ROCQ CAPITAL

Third Quarter 2019

The US Federal Reserve ("Fed") cut interest rates twice during the quarter, in July and in September, as the pace of growth and hiring of workers continued to slow. Economic data globally was generally weaker, with the European Central Bank ("ECB") acting in concert with the Fed to ease monetary conditions and prolong the economic expansion. Despite policymakers easing monetary conditions, growth data has remained muted. In Europe, weaker economic data, particularly from German manufacturers, saw them not only cut rates but also restart quantitative easing and asset purchases aimed at lifting inflation.

Brexit continues to run roughshod over UK markets with Parliament first legislating that a 'no deal' Brexit should be off the table before the Prime Minister unlawfully prorogued parliament, seemingly to try and force a Brexit at the end of October, deal or no deal. A general election within the next few months seems the most likely outcome unless a workable deal suddenly appears. The Bank of England chose not to act during the quarter. For the first time recently though, they suggested they could follow other central banks and cut rates in the near term, despite previously suggesting a hike was possible. Until a Brexit outcome becomes clear though, a move either way is unlikely.

Trade wars had a significant impact on markets, particularly hurting Asian equities, which were the weakest performers during the quarter. Increased tariffs are expected to take effect at year end unless there is a resolution of the disagreement between the US and China. Many market participants see a resolution as certain, with President Trump using it as a campaign tool to show how he bullied China into submission. Whether or not this tactic will work against a determined China remains to be seen. Both economies are slowing but President Xi doesn't have an election campaign to fight in the next year so his concession is far from guaranteed.

July saw the S&P 500 hit new highs whilst the 10 year US Treasury yield stabilised at around 2%. August though saw a sharp increase in volatility with equities bouncing around and ending the month slightly down while investors ran in droves to "safe" investments and pushed the 10 year yield down to 1.5%. European and UK benchmark yields moved in tandem with the US to new lows. In September rates whipsawed violently, first bouncing back up significantly in the first two weeks of the month before collapsing again to finish the month barely higher than where they started.

A second order effect of bond markets moving violently in September was a sharp sector and style rotation in equity markets, with the darlings of recent years, namely large cap growth companies and particularly technology stocks, underperforming value names including the unloved financials sector.

August saw the US 2 year yield move higher than the 10 year yield for the first time since prior to the 2008 financial crisis. Historically, in most cases, this has indicated a recession within the next two years although the continual global easing of monetary policy, and particularly President Trump's aggressive rhetoric aimed at the Federal Reserve, is clearly aimed at kicking the can down the road and stretching this already record length economic expansion out as long as possible. How long this can last, and what the longer-term impact of this prolonged period of easy money will be, is still unclear.

Tensions between Iran and Saudi Arabia escalated at the end of the quarter with the Saudis accusing Iran of launching drone attacks on their oil fields. Oil spiked briefly but ended the quarter lower than it started. The resumption of tensions though and suspicions that the US may not step in quite as readily as previously makes the chances of increased volatility in oil prices significant.

Outlook

As we move further through this economic cycle, it is of no surprise to start to witness a pick-up in volatility becoming more frequent and lasting longer than in recent years (although this is coming off a period of record lows). Along with this we would expect to see the increased dispersion between sectors and styles continue and so having high conviction exposure across different styles and strategies remains key to delivering a consistent return.

Whilst the overall impact on a globally diversified portfolio is small, Brexit still poses a significant risk to the United Kingdom and importantly, investors with Sterling denominated portfolios. The currency is likely to bear the brunt of any good or bad news and until a clear path is laid out one way or another, will add volatility to investors' portfolios. At some stage Prime Minister Johnson's posturing will annoy European leaders enough that they refuse to consider any further deal and drive Britain towards a "no deal" Brexit, or an extension. An extension would almost certainly lead to a general election although with both Conservative and Labour politicians and constituencies split on their Brexit views, it is unlikely that would create any great certainty.

As we move into the final quarter of 2019, both equity and fixed income markets have had very solid performance so far. In equities this has generally meant recouping the losses from the fourth quarter last year but in bond markets this has meant regularly pushing to new highs. It would not be a great shock to see some profit taking towards year end but with monetary conditions still loose and consumers still spending, taking too much risk out of investor portfolios could result in missed opportunities. We therefore remain prudently diversified across markets to reduce risk whilst leaving opportunities to benefit from upside moves.