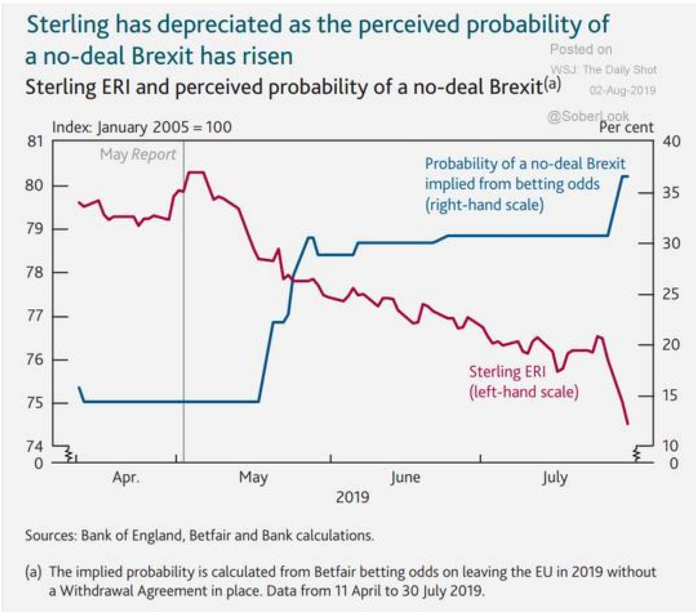
Monthly Commentary 5th August 2019

July was largely a flat month for equities and commodities but a very strong month for fixed income and the US Dollar. In fact developed government bonds and corporate bonds have been so strong that looking at their year-to-date performance of high single digits and even double digits, investors would be happy if riskier assets had done so well in any year. A prominent big loser in July was the pound sterling, as the probability of a no-deal Brexit has risen dramatically since the anointment of Boris Johnson to the position of prime minister of the UK. Time to buy cheap assets in the UK?



Where to for markets from here?

If only we knew. There are catalysts for a continuation of this year's equity market rally but there are also equally worrying factors that could reverse many of the gains. Below we list some of the "good" and "bad":

Some catalysts for further upside in risk assets:

- US consumer confidence is close to an all-time high. Not a surprise with unemployment at 3.6%, lower debt burdens and higher savings rates. Being by far the most important driver of the US (and thus the global) economy, this is good news.
- US corporations are expected to spend more than $800 billion in buying back their own stock. This would be an all-time record. This is good for stocks.
- Flows out of equities have already hit more than $150 billion so far this year, whereas flows into bonds are almost $280 billion. This is a classic contrarian indicator that is bullish for stocks.
- The price of money continues to fall, and Central Banks around the world are doing their best to keep it that way. As such, servicing debt is much cheaper.
- High yield bonds continue to be resilient. They usually capitulate if they see problems in the horizon

And some not-so-good omens:

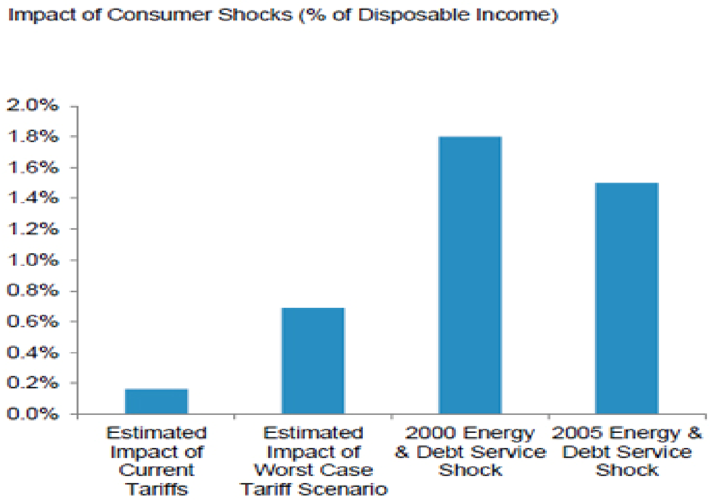
- The US-China trade war has just been re-ignited with the imposition of further tariffs of 10% on $300 billion worth of Chinese goods. Many of these goods will hit the US consumer.
- Earnings expectations for companies in both the US and other economies have come down. Not good, as earnings growth is one of the primary equity-market drivers.
- Outside of the US, developed economies have seen a marked slowdown activity.
- This year's equity market rally has been very narrow, with 6% of global stocks accounting for more than 50% of the total gains. At the same time more than half of global stocks are in bear markets (more than 20% below their previous highs).

So, there is plenty to feel good about as well as plenty to be worried for. As we have stressed many times in the past, positioning (in investing) should not be about what our market expectations are but rather what our tolerance to risk is and time horizon are.

Impact of new US tariffs on Chines goods

Contrary to what many believe, the US economy is able to absorb the shock of these extra tariffs. The chart below shows that the as a percentage of disposable income the impact of this shock is only 0.7%, which is negligible compared to past shocks.

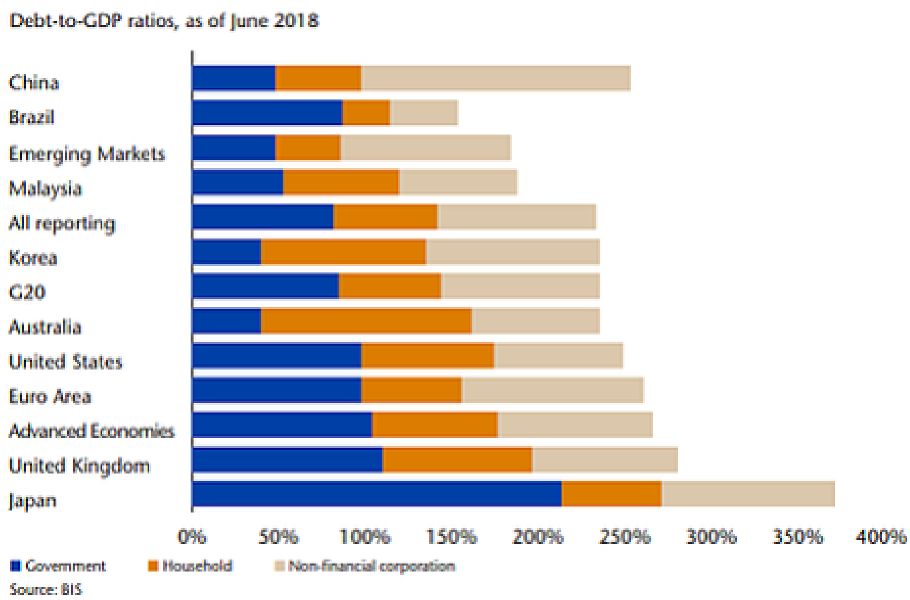
Impact of consumer shocks as % of disposable income



Of course, the new tariffs will have a much broader negative impact on corporations worldwide, especially for countries that have large exports. So, it's not only about the US consumer. As an example, the German stock market fell more than 3% the day after the new tariffs were announced. As is well known, German exports are a much larger portion of its GDP than US exports are for US GDP.

Debt, debt, debt

Amazingly, the yields on more than $14 trillion worth of debt are currently negative! Considering that total global debt is in the region of $184 trillion, that's a sizeable percentage. So how is total debt measured in proportion to GDP? While many think that Chinese debt is unsustainable, perhaps they need to consider the below chart, to see how it compares with other countries:



As August is largely a holiday month, we wish you all a relaxing vacation.

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