ROCQ CAPITAL

Fourth Quarter 2019

In our last quarterly commentary, we mentioned that the economic data released during Q3 was indicative of a slowdown in growth across most of the world. This was led by the global manufacturing sector, with weakness in the service sector more modest. During the fourth quarter, it was reassuring to see that this did not develop further, and in fact there were some signs of stabilisation. The growth picture looks more like a mid-cycle slowdown than the onset of recession, and markets seemed to take this view as well with stocks performing well in November and December. This capped a strong year for global equities, in particular those listed in the US. In local currency terms, the S&P 500 index of the largest US stocks rose 8.5% during the final quarter while the Eurostoxx 50 index of leading Eurozone companies gained 4.9%; however, both these figures were reduced to around +0.50% if considered in Sterling terms, as the pound rallied during the quarter.

Helping sentiment in December was the double-whammy of the UK election result and some positive developments in the US-China trade dispute. The Conservatives' decisive victory, at the very top end of pre-election predictions in terms of seats gained, has given investors some certainty over the path ahead for the UK. While Brexit was viewed negatively by investors for a long time, it now seems that uncertainty is the greatest enemy and therefore Boris Johnson's repeated pledge to "Get Brexit Done" has been welcomed by many. UK equities and the pound rose immediately following the result. While the stockmarket remained elevated with the FTSE 100 posting a final quarter return of +1.8%, the currency subsequently eased back on concerns that the timetable for agreeing the future UK/EU relationship is extremely tight at just 11 months.

In early December there were also some signs of progress in Donald Trump's long drawn-out negotiations with China over tariffs—a "phase-one" deal has been agreed under which the US will suspend plans for new tariffs on Chinese imports and reduce some existing levies. While there is much still to discuss, this was welcomed by investors who continue to worry about the impact on sentiment and activity as this issue rumbles on. This helped US equity markets reach record highs towards the end of the year, and it is assumed that Trump will not wish to rock the boat too much in 2020 as it is an election year—though his unpredictable nature makes this hard to forecast with a great deal of confidence.

Government bonds, particularly in the UK, had a weak quarter. The US Federal Reserve, having cut rates for a third time this year in October, signalled that it is likely to pause for the foreseeable future which helped put a stop to the downward march of Treasury yields. In the UK, during the election campaign the spending plans of both Labour and the Conservatives were viewed as more ambitious than the current administration and gilts were weaker as a result. It remains to be seen exactly what the new government will announce in its first budget, but a number of infrastructure projects look likely at the least.

Looking at the year as a whole, both equity and bond markets performed very well despite the occasional wobble. In Sterling terms, the MSCI World index rose by 20% and the US S&P 500 index gained over 23%. Closer to home, the FTSE 100 returned 12% and the Eurozone's Eurostoxx 50 added more than 17%. After notable volatility and weakness at the end of 2018, these return levels were most welcome for international investors. Corporate bonds also appreciated in value and government bonds rallied for the first three quarters of the year, with UK gilts returning +6.9% during 2019.

Outlook

With government spending programmes back in vogue, notably in the UK but also elsewhere, we expect to see some upward pressure on government bond yields continue, though probably not in a dramatic fashion. The Federal Reserve also seems to have shifted its approach slightly, indicating that it would wait until inflation reaches 2% before seeking to tighten monetary policy i.e. no longer being so reliant on its inflation forecasts and instead waiting to see inflation manifest itself in the real world. To the extent that central banks can control inflation, this suggests that inflation may be 'allowed' to rise which again argues for limited exposure to duration (interest rate risk) within our fixed income allocation. Real assets such as physical infrastructure and property may perform quite strongly in this environment, hence our decision at the end of the summer to purchase the new J.P. Morgan Global Core Real Assets investment trust which provides a diversified exposure to a variety of assets and is expected to pay a healthy yield.

Reasonable economic data and an environment of low rates may continue to support stock markets and corporate activity, which encouraged us to reduce the portfolio's cash balance during the quarter. After a strong year for markets, it is prudent to keep a reasonable balance via bonds and 'alternatives', but equities still look likely to be an important source of returns and income in the year ahead.

Within equity markets, there seems a clear valuation advantage for UK and emerging markets compared to other regions. Having had virtually no UK exposure coming into 2019, we added a fund in the spring and are now contemplating increasing our allocation to UK stocks given the clearer path on Brexit being mapped out by the government. We have retained a reasonable weighting to emerging markets throughout the year and remain attracted to the long-term themes at play, particularly in Asia where the middle class expands at a staggering pace and creates many opportunities.