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INVESTMENT VIEWS

APRIL 2018

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EQUITIES	:	Tech and trade sensitive stocks lead global markets lower
BONDS	:	Core Government debt advances as credit spreads widen
CURRENCIES	:	The HK$ slides towards the lower peg limit; sterling rallies
COMMODITIES	:	Agri prices recover as trade tensions push metals higher

As modern day Central Bankers go, Jay Powell seems cut from a different cloth. His CV describes a generalist, grounded in commerce; banker, lawyer and private equity investor were just some of the roles he filled before assuming the Chair at the US Federal Reserve.

He was preceded by a long line of scholarly types who, anchored in academia, relied on theories and models as their guiding lights. Instead, he brings with him practical, real world experience; a different perspective that could herald a more pragmatic policy regime.

Given this observation, will Powells arrival fundamentally alter Fed behaviour? After all US growth and inflation continue to rub along as the Trump fiscal splurge replaces receding QE as the marginal economic stimulus. Will he stray from the “slow and steady” rate-rise plan bequeathed by Chairwoman Yellen?

At face value, the answer appears to be “no”. Since he began in February he has adhered to the status quo. Having hiked the Fed funds target range by 0.25% to 1.5-1.75% last month, Powell guided that rates will increase twice more this year; in line with most forecasts. His expectation that rates will need to rise three times next year is marginally more hawkish than before, but simply reflects a forecast uptick in growth and prices.

However it is his reaction, or the lack thereof, to recent market volatility where subtle, yet significant differences emerge. During his two month tenure the S&P500 has suffered two meaningful falls; peak-to-trough slumps of 10% in February and 7% last month. Yet Powell seems unperturbed, ploughing on with the rate hike, signalling more to come and eschewing various opportunities to verbally reassure markets.

Unlike Greenspan, Bernanke and Yellen before, who often relented when markets protested less supportive policy, Powell is showing early signs that he will tolerate pain on “Wall Street” as long as he feels Fed policy suits “Main Street” or the real economy. Lest one damns this as reckless, one notes that a 22% fall in the US equity market, from its recent peak, would only unravel the gains of 2017. A 26% tumble takes the index back to early-2015 levels.

If one disregards some of the noise, the recent gyrations are a perfectly normal late cycle narrative of rates rising to stop an economy overheating. Assuming US inflation continues to drift higher, as the delayed impact of the weaker dollar and Trump tax cuts stimulate an economy near full capacity, the Fed will be predisposed to persevere with its planned rate hikes. This would gradually drain liquidity from the system at a time when bond and equity valuations are historically elevated. With a less market-friendly Fed Chairman at the helm (and US/China trade relations deteriorating), US stocks look exposed.

Given this backdrop the breakdown in large US tech names assumes greater significance. The 5 FAANG's (Facebook, Apple, Amazon, Netflix and Google) account for 14% of the S&P 500 and have been an outsized driver of headline index returns. Indeed, for the 14 months to end February 2018, the FAANGs plus Microsoft accounted for 30% of the return from the S&P500 (source: Morningstar, Seeking α). As this bull market matures, the return drivers have become increasingly concentrated.

As we have touched on before in these pages, the big tech hegemony is now under threat, with regulatory and compliance concerns cutting billions of dollars off FAANG valuations last month.

A cautionary tale for the likes of Google and Twitter, the data incontinence at Facebook (FB) serves to illustrate. Having formally agreed with the Federal Trade Commission (FTC) in 2011 on how to handle user data, the transfer of 87 million FB users data to an App researcher and thence to Cambridge Analytica (a UK political consultancy) seems to contravene FBs privacy rules and the FTC agreement. If so, the FTC fines could run to hundreds of billions of dollars and threaten the unconstrained business use of sensitive client data; a fundamental challenge to the business models of many platform companies.

Of equal import, users are now more conscious of how these platform companies harvest and monetise their personal data, leading people to reconsider the frequency of their engagement. Less user interactions threaten the advertising revenue lifeblood and, as the mood music changes, the promise of super-normal returns in the future will be questioned; nervous investors will demand profits today.

Admittedly this will not happen overnight but, as public and political opinion sours, monopolistic power will be challenged; put simply, if you want to disengage with FB or Google, what are the realistic alternatives? Like the 1911 break-up of JD Rockefellers Standard Oil or the division of AT&T into the "Baby Bells" during the Reagan years, large tech is increasingly seen as a poor steward of their market dominance attracting the anti-trust focus of global authorities. Aggressive tax planning, that engineers an ultra-low effective tax rate for many of these corporates, is also coming under scrutiny. The EU is already proposing a 3% levy on the online revenues of the likes of Google whilst Trump's anti-Amazon tweets also referenced tax; "Our fully tax paying retailers are closing stores all over the country…not a level playing field".

Finally, pie-in-the-sky P&Ls will be questioned. The poster child for this must surely be Tesla. Elon Musk's electric car company lost $2bn in 2017 and had negative cash flow of $3.5bn; it produced about 100,000 cars. By comparison, Ford produced 6m cars, made $7.6bn of profits and has $12bn of cash at the bank; Ford's market cap is the same as Tesla. Will Musk's April fool Tweet, that Tesla is bankrupt, yet prove prescient?

As investors shift to a "jam today" rather than a "jam tomorrow" mentality and stretched valuations meet rising interest rates, safety may finally best speculation. S&P500 – caveat emptor.

IN OTHER NEWS…

Stephen Hawkins died on 14th March, aged 76. Resident at Cambridge University, he found fame as theoretical physicist, cosmologist and author. His book, 'A Brief History of Time' appeared on the Sunday Times best seller list for a record 237 weeks. Suffering from the degenerative motor neurone disease, he was forced to rely on a speech generating device to communicate; in his final years he operated it using a single cheek muscle. A few quotes from this inspirational figure.

"I have noticed that even people who claim everything is predetermined and that we can do nothing to change it, look before they cross the road."

"There is a fundamental difference between religion, which is based on authority, [and] science, which is based on observation and reason. Science will win, because it works."

And referring to the actor who portrayed him in the 2014 biopic about his life, The Theory of Everything, he said "Unfortunately, Eddie (Redmayne) did not have my good looks."

Finally, the comedian Ken Dodd also passed on in March. Referring to his tax fraud trial, the Liverpudlian quipped "In the 1800s, one of the MPs in London decided to introduce tax. In those days it was 2p in the pound. I thought it still was!"

EQUITIES

Equity markets had a tough month. The S&P 500 fell by 2.7% whilst the tech-heavy Nasdaq index lost 2.9%. Investor sentiment was damaged by trade war talk and a raft of negative news for technology firms. It is interesting to note that the darlings of this bull market are now starting to underperform a falling market; this has not happened in prior corrections.

Global trade tensions are escalating. The Trump administration announced a series of new import tariffs aimed squarely at China. US$60bn of Chinese steel and aluminium imports are "in scope" for tariffs of up to 25%. American allies such as Canada, Mexico and the EU were given a temporary exemption. At face value, the new sanctions make very little sense. Bureau of Economic Analysis data suggests that the U.S. steel industry accounts for around 0.8% of GDP, while industries that use steel as a primary input account for around 3% of GDP in value-added terms (source: PIMCO). The US Chamber of Commerce warned that unilateral tariffs on Chinese goods would damage US growth, with resultant price increases acting as a tax on consumers.

China responded by imposing tariffs on 128 US food imports at a rate of up to 25%. This was a surgical strike aimed at some of Trump's biggest supporters: American farmers. China is the second biggest customer for US agricultural exports after Canada. Interestingly, valuable US soya bean exports were initially excluded from the sanctions, but were subsequently added in early April. This was unexpected given Chinese reliance on the US for this bedrock foodstuff.

Trump's top economic adviser and free trade advocate, Gary Cohn, was quick to resign. Without Cohn in the picture, Trump's trade adviser Peter Navarro will have a clearer run at a more protectionist agenda. With the sacking of Secretary of State Rex Tillerson (the man who allegedly called Trump a 'moron'), independent voices are increasingly absent from Trump's entourage.

Technology shares were under the spotlight this month for a host of reasons. Facebook shares plummeted by more than 10% during March after reports that British political consulting firm Cambridge Analytica harvested private information from over 87 million Facebook user profiles without permission. Founder and CEO Mark Zuckerberg eventually admitted to short comings in their use and protection of user data. As noted in the lead article, platform companies probably face a more regulated future, with growing threats to their market power.

Other technology darlings in the news included Amazon and Tesla. Amazon (who's founder owns the Trump baiting Washington Post) came under twitter attack from the President for costing the US postal service "many billions of dollars". Amazon fell by 9% this month but remains 24% higher this year. Tesla dropped 22% after its bonds were downgraded; the yield on their 2025 debt, trading at 3.4% in mid-2016, touched 7.6% in mid-March. The company is reportedly burning through $6,500 every minute and will likely run out of cash by year end; future finance will come at a price.

Outside of the US, there were few places to hide as markets moved in lockstep. The FTSE All Share lost 2% and is now down 8% from the start of the year; mid-month, the FTSE100 touched a level seen in 1999. Germany and France were down 3%, whilst the Australian market fell by 4%.

The Japanese Topix fell by 3% with Prime Minister Abe in the spotlight once again. PM Abe and his wife have been linked to the Moritomo Gakuen scandal in which public land was sold at a knock-down rate to a school operator. Mrs Abe was honorary Principal of the school which promoted a nationalist curriculum favoured by her husband. It now appears that Finance Ministry officials altered documents to remove references to the PM and his wife. The episode has cost the politician over 10% in polls. The principal threat to Abe comes from his own party as he has to stand for re-election as leader of the LDP before the end of September; the opposition parties remain in disarray.

Encouragingly, emerging markets have proved reasonably resilient so far this year; although the MSCI EM index lost 2% in March, it is flat since the start of the year (aided by weakness in the US dollar). In particular, commodity export countries such as Brazil have made large gains this year; the Bovespa index is up 12% in 2018.

BONDS

The US Federal Open Market Committee announced a further 0.25% increase in rates, taking the target range for short rates up to 1.5%-1.75%. The move was as expected. New Fed Chair Jay Powell was closely watched at his first press conference for any signs of divergence from previous policy. The Fed forecast at least two more hikes in 2018 and three more in 2019. Mr Powell said the central bank would be staying on the path of gradual rate increases and would be watchful of inflation. The Fed upgraded its outlook for growth and unemployment; the economy is expected to expand by 2.7% in 2018 and 2.4% in 2019, with unemployment forecast to fall to 3.6% by the end of 2019. Despite this slightly more bullish rhetoric the sell-off in equity markets triggered a bid for bonds. The yield on a ten year Treasury ended March 0.14% lower at 2.74%.

The OECD, whilst upgrading its forecasts for global growth to 3.9% for this year and next, reduced UK forecast growth to just 1.3% this year and 1.1% in 2019. It noted that high inflation continues to weigh on real household income whilst business investment has slowed as a result of Brexit uncertainty.

UK inflation slowed a little this month. Headline consumer price inflation (CPI) fell from 3% to 2.7% helped by falling petrol prices and a slower rise in the cost of food during February. Core CPI (excluding food and energy prices) slowed to 2.4% from 2.7%. The Bank of England kept rates unchanged but two policymakers voted for a rate hike this month, citing the need to exit emergency policy measures.

Interestingly wages are showing signs of life. Nominal wages rose by 2.8%, suggesting UK workers saw a modest rise in real wage growth (i.e. after inflation) as unemployment fell to just 4.3%. The government also signalled an end to the 1% public sector pay cap, with a 6.5% wage increase over the next 3 years for 1.3 million NHS workers. The pay rise is front-loaded with a 3% rise this year and tilted towards the lowest earners such as hospital porters, who will see an increase of 25% over the next three years. Whether this is the start of a generally firmer real wage narrative is yet to be seen. In the meantime, the gilt market remains sanguine; the yield on 10 year government paper decreased 0.15% to 1.35%.

European Q4 GDP growth at 0.6% was slightly above the UK rate. However, Eurozone inflation slowed to 1.1%. Inflation remains stubbornly low as the 2017 growth impulse wanes and the banking system remains hamstrung by unrecognised, elevated bad debts. The Swedish Riksbank Deputy Governor warned that inflation may be decelerating. She warned that "it's starting to look like a Japan scenario where we will get an economic downturn before rates go up in Sweden or the Eurozone". The bond market looks like it agrees. Although German ten-year yields have risen from their historic lows, they still offer a paltry yield of less than 0.5%.

In Australia, the Reserve Bank continued to warn about elevated levels of household debt. Despite low unemployment of 5.5%, a definitive pick-up in real wages is absent as per many other developed countries. Although policymakers remain confident the economy will exceed its potential growth rate in 2018, long bond yields continued to converge with other developed markets. The ten-year Australian bond now offers 2.6%, broadly comparable with the US market.

As ever, ratings agencies remain behind the curve in emerging markets. Standard & Poors cut Brazil's credit rating to BB- from BB, three notches below investment grade, citing delays to vital pension reform. However, economic news continues to improve. The current account deficit narrowed to $10bn whilst foreign direct investment swelled to over $70bn. Inflation came in below expectations which gave the central bank wiggle room to cut rates by another 0.25% to an all-time low of 6.5%. Turning east, China reached a major landmark this month after Bloomberg/Barclays announced that local debt will be admitted to the global aggregate bond index, a key benchmark for institutional investors. Many emerging market bonds continue to offer attractive real rates of interest in stark contrast to developed market peers. We retain an active exposure.

CURRENCIES

The weak US dollar continues to dominate currency markets. This trend continued with the greenback falling by another 0.7% this month. It is 10% lower year-on-year. US economic growth was revised up to 2.9% (year on year) in the fourth quarter as data showed consumer spending increased by more than previously estimated. However, concerns remain over the profligacy of the Trump administration. Congress approved a $1.3 trillion spending bill which will keep the government funded until the end of September and included large increases in the military budget. Combined with the recent tax cuts, the bill is expected to lead to budget deficits of more than $800bn this year and $1tr in 2019. As US rates rise, the impact of such bloated deficits will begin to bite.

Across the Atlantic, sterling continued its recent run of form. It gained 2% against the dollar and is now 12% higher than a year ago. Depressed sentiment surrounding the UK was somewhat alleviated by signs of progress in the Brexit negotiations. The 27 EU countries agreed a post-Brexit transition period and ground rules for further discussion. Controversially, the guidelines include a provision for the UK to change its mind and return to the EU single market and customs union. Meanwhile UK public sector net borrowing was £1.3bn in February, over £0.5bn less than expected; the government looks likely to hit its 2017/18 deficit target. Sterling finished the month trading at $1.40 against the dollar and €1.14 against the euro.

The Hong Kong dollar reached HK$7.84, the lowest since the present trading band (7.75-7.85) was introduced in 2005 (source: GaveKal). Since the US Federal Reserve began to raise rates at the end of 2015, we have witnessed a divergence in US$ and HK$ cash rates. At the end of March 1m HIBOR stood at 1% with the US$ equivalent at 1.9%. This discount was 0.5% at the start of the year. Backed by the HK$4tr exchange fund, the HKMA is poised to intervene; as the HK$ monetary base contracts, HK rates should rise towards their US counterparts, challenging rate sensitive sectors in the SAR and various HK$ funded carry trades.

The Mexican peso has been one of the stand-out performers in currency markets this year. It gained another 3.6% this month and is now 8.1% stronger against the US dollar than at the start of the year. Uncertainty surrounding NAFTA trade re-negotiations have previously cast a shadow over both the peso and Canadian dollar. However rumours that a preliminary deal could be announced during the forthcoming ‘Summit of the Americas’ in Peru bolstered sentiment. This comes despite the US President’s ongoing twitter threats to withdraw if Mexico does not do more to stop the flow of immigrants crossing the border.

GOLD/COMMODITIES

Escalating trade tensions had a notable impact on commodity markets. Aluminium prices fell 6% whilst iron ore collapsed by 19%. As we write, news has just broken that Chinese tariffs would be extended to include soybeans. According to the US Department of Agriculture, the US exported $12.4bn of soybeans to China last year. The US Soybean Export Council warned that tariffs would not only harm US farmers and exporters, but also Chinese soy processing firms, animal producers and consumers. Brazilian soybean futures spiked higher, given their role as a US substitute. So far this year corn, wheat, rice and soybean prices have risen 8% (on average), recovering from their 2017 slump. Drought conditions in South America, especially in Argentina, are the worst in decades.

Oil prices surged this month. US WTI oil was 6% higher, whilst European Brent was up 7%. Saudi Arabia's Energy Minister said OPEC members would continue to co-ordinate supply curbs in 2019 until inventories are reduced to a level that would support higher prices. This would also involve the ongoing cooperation of non-OPEC producers like Russia. Oil production in troubled Venezuela fell by 26% this month, and is now 43% lower than this time last year. The country's oil production is now just 1m barrels per day, down 2/3rds from the early days of Chavez's presidency in 2000. The country is mired in a hyper-inflation spiral; even though the local stock market has risen 268% this year, inflation is running at over 6,000% pa. Oil prices were also given a jolt higher after an attack on a Saudi tanker by Yemen's Houthi tribe. This served as a reminder of elevated political tensions across the region.

Precious metals held their value this month, against the backdrop of falling equity markets. Gold gained 0.5% and finished the month at $1,325. The 2016 high of $1,366 is seen as a key technical barrier; if gold closes higher than this, further strength could well unfold.

POLICY SUMMARY MATRIX

The matrix set out below is a summary of our current policy stance on the various equity and bond markets which we monitor. It is not intended as anything other than a guide on where we stand and we will change the content as our views alter. Cash exposure is a residual and will tend to be high when negatives outweigh positives and vice versa.

6-12 Month View	OVERALL	EQUITIES	BONDS	ALTERNATIVES
+	ALTERNATIVES	Asia Latin America	Inflation Linked Emerging Market	Uncorrelated Strategies, Gold
O		UK, European Japanese Australian High Yield Healthcare Resources	US, Australian	
–	EQUITIES BONDS	US, Technology	UK, European Japanese Corporate High Yield	

MARKET PERFORMANCE

All performance numbers show % changes except for bond yields which show yield changes.

	31-MAR-18	1 MTH	3 MTH	12 MTH
CURRENCIES (VS USD)				
GBP	1.4015	+1.9%	+3.7%	+11.7%
CHF	1.0486	-1.0%	+2.2%	+5.2%
AUD	0.7679	-1.1%	-1.7%	+0.7%
JPY	106.28	+0.4%	+6.0%	+4.8%
EUR	1.2324	+1.1%	+2.7%	+15.7%
BOND YIELDS (10 yr)				
UK	1.35	-0.15	+0.16	+0.21
US	2.74	-0.12	+0.33	+0.35
Germany	0.49	-0.16	+0.07	+0.17
Australia	2.60	-0.21	-0.03	-0.10
Japan	0.04	+0.00	+0.00	-0.02
EQUITIES				
US. S&P 500 (USD)	2,640.87	-2.7%	-1.2%	+11.8%
UK. FTSE 100 (GBP)	7,056.61	-2.4%	-8.2%	-3.6%
MSCI Europe ex UK (EUR)	1,296.77	-2.2%	-3.6%	+0.7%
Japan. Topix (JPY)	1,716.30	-2.9%	-5.6%	+13.5%
China. Shanghai Comp (RMB)	3,168.90	-2.8%	-4.2%	-1.7%
HK. Hang Seng (HKD)	30,093.38	-2.4%	+0.6%	+24.8%
Australia. All Ords (AUD)	5,868.91	-4.1%	-4.8%	-0.6%
MSCI Pacific ex Japan (USD)	1,355.87	-4.6%	-4.6%	+4.4%
MSCI World (USD)	2,066.85	-2.4%	-1.7%	+11.5%
MSCI World (GBP)	1,472.74	-4.1%	-5.3%	-0.4%
COMMODITIES				
Oil (WTI)	64.94	+5.6%	+7.7%	+24.9%
Gold	1,325.00	+0.5%	+1.7%	+6.1%

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CONTACTS AND REGULATION

Published and distributed in UK by **Bentley Reid & Co (UK) Limited**
29 Queen Anne's Gate, London SW1H 9BU, England,
Tel +44 (0) 20 7222 8081, Fax +44 (0) 20 7227 8440, Email UK@bentleyreid.co.uk
Authorized and regulated by the Financial Conduct Authority, registered office 29 Queen Anne's Gate, London SW1H 9BU. Registered Number 07602886

Published and distributed outside the UK by **Bentley Reid & Co Limited**
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