%
Global Convertible Bonds	ICE BofAML Global Convertibles	**USD**	-1.1%	3.7%	10.7%	1.9%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	-2.7%	2.1%	8.7%	11.0%

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | **) denotes estimate*

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 30 August 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Property						
US Property Securities	MSCI US REIT NR	**USD**	3.9%	3.6%	4.0%*	4.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	0.7%	5.8%	20.4%	13.9%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-3.3%	-2.0%	5.8%	5.0%
Global Property Securities	S&P Global Property USD TR	**USD**	1.0%	3.6%	16.2%	7.6%
Currencies						
Euro		**USD**	-0.8%	-1.7%	-4.2%	-5.3%
UK Pound Sterling		**USD**	0.0%	-3.7%	-4.7%	-6.2%
Japanese Yen		**USD**	2.4%	1.9%	3.2%	4.5%
Australian Dollar		**USD**	-1.6%	-3.0%	-4.5%	-6.3%
South African Rand		**USD**	-5.6%	-4.1%	-5.5%	-3.4%
Commodities & Alternatives						
Commodities	RICI TR	**USD**	-3.6%	-1.3%	3.3%	-8.6%
Agricultural Commodities	RICI Agriculture TR	**USD**	-5.3%	-9.2%	-9.9%	-13.0%
Oil	Brent Crude Oil	**USD**	-7.3%	-6.3%	12.3%	-21.9%
Gold	Gold Spot	**USD**	7.5%	16.5%	18.5%	26.5%
Hedge funds	HFRX Global Hedge Fund	**USD**	0.2%*	2.6%*	5.3%*	-1.3%*
Interest rates						
United States			2.25%			
United Kingdom			0.75%			
Eurozone			0.00%			
Japan			0.10%			
Australia			1.00%			
South Africa			6.50%			

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 August 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Developed markets equities						
UK - All Cap	MSCI UK NR	**GBP**	-4.2%	1.7%	10.5%	1.2%
UK - Large Cap	MSCI UK Large Cap NR	**GBP**	-4.4%	1.1%	9.9%	2.3%
UK - Mid Cap	MSCI UK Mid Cap NR	**GBP**	-3.6%	3.0%	9.6%	-6.4%
UK - Small Cap	MSCI Small Cap NR	**GBP**	-2.1%	-0.2%	13.0%	-6.9%
United States	S&P 500 NR	**USD**	-1.3%	10.8%	23.5%	9.0%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-1.5%	6.9%	17.5%	4.2%
Japan	Topix TR	**JPY**	-1.0%	6.1%	11.2%*	-0.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-4.0%	4.2%	11.0%	1.4%
Global developed markets	MSCI World NR	**USD**	-1.7%	8.9%	20.6%	6.8%
Global emerging markets	MSCI Emerging Markets NR	**USD**	-4.5%	3.6%	8.9%	1.9%
Bonds						
Gilts - All	ICE BofAML UK Gilt TR	**GBP**	3.8%	6.2%	11.4%	11.8%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	**GBP**	0.1%	0.7%	1.5%	1.9%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	**GBP**	1.5%	3.7%	7.1%	8.7%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	**GBP**	6.5%	10.1%	18.8%	18.4%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	**GBP**	4.6%	7.6%	17.3%	18.2%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15 years	**GBP**	2.0%	5.8%	9.6%	12.5%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+ years	**GBP**	6.0%	8.9%	21.5%	21.8%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	**GBP**	1.5%	4.8%	10.1%	9.2%
US Treasuries	JP Morgan US Government Bond TR	**USD**	4.0%	8.5%	14.3%	18.1%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	**USD**	3.1%	6.3%	13.9%	13.3%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	**USD**	0.4%	3.3%	11.0%	6.6%
Euro Government Bonds	ICE BofAML Euro Government TR	**EUR**	2.5%	6.6%	10.5%	12.0%
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Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**GBP**	-2.3%	6.0%	13.9%	18.3%

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 30 August 2019				
		Currency	1 Month	3 Months	Year to date	12 Months
Property						
Global Property Securities	S&P Global Property TR	**GBP**	1.4%	7.5%	21.8%	14.6%
Currencies						
Euro		**GBP**	-0.8%	2.3%	0.6%	1.0%
US Dollar		**GBP**	0.0%	3.9%	4.9%	6.6%
Japanese Yen		**GBP**	2.3%	5.8%	8.2%	11.3%
Commodities & Alternatives						
Commodities	RICI TR	**GBP**	-3.2%	2.4%	8.2%	-2.7%
Agricultural Commodities	RICI Agriculture TR	**GBP**	-4.9%	-5.8%	-5.6%	-7.3%
Oil	Brent Crude Oil	**GBP**	-6.9%	-2.7%	17.7%	-16.9%
Gold	Gold Spot	**GBP**	7.9%	20.9%	24.2%	34.8%
Interest rates						
United Kingdom			0.75%			
United States			2.25%			
Eurozone			0.00%			
Japan			0.10%			

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | *ᵉ denotes estimate*

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