CAMBRIDGE
INVESTMENTS LIMITED

THE **CAMBRIDGE** WEEKLY

6 January 2020

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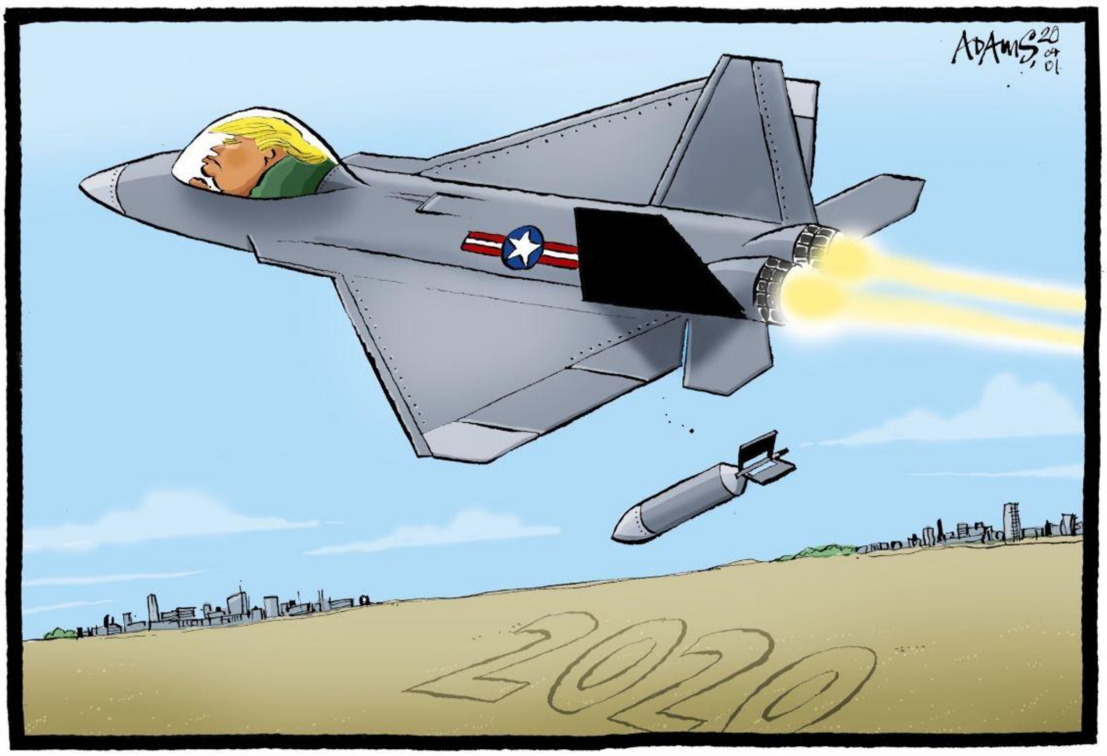


2020 starts with a Trump card

And it was all going so smoothly, we had planned to write that it was a quiet week. Christmas a fading memory and the New Year with had some positive news on US-China trade relations, helping markets edge higher on Thursday night. Then came the biggest geopolitical act in months: a US drone airstrike killed Qasem Soleimani, the head of Iran's elite Quds force, on the streets of Baghdad. It is hard to overstate how important a figure Soleimani was in Iran. He was accepted as Islamic Republic's second most powerful leader, ahead of President Rouhani and behind only the Ayatollah. This is a massive step up in tensions between Iran and the US, and a significant increase in near-term global risks.

This event brings into contrast our recently discussion that both markets and the underlying economy are finely balanced. A return of confidence led to an ongoing rally in asset prices and the reduction in US / China political risks had created a large flow of cash into riskier investments.

Now, markets have been "re-sensitized" to political shocks and all geopolitical news is able to create reaction. President Trump's announced the drone strike by simply tweeting an image of the American flag, and escalating tensions further. Global oil prices spiked more than 4% up in the wake of the news, equities fell, and fixed-income bonds saw reversals of the sharp losses experienced during the quiet period – evidence of the impact such events have on markets.

However, Iran is not the only geopolitical spook story. Over the holiday period, North Korea became a focus because of Kim Jong Un's "deadline" for the US to change its sanctions policy, and the implied threats of a return to over nuclear weapon development. Despite the death of Soleimani, for now, we can take comfort in the fact that things have not in deteriorated in North Korea.

Global market action in the first few days of 2020 was dominated by China, which went without the Christmas break. Markets were buoyed by news that phase one of a trade deal between the US and China is likely to be signed on the 15th of this month. The trade war between the world's two largest economies usually tops the list of concerns for global investors, so a thawing of relations here is undoubtedly a plus.

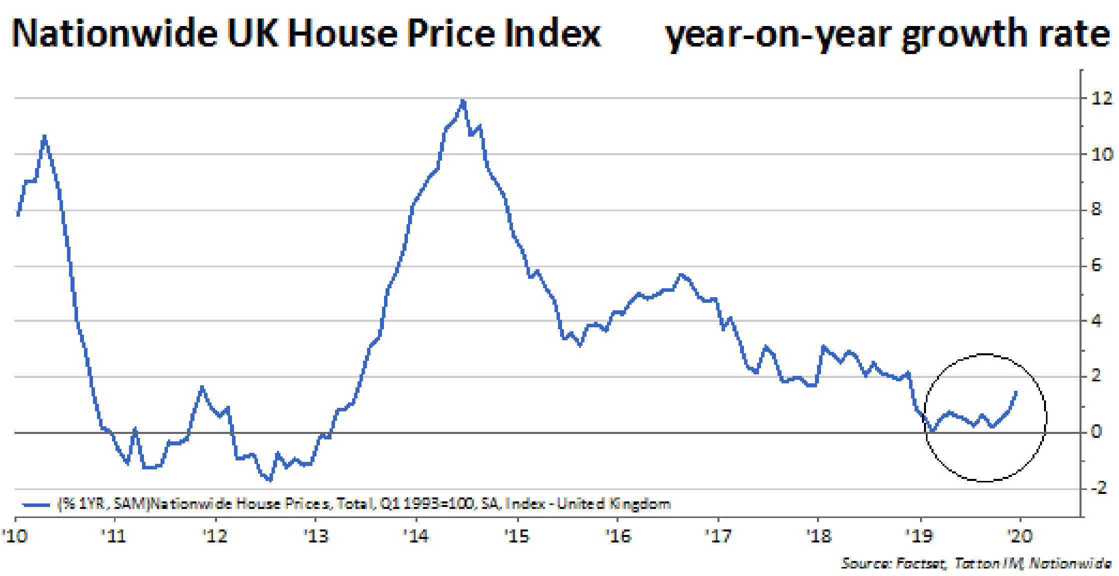
As we would expect the Trump administration likes to claim victory, and so economic advisor Peter Navarro riled Chinese negotiators by implying that the US had cowed them into submission at a weak moment and this before details of the agreement have not yet been released. However, a crucial development has been a rise in the value of RMB against the dollar, with $1 now buying less than 7 RMB. This is significant, because it suggests that currency value was part of the arrangement.

The Trump administration officially labelled China a "currency manipulator" back in 2016 for pushing down the value of its currency to boost demand for its exports. How accurate that charge has actually been over the last four years is debatable, but it has certainly proven a sticking point during negotiations. Previously, Chinese officials seemed to regard a currency pact as not up for discussion – worried that it would lead to the situation of the bursting asset bubble and decades of economic stagnation that Japan experienced following the Plaza Accord in 1985.

Chinese officials will still be wary of that, but may now consider it a necessary ill. In order to offset the negative impact on China's exports, the People's Bank of China has opted to ease monetary policy – lowering reserve requirement ratios and fixing mortgage rates to a new more flexible benchmark. Actual economic data in China is still less than ideal – as it was for all of last year, but officials can take some heart in the latest forward-looking data, with manufacturers' new orders rising somewhat.

This was enough to send Chinese equities higher for the week. A resolution to the trade war and a reacceleration in Chinese growth will be crucial for markets and the global economy. So as ever, these are some of the most important stories to watch as we head into a delicate economic situation this year.

Back at home, news over the last few weeks has been more 'silent night' than 'rocking around the Christmas tree'. The decisive election result has led to a general feeling that the Brexit drama will finally see a definitive end. House prices have risen slightly, and there is some optimism among estate agents that the spring could be quite good.



The strength of sterling (although tempered a little this week) is also helping sales of holiday packages.

In the EU economic data was mixed. Things are still sluggish, but the continent is showing some signs of relative improvement.

Ample liquidity has been one of the main themes recently. Over Christmas and the first active day of 2020, global equities and high-risk corporate bonds did well. Low risk assets such as government bonds were out of favour. Commodities, especially oil, were supported by positive signals for economic growth.

Meanwhile, fears that there could still be problems in the global money markets disappeared completely. The US dollar's rate of interest charged for the year-end was no different to a normal day – trading mostly at around 1.55% (annualised). Indeed, the interbank funding rate was unusually close to the government's risk-free rate.

The difference between the two-year bank rate and the two-year US treasury bond is now down to 0.01%. This seems a little like overkill, and talk is growing that this may start to be a policy error on the Federal Reserve's part.

So far, investor liquidity still seems to be heading for large tech stocks rather than the more economically sensitive sectors such as banks and small-caps. Optimism about growth should at least provide some support for these previously unloved areas.

At the same time, fears of 'too liquid for too long' has the potential to spook bond markets. Long bond prices went lower over the quiet period and, should the US-Iran conflict not escalate, the biggest risk is actually for a bond selloff. Globally, and especially in the US, wage inflation is starting to return. Central banks have already told us that they are prepared to let their respective economies run a little hot. In this situation, businesses that have already budgeted for spending on labour-replacement technology will do better than others. On the other side of that coin, we could get an odd situation where the economy is strong but the number of struggling businesses rises, especially in the SME ("Small and Medium-sized Enterprises") area.

That is, only if shocks from elsewhere don't get in the way. Unfortunately for investors, President Trump, now impeached, is heading into an election year needing victories and whilst it might help to get him re-elected, his irrational policies can easily translate into market behaviour. Let's hope he, and the markets, stay calm.

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Global Equity Markets

Market	FRI 13:44	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	7596.4	-0.5	-35.8	↗	⬀
FTSE 250	21970	-0.1	-11.2	↗	↗
FTSE AS	4223.5	-0.4	-15.8	↗	⬀
FTSE Small	5965.8	0.3	19.0	↗	↗
CAC	6030.2	0.0	0.6	→	↗
DAX	13211.2	-0.8	-107.7	→	↗
Dow	28869	1.2	353.4	⬀	↗
S&P 500	3257.9	1.1	34.5	↗	↗
Nasdaq	8872.2	2.0	172.7	↗	↗
Nikkei	23656.6	-0.7	-164.5	→	↗
MSCI World	2375.9	0.7	15.7	↗	↗
MSCI EM	1128.0	1.4	15.9	↗	⬀

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
Fresnillo	10.0	Bunzl	-3.3
Persimmon	3.2	Rolls-Royce	-3.1
Flutter Ents	2.4	Pearson	-2.8
Brit-AM Tobacco	2.3	Carnival	-2.7
Land Securities	2.2	Sage	-2.7

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.309	0.1	Oil	68.73	1.2
GBP/EUR	0.852	0.3	Gold	1545.7	2.3
USD/EUR	1.11	-0.3	Silver	18.10	1.9
JPY/USD	108.13	1.2	Copper	278.3	-2.8
CNY/USD	6.969	0.4	Aluminium	1804.5	0.0

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.7	18.4	13.5	13.2
FTSE 250	3.6	26.0	15.5	14.2
FTSE AS	4.5	19.5	13.7	13.4
FTSE Small	3.3	211.8	-	13.9
CAC	3.0	21.6	14.9	13.5
DAX	3.0	24.5	14.1	12.5
Dow	2.2	19.8	17.3	15.0
S&P 500	1.8	21.8	18.7	16.0
Nasdaq	1.0	28.0	23.1	18.0
Nikkei	1.9	18.8	18.3	17.2
MSCI World	2.3	20.8	17.3	15.2
MSCI EM	2.6	15.6	13.3	11.9

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.7	-0.0
UK 15-Yr	1.0	-0.0
US 10-Yr	1.8	-0.0
French 10-Yr	0.0	-0.0
German 10-Yr	-0.3	-0.0
Japanese 10-Yr	-0.0	-0.0

UK Mortgage Rates

Mortgage Rates	Nov	Oct
Base Rate Tracker	2.57	2.54
2-yr Fixed Rate	1.44	1.50
3-yr Fixed Rate	1.59	1.61
5-yr Fixed Rate	1.69	1.71
10-yr Fixed Rate	2.61	2.61
Standard Variable	4.28	4.28

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

For any questions, as always, please ask!
If anybody wants to be added or removed from the distribution list, please email enquiries@cambridgeinvestments.co.uk

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Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

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