Marlborough International

October 2019

Global Investment Commentary

SUMMARY

October's headlines continued to be dominated by Brexit, with the UK avoiding a no-deal departure by agreeing an extension to the deadline. Before the next steps are agreed, there is the small matter of a festive season general election. Elsewhere, the US Federal Reserve cut interest rates for the third time this year and financial markets welcomed signs of an easing in geopolitical tensions, with the US and China moving closer to agreeing a partial trade deal.

Market Round Up

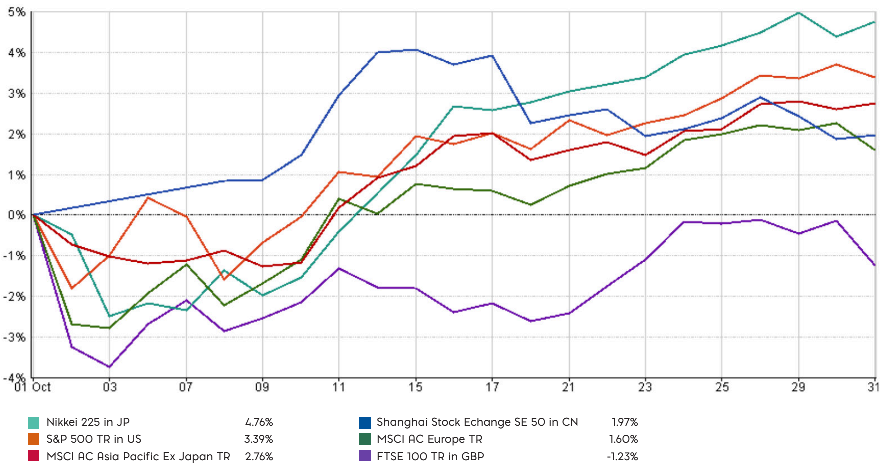
Emerging markets returned 3.06% compared to 2.88% from developed markets during a generally good month for equities. For those that follow the growth versus value debate, growth stocks delivered 3.32%, outstripping value stocks by 0.91%, stretching the lead of growth over value to 10% on a year-to-date basis.

With a market perception that the risk is reducing of the UK leaving the EU without a deal, sterling strengthened against both the euro and dollar. As it is estimated that only 30% of the FTSE 100's revenues are generated in the UK, the currency rally led to the blue-chip index being one of the weaker performing markets, finishing -1.23%.

In the US, the S&P 500 gained a further 3.39% to reach a new high, while European equities posted a positive return of 1.60%, despite data continuing to suggest a slowdown.

Japan's Nikkei 225 rose by 4.76%, while Chinese equities rose 1.97% to produce an astonishing year-to-date gain of 28.85%.

Figure 1: October



Source: FE: data from 01/10/2019 to 31/10/2019

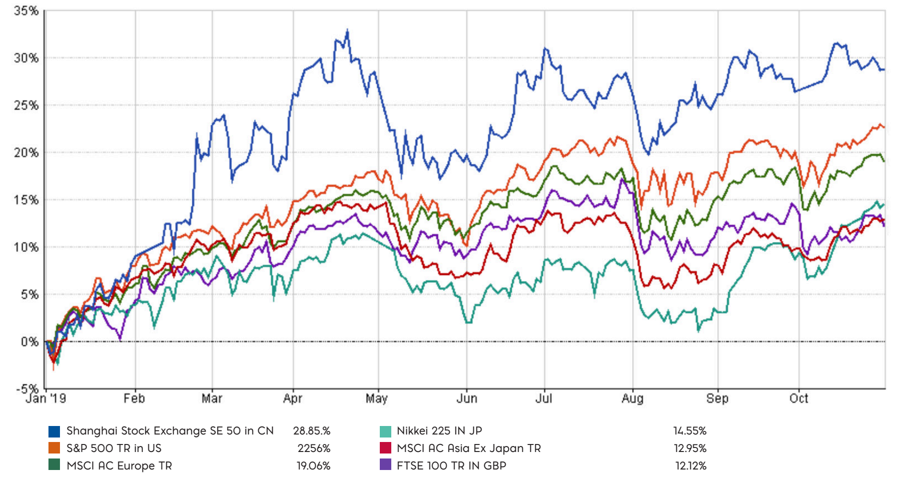
UK - Is this as hard as we are making it?

To the surprise of many, Prime Minister Boris Johnson managed to agree a new Brexit deal with Brussels. He did this by agreeing to put a customs border in the Irish Sea, avoiding the need for a hard border between Northern Ireland and the Republic of Ireland, and for Northern Ireland to remain more closely tied to the European Union (EU) than mainland Britain.

Although the new deal gained more House of Commons support, MPs rejected rushing through legislation in order to leave the EU by a 31 October deadline. It was no great shock that an extension to the departure deadline was agreed to 31 January 2020. The Prime Minister is seeking a parliamentary majority to pass the deal and his wish for a 12 December general election was granted.

Away from the bluster of Westminster, in the calmer world of economic statistics, the UK labour market showed signs of weakening, with the unemployment rate rising to 3.9% in August 2019. The number of vacancies has continued to fall, as has been the case since the start of the year. The next steps for the Bank of England are now likely to be dependent on Brexit. Should uncertainty for businesses and households be further prolonged, an interest rate cut cannot be ruled out.

Figure 2: Year to Date



Source: FE: data from 01/01/2019 to 31/10/2019

US - Keep your friends close

What has been called the 'phase one' trade deal between the US and China involves China committing to increase purchases of US agricultural products, accelerating access to its financial sector and allowing more transparency in respect of currency movements. While it takes the discussions in a more constructive direction, complete resolution may still be some way off.

Polls suggest that US voters remain sceptical about the relative fairness of Chinese trade practices and both sides harbour ambitions to be the number one player in global technology. It's not unthinkable that the pendulum could swing back towards escalation in the coming months if President Trump decides to ramp up anti-China rhetoric to boost support ahead of the presidential election in November of next year.

While financial markets welcomed the announcement of a potential trade agreement, figures from the US continued to suggest that the economy is losing momentum. The weakness remains most pronounced in the trade-dependent manufacturing sector, where the purchasing managers' index (PMI) indicates a contraction. Of more concern is that manufacturing weakness seems to be gradually seeping into the broader economy, with cracks beginning to appear in the US consumer numbers. Consumer confidence fell in October, while the pace of jobs growth has also slowed.

'The implications of global developments' was the official line about the Federal Reserve's decision to cut interest rates by 0.25% for a third time this year, which should mean lending conditions remain supportive. The key question now is whether easier monetary policy will help to avoid consumer confidence and the labour market from deteriorating in the same way as the manufacturing sector.

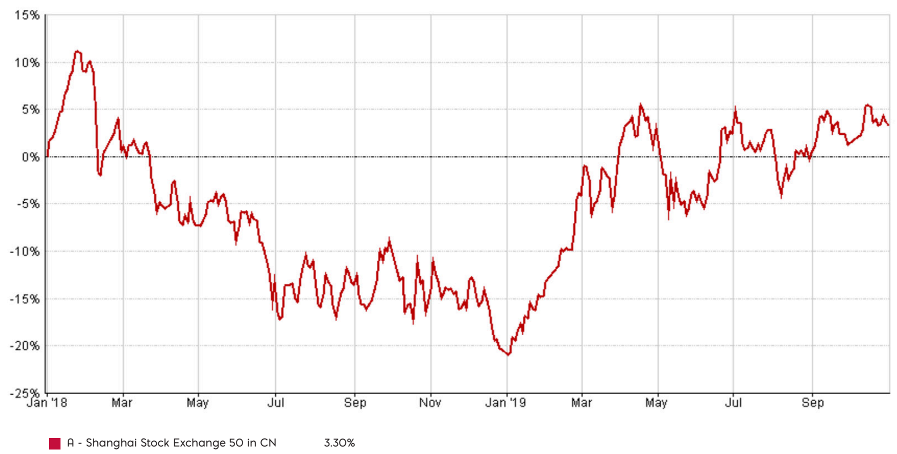
Earnings season for the third quarter is well underway, with companies so far doing better than expected. Earnings per share and sales are generally growing in the S&P 500, however, US companies continue to warn of lower expectations for next year's earnings, with the trade dispute an ongoing theme.

Europe - Bad workmen blame their tools, assuming they have some

It looks fragile. The trade war continues to weigh most heavily in the eurozone, particularly in Germany. This is due to Europe being more heavily dependent on international trade than other regions.

October's European Central Bank (ECB) meeting marked Mario Draghi's final press conference as president. Christine Lagarde, former head of the International Monetary Fund, now takes the reins. Lagarde inherits an ECB tool bag that has few tools left. Interest rates are at -0.5% and quantitative easing is in place until the inflation target is close to being achieved. With few levers left to pull, the challenge will be whether Lagarde can convince governments to loosen the fiscal purse strings to stimulate the economy.

Figure 3: Shanghai Stock Exchange 50 - 1 Jan 2018 to date



Source: FE: data from 29/12/2017 to 31/10/2019

China - What a difference a year makes

It is reasonable for investors to ask why more of their portfolio hasn't been invested in China, with the Shanghai Stock Exchange 50 (SSE 50) index up 28.85% year to date. Context is important though. For those with heavy exposure to China, the dull pain of a 20% hit during 2018 will still be lingering. Unsurprisingly, after a miraculous recovery, figures released in October showed the annual pace of real GDP growth in China eased to 6% for the third quarter, down from 6.2% in the previous quarter. Weaker growth is slowing Chinese demand for imports. However, industrial production and retail sales are more positive. After last month's 0.5% cut in the reserve requirement ratio, the People's Bank of China implemented a second 0.5% cut, with a third likely to follow, collectively releasing 900 billion Chinese yuan (approximately 1% of GDP) into the banking system. The rate cuts appeared to have had the desired impact, with credit data revealing a significant tick up in new bank loans and other financing.

In a world where markets have continued to rise, even when economic and mathematical logic says they shouldn't, investors will inevitably fear missing out on further gains. With markets seemingly driven by narrative more than anything else though, we believe the key to meeting investor expectations is to ensure that they are invested in the right portfolio for the right timeframe.

Marlborough Multi-Asset team
06/11/2019

Economic Projections (31/10/2019)

Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2019	2020	2021
UK	1.2	1.0	1.5
USA	2.3	1.7	1.8
Eurozone	1.1	1.0	1.3
Germany	0.5	0.7	1.2
France	1.3	1.2	1.4
Japan	0.9	0.3	0.8
China	6.1	5.9	5.8
India	6.2	6.1	6.7
Asia	5.4	5.3	5.4
Emerging Markets	4.5	4.6	4.8

Source: Bloomberg

Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2019	2020	2021
UK	0.75	0.70	0.95
USA	1.75	1.50	1.65
Eurozone	0.00	0.00	0.00
Japan	-0.10	0.00	0.00
China	4.35	4.25	4.15
India	4.95	4.85	5.00

Source: Bloomberg

Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2019	2020	2021
GBP/USD	1.24	1.32	1.35
EUR/GBP	0.88	0.88	0.87
EUR/USD	1.10	1.15	1.18
USD/JPY	107.00	105.00	108.00
EUR/JPY	118.00	120.50	127.50
USD/CNY	7.15	7.12	7.00
USD/INR	71.80	70.00	69.60

Source: Bloomberg

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