MARKET BULLETIN

ST. JAMES'S PLACE WEALTH MANAGEMENT

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Positional play

Half a league, half a league,
Half a league onward,
All in the valley of Death
Rode the six hundred.
"Forward, the Light Brigade!"

So opened Tennyson's poem describing the mistaken British charge against a Russian artillery battery in Crimea in 1854. Last week, it was Ukraine's turn to feel the force of Moscow's intentions in the region, as three Ukrainian naval ships were requisitioned by Russia's fleet off the Crimean coast.

The timing could barely have been worse for international relations – perhaps intentionally so – coming the same week that the G20 gathered in Buenos Aires amid growing political divisions worldwide. Adding to the sense of a summit doomed to failure, Angela Merkel's plane was forced to turn back due to a technical failure, ensuring she missed the opening.

The growing clefts are apparent across several of the world's most important economic unions and relationships. In Europe, there was a face-off last week between a group of fiscally-conservative northern nations (dubbed the 'Hanseatic' group) and a France in search of further eurozone integration; the German finance minister floated the idea of France giving its UN Security Council seat to the EU; the US president warned Theresa May's EU withdrawal deal was "good for the EU" and would make it harder for the UK to sign a trade deal with the US; he also cancelled his scheduled G20 head-to-head with Putin; the EU said it would extend its sanctions on Russia beyond their current December expiration; and Washington pledged a second round of "very severe" US sanctions on Moscow.

Not that the previous round has yet inflicted much visible damage. Instead, a largely strong oil price has proved a boon to the Russian economy, although in recent days it slid below $50 for the first time since October 2017. (Putin met with the Saudi crown prince last week to agree production cuts.)

Fresh threats of US sanctions are expected to target Russian debt; but last week the finance ministry in Moscow reported a $1 billion issuance of seven-year bonds, denominated not in dollars but in euros. "We are not leaving the dollar," Vladimir Putin said on Wednesday. "The dollar is leaving us." The finance ministry reported that 75% of the issue was bought up by foreign investors. In this area, the Kremlin may in fact be making a bet that long-term investors do not allow politics to dominate their investment decisions, partly because nimble companies can work around all kinds of headwinds, and partly because it is difficult to price geopolitics – or even trade troubles, when they are so entangled in geopolitics.

"Geopolitical risks are significant at the moment and we investors have absolutely no idea how to price any of that in," said Megan Greene of Manulife.

Honey run

One key risk companies have been having to work around has been the deepening US-China trade war. With $250 billion in tariffs already active, the impact is increasingly being felt by companies. Yet the trend makes last week's US trade balance figures appear all the stranger – the US reported its largest trade deficit in five months. There is evidence this could be a case of unintended consequences.

"A few countries will do really well from this tariff war, mainly around China – Malaysia, Thailand and Vietnam – and it's because of trans-shipping," said Manulife's Greene. "In some cases, China sent solar panels to Malaysia, where they put a label on them and then sent them to the US and no tariffs were ever exchanged. Likewise, China is the biggest honey producer in the world. So China has just started sending plain glass bottles of honey to Malaysia where they literally put labels on them and send them to the US."

In fact, the G20 saw the US and China agree a cooling-off period, suspending some new tariffs and reducing others, with a 90-day truce. The suspension will come as a relief to Beijing, as figures last week showed that Chinese factories are now producing more than they are selling – if demand fails to pick up again, Chinese businesses will ultimately have to shut down some production. (The Shanghai Composite ended the week marginally higher.) Despite GM's announcement of US factory closures last week, the US looks to be a in a stronger position; last week, third quarter GDP was confirmed at 3.5% and equities even received a boost from some apparently dovish comments by the Federal Reserve's governor – the S&P 500 enjoyed a strong week.

His words were arguably most important in emerging markets, where a strong dollar has weighed on companies with dollar-denominated debt. Moreover, after the sell-off in emerging market equities earlier this year – in part on Fed policy and trade worries – there are signs investors may have overreacted to troubles.

"There is an opportunity in emerging markets because you see value supported by robust fundamentals, especially since the sell-off," said Wei Li, head of investment strategy at Blackrock. "The main emerging markets index is down 13% on the year versus a 35% return in 2017, opening up a significant value gap. And that is despite robust global growth dynamics, which tend to benefit emerging markets more than developed markets. Added to it all, we've seen strong earnings growth."

Wei is not alone in her view.

"The last time that we saw such negative investor sentiment on emerging markets was in 2000," said Tommy Garvey of GMO, co-manager of the St. James's Place Balanced Managed fund. "Back then you couldn't find anybody saying anything good about emerging markets. Over the next ten years, emerging markets returned about 11% per annum, while the S&P 500 did nothing. We don't think that in its current form the trade wars have any meaningful impact on the outlook for emerging markets."

Pawn in their hands?

Clear views on the UK's trade outlook, on the other hand, are harder to find. Last week, as the world chess champion won a tiebreaker to hold onto his title in London, Theresa May faced a task fit for a political grandmaster: marshalling as many MPs as possible to vote for her much-criticised deal by 11 December. She was obliged to acknowledge Bank of England and UK government forecasts of a loss of GDP in all forms of Brexit; the latter claimed alternative trade deals would not make a meaningful difference to the balance.

A study by Capital Economics said the government report was "probably a little too pessimistic about the fallout from a no-deal Brexit and a little too optimistic about the impact of a deal based on the Chequers plan."

At any rate, November was a rough month for sterling, while a leading poll aggregator showed a shift from the Tories to Labour. John McDonnell, shadow chancellor, last week told media that a second referendum was "inevitable", while the Secretary-General of the European Commission crowed that the withdrawal deal meant "the power is with us". The FTSE 100 enjoyed a marginally positive week, aided by an early fall for sterling.

Theresa May could at least console herself that, should she need to quit politics, her State Pension might be available sooner than the 62-year old had expected. On Friday, a campaign group won the right to a judicial review of the government's handling of the rise in the state pension age from 60 to 65. Sadly, even a reversion to 60 won't offer women retirees much of a boost. Figures from 2017 show the average woman's State Pension was £126 a week, versus £154 for a man, highlighting the urgent need for adequate retirement planning.

Blackrock, GMO and Manulife are fund managers for St. James's Place.

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