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October 2019 Portfolio Review

It's been another month dominated by politics and the central banks, but recent PMI data has brought economics back into focus. Markets have made some progress, not least in the US where equities reached fresh all-time highs thanks to positive sentiment over trade war tensions easing.

Looking at the politics first, the combination of the Brexit deal being passed, but the 31st October deadline voted down was pretty much as expected and the EU has granted the UK a third Brexit extension to 31st January 2020. Having 'paused' his Brexit plan, the UK is now set to head to the polls on December 12th. Election uncertainty is high given fragmented polling and the UK's first-past-the-post electoral system. Current polls suggest the Conservatives will win an outright majority. But the numbers are tight, historical poll-to-seat mappings are imprecise given today's political fragmentation, and polls will likely swing in coming weeks. So, the result remains as yet unclear, with an outright majority for the Conservatives or another hung Parliament being equally likely outcomes. Brexit? Maybe, but not just yet.

Elsewhere in US politics, the impeachment process made a step forward following a vote in the House (controlled by the Democrats) to move to open hearings, which will mean those witnesses that have previously testified in private will now be heard in public. The vote in the House reiterates the political nature of this process, with votes almost entirely split on party lines. The Republican opposition to the process suggests that impeachment will not progress when it comes to a Senate vote (where they hold a majority) unless the evidence becomes overwhelming.

President Trump talked up the chances of a 'phase one' trade deal with China in November. White House economic advisor Larry Kudlow suggested that tariffs scheduled for December could be withdrawn if talks go well. Meanwhile, China's vice-premier Li also highlighted substantial progress in trade talks. Over the weekend there were reports that the US and China are close to completing some sections of the initial trade deal.

However, the impeachment proceedings against President Trump cast a shadow over proceedings. With the US Presidential election in November 2020, will Trump settle for a 'quick win' with US voters by getting China to make additional purchases of American agricultural produce rather than addressing the longer-term security threats posed by Chinese policy?

Looking more specifically at October's economic data, Asian data showed Japan still to be contracting but the Chinese data was positive for the third consecutive month and stronger than expected. In Europe, Germany's Bundesbank said that economic output could have shrunk again slightly in the third quarter of 2019. Early indicators provide few signs of a sustainable recovery in exports and raise the risk that the slowdown extends to more domestically orientated sectors.

In his last statement as President of the European Central bank (ECB), Mario Draghi confirmed the widely expected QE stimulus measures with the ECB's bond buying programme to start at €20bn a month in November. He also called upon those European governments with financial headroom to undertake fiscal stimulus. His successor, Christine Lagarde, noted there "isn't enough solidarity" in the currency zone, saying "we share a currency, but we don't share much budgetary policy for now". However, it is widely acknowledged that monetary policy has little left to give, hence the pressure from Lagarde and others on European politicians will continue to rise, not least if the economic data continues to deteriorate.

The US reported third quarter growth at a better than expected rate of 1.9% annualised. This was slightly lower than the second quarter, but it remains the case that US growth is holding up better than elsewhere. Digging into the data, it remains clear that business investment is falling, and the US consumer is very much the driving force behind the sustained economic growth.

We await the equivalent data for the UK, due to be released on 11 November, with interest – expectations are the UK has just avoided a recession, but the economic backdrop still appears to be fragile.

Portfolios

With further volatility in the global fixed income arena, UK index-linked government debt weakened on the back of prospects for UK GDP growth slowing, and the Vanguard index posted negative returns of c5%.

In contrast, Amati's UK Smaller Companies portfolio generated a strong positive return of just over 2.6% although the manager noted it was difficult to establish a general reason other than the quality of the underlying companies, given the challenging political and economic environment.

The turbulence within fixed income and currency markets also played to H2O's strengths, generating 2% over the month and maintaining a strong year to date return of 15.5%.

Overall, portfolios protected investors, maintaining low volatility. The best return favoured Ethical Investors at -0.33% with the worst return being limited to -1.38% for investors in the V14 Risk 8 growth portfolio.