



## Weekly Market Comment

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## February 2018 asset class returns

	Index	February	YTD	12 Months
Equities	FTSE 100 (UK)	-3.4%	-5.3%	3.6%
	FTSE4Good 50 (UK Ethical Index)	-3.4%	-5.4%	-0.3%
	MSCI Europe ex UK (Euro-Zone)	-2.7%	-1.6%	9.5%
	S&P 500 (USA)	-0.6%	0.0%	5.7%
	Nikkei 225 (Japan)	0.9%	0.5%	11.9%
	MSCI All Countries World	-1.2%	-1.0%	5.2%
Bonds	FTSE Gilts All Stocks	0.2%	-1.8%	-0.9%
	£ Corporate Bond Index	-1.2%	-1.9%	1.6%
	Barclays Global Aggregate Bond Index	2.3%	-1.5%	-4.0%
Commodities	Goldman Sachs Commodity Index	-0.2%	-1.9%	-2.9%
	Brent Crude Oil Price	-1.7%	-3.4%	6.4%
	LBMA Spot Gold Price	1.4%	0.0%	-4.9%
Inflation	UK Consumer Price Index (annual rate)	n/a	n/a	n/a
Cash rates	Libor 3 month GBP	n/a	0.1%	0.3%

Source: Morningstar, all returns in – Sterling (£ - GBP)

## Time to take some profits

February brought a sudden, even if long expected end to the calm and steady rising equity market conditions. We wrote at length during the month what triggered the correction and what it is likely to mean going forward. In a nutshell, we agree with the view of many respected investment research institutions, that the return of more resilient global economic growth means that the end of the deflationary era has finally arrived. This will lead to a gradual normalisation of interest rates and bond yields away from the 'lower zero bound', but probably not higher than 3.5 - 4.5% over the remainder of this rate cycle. This reduces the relative attractiveness of equities and makes extended equity valuations less easily justified.

But exactly because this shift in relative valuation dynamics is occurring as a consequence of economic growth and not fear of decline, it is unlikely that February's correction heralds a medium-term equity bear market. However, it does mean that the relative attractiveness of different parts of the stock markets will be shifting. Those who particularly benefited from low cost of debt capital and investors' relentless hunger for growth prospects might suffer, while vice-versa those who can sustain or improve their margins when input costs rise should now become more attractive. Over the shorter term this reorientation is likely to result in more market volatility, while over the medium-term risk asset markets retain upside potential in sync with further economic expansion.

During this period those parts of the market that have done best in the run-up to the correction are likely to come under the most scrutiny. Emerging market equities as well as US tech stocks are such areas. We already took some profits in the tech stock area at the end of last year and we have now decided to reduce our allocations to emerging market stocks. As an asset class they have gained around 80% since the start of the rally in February 2016 and we judge them as vulnerable in the upcoming market environment.

In other news, the first public appearance of the new US central bank chair Jay Powell, who came across as more assertive than previous chief central bankers, appeared to confirm market concerns that they will no longer be able to rely on monetary support should stock markets wobble. They duly sold off again, not helped by president Trump's announcement that he is prepared to slap tariffs on steel and aluminium imports.

I am not sure I agree with the notion that he has declared 'trade war' with the rest of the world, but rather that he means business with his intention to secure better trading terms for the US. However, as his sudden softening on the firearms issue in light of the swelling public support for the '#NeverAgain' high school movement has shown, he is swayed more by popular opinion than feeling tied by previous statements of principle. Expect a deal to be done, rather than a painful trade war to be fought.

Similar bargaining tactics could be observed between the EU Commission and the UK government in the Brexit negotiations. The provocative language on both sides tells us that we may soon see more specific positions being teased out, which would be about time, given the beginning of the first potential transition period is only a little over a year away. Capital markets continue to indicate that they expect a 'muddle through Brexit' rather than a Hard Brexit or Remain.

Behind the political noise, economic data flow around the world told a story of continued strong and synchronised economic expansion, even if the rate of the expansion no longer seems to be accelerating further. The UK remains a special case due to Brexit, but even here construction and manufacturing business sentiment were reported at healthy expansion levels, although still considerably behind the Eurozone economies.

### Schrödinger's markets: don't fear growth and higher rates

Trying to make sense of markets in 2018 is a bit like attempting to understand quantum physics. Today's markets feel a little bit like Erwin Schrödinger's famous, but mind-bending, thought experiment. Until someone actually checks, his imaginary cat that sits in a sealed box is simultaneously alive and dead ([https://en.wikipedia.org/wiki/Schr%C3%B6dinger%27s\\_cat](https://en.wikipedia.org/wiki/Schr%C3%B6dinger%27s_cat)).

So will investors face trick or treat this year?

Well it depends on who you talk to. Those who are optimistic that normalising bond yields will not upset capital markets are still bullish for stock markets, while those expecting a bond market 'earthquake' remain bearish. Thanks Schrödinger!

Schrödinger's baffling paradox is meant to show how the act of observation can itself affect the outcome (Even though experts will know that Schrödinger aim was actually a different one). This is because, in quantum theory, an outcome does not actually exist until it is observed. Similarly,

for markets, whether it is a bears' or a bulls' majority that 'open the box' could likewise affect the outcome, as investors ponder the newly emerging investment backdrop of more normal inflation and higher interest rates and bond yields than before.

Since the end of the Global Financial Crisis (GFC) a decade ago, the bulls have largely been in charge, sending equity markets to record highs and bond yields to record lows. Investors had been supported by unprecedented monetary support activity from central banks (QE, continued low rates) and a fragile but gradually improving economic backdrop, in what now seemed like a never-ending goldilocks environment.

Over the years, there have been various opportune entry points into the current credit and equity bull-run. Arguably, the last such point was just a little over two years ago (Feb 11 2016), when investors feared a meltdown in China, Emerging Markets, oil prices and High Yield bonds. This produced bearish positioning among investors amid falling global profit estimates, but those fears eased once China launched a big policy stimulus initiative.

Since that point, global stock markets are up 58% (world market cap is now an impressive \$30 trillion), US high yield bonds are up 69%, financials stocks have jumped 69%, EM equities are up 81%, tech stocks jumped 92% and the oil price is up 139%. Just two asset classes saw bear markets since Feb 16, the US dollar (-8%) and volatility (if you can call it an asset class); both the bo8nd MOVE and equity VIX indices recently touched 50-year lows.

2018 saw the goldilocks environment initially continue, with markets rallying higher in January amid low volatility. However, that all came to an abrupt end in February with a volatility earthquake and an equity market drop, triggered initially by increasing inflationary pressures. Investors fear that central banks might increase interest rates more quickly than currently priced in, along with the gradual removal of the huge liquidity provided by their QE programs. In 1994 such a bout of sudden tightening of financial conditions under similar circumstances turned out to have been a policy error that led to downward pressure on equities.

For some investors, new Federal Reserve chair Jay Powell in his (impressive) first public appearance seemed to reinforce the view that more rate rises may be needed, causing further jitters. We have a slightly different take. We suspect his assertive tone was misinterpreted as hawkishness by Fed watchers who have become used to the more indefinite and academic tone struck by former chairs Ben Bernanke and Janet Yellen.

The combination of Powell and the flash crash produced the first down-February for the Dow Industrials index since 2009, the worst Feb for the S&P500 in 9 years, the first down-month since Oct 2016 and the biggest monthly drop since Jan 2016. On top of this, the dollar has clearly bounced significantly, and further strength may be on the way, which is pressuring commodity prices.

Some of February's notable moves were:

- Trannies (DOW Transports) worst month since Jan 2016
- Small Caps worst month since Oct 2016
- VIX biggest monthly jump since Aug 2015
- WTI (Oil) worst month since Aug 2017

- Gold worst month since Sept 2017

February's sell-off was global:

- European stocks had their worst month since June 2016 (Brexit) and worst Feb since 2009.
- Japan's worst month since June 2016.
- China's worst month since Jan 2016.

Despite all the scary looking bullet points above, the end of the month was a bit more balanced. Of the 39 indices watched by Deutsche Bank, 17 maintained a positive year-to-date (YTD) return in local currency terms, while counting in USD terms puts that number up to 26.

Putting February's correction further into perspective, most equity markets have merely returned to the levels they were at the end of 2017. In light of the strong returns seen over the past 2 years, February's moves still look more like a blip on a graph.



Global stock market trend channel since February 2016; Source: Bloomberg

Of course, there are risks to asset prices. Intraday price action on most equity markets have become very messy since the volatility spike, often swinging many hundreds of points up and down in the case of the Dow.

On a technical Fibonacci basis, markets have retraced about 75% of the flash crash falls, but upward momentum appears to have stalled. Prices remain around or below longer-term moving averages (MAV) like the 50 or 100-day levels. It seems that both bulls and bears are in 'wait and see' mode, with narrow or thin trading volumes while investors seem to be trying to get their heads around the new (old) reality.

Herein lies the paradox. The coming economic phase has its pros (growth, end of deflation fears) and its cons (higher cost of capital, lower valuation multiples) depending on who's looking. If the bulls look first and start buying accordingly, it could well return positive momentum to stock markets, which will boost asset prices. If the bears are first, the opposite could happen. But until someone opens the box, markets are neither alive nor dead.

We believe there are two components of this new regime that are worth recognising:

Short-term – volatility is back and technical analysis that help decipher and project investor emotions may become more important decision parameters as prices see greater movements.

Longer-term – the shift from deflation and low rates to inflation and higher interest rates will produce winners and losers, which could give active stock selection management an edge over the tracker approach.

The post-GFC lethargy has faded and been replaced by synchronised global growth, which is the real long-term driver of asset prices or value. And while some economists expect growth to slow this year or next, the trend remains positive. Global GDP is increasing, which will help support higher stock prices and valuations.

Yes, politics remains a risk factor. Italian elections, German coalition negotiations and Brexit uncertainties all present risks, but strangely these events rarely turn out as bad as many fear. Yes, central banks might make a policy error (unlikely as currently still fearing deflation more than inflation) and rising rates typically reign in economic growth, but history shows that this does not have to be fatal for stocks. In fact, as long as revenues rise faster than rising input costs can erode margins, corporate earnings can continue to expand despite rising yields.

This is indeed what we have witnessed over the past 18 months with double digit earnings growth figures. But this is where we once again return to the question of interpretation. Optimists and pessimists differ quite strongly whether such growth is sustainable and whether capital markets will remain stable once central banks remove their extraordinary (life-) support measures.

Our view is that a perception of gradual normalisation will eventually become the majority view. With any luck, perhaps investors may eventually come to see higher rates and bond yields as a natural side effect of accelerating growth and inflation, as something positive and not something to fear.

However, until we get there, expect market participants to veer from one extreme to the other. Just as we observed the optimists having the upper hand week before last, this past week the pessimists had the upper hand.

## UK Retailers feel the chill

It's been a difficult week for UK retailers. Wednesday saw two well-known high street names go into administration, as both Toys R Us and electronics store Maplin fell into financial disaster. The troubles didn't stop there for high street shops. On Thursday, Carpetright warned that its profits had been so dire that it risks breaching the terms of its banking covenant, while restaurant chain Prezzo has announced the closure of 100 branches and clothing store New Look may have to close up to 600 branches in a restructuring plan.

These latest developments come after what was a very tough January for the high street. Sales volumes rose just 0.1% from December to January, well below market expectations of 0.5%. A 0.1% rise might not sound like a disaster, but when one bears in mind the surprisingly large fall in December – a huge 1.4% month-on-month – things look a great deal worse. Analysts had expected somewhat of a recovery from the Christmas drop, but sales have been found wanting. Food sales

were down 0.9% on the month, with that negative figure being compensated for by growth in gym equipment and (ironically enough for Toys R Us) kids' toys.

One senior statistician at the Office for National Statistics (ONS) was suitably bleak in her assessment: "Retail sales growth was broadly flat at the beginning of the new year with the longer-term picture showing a continued slowdown in the sector." The ONS sees the retail demand woes as a symptom of the declining health of the British consumer. Falling real wages, increasing borrowing costs and high levels of private debt are sapping spending power, putting real strain on high street sales.

Lacklustre consumer demand is a major factor in the fall of the once-great retailers, but it doesn't tell the whole story. Longer term trends towards online purchases from giants like Amazon cast doubt on the sustainability of the high street model. As we've seen over the past few years with the collapse of BHS, Warren Evans and the like, British retailers have been faltering for some time. Indeed, as the Guardian wrote of Toys R Us and Maplin, one only need pay the stores a visit to see why they are having such trouble. But why now specifically?

A lot of the story is to do with the extraordinarily loose monetary policy since the post-crisis recession. Extremely low interest rates and QE from the world's central banks made cheap credit readily available, meaning that ailing retailers could afford to borrow more money to cover gaps in their balance sheet and wait until sales improved. Effectively, this meant that companies who would otherwise have dropped out of the market some time ago were given life support by the low rates environment.

Naturally, when this life support is taken away, you would expect companies with high debt leverage and uninspiring outlook on profits to come under serious pressure. And sure enough, now that the Bank of England (and the most of the developed world's central banks for that matter) has begun its rate-rising path (with markets currently expecting another hike from the BoE in May), we are seeing a great deal of strain in the retail industry.

In fact, the debt-leverage story is one we're seeing across all sectors. The Carillion collapse and the troubles at Capita over in the public services industry are some of the clearest recent examples. There, just like here, are sector specific issues (structural issues with the PFI model in the services case and disruption from online competition in the retail case) which were kept from snowballing by the ease of borrowing. But when that easy borrowing dried up, the lingering issues quickly turned into existential threats.

So, should we be worried about the ailing retail sector and its effects on the wider economy? Not necessarily. Ultimately, the fall of some highly leveraged and not-so-efficient companies is part of the process of normalisation back from the extreme era of monetary easing. The struggling of the old guard of high street shops isn't so much a nail in the coffin of retail as much as it is a wake-up call.

As Harriet Russell wrote in the FT on the issue last month, there are as ever winners and losers. Those retailers who have failed to adapt to online sales, who have a large physical footprint and (especially) who have a high amount of debt on their balance sheets are the ones who look vulnerable. But others who have adapted should be ready to weather the storm. That will likely mean a great deal of closures of outlets, especially among some of the big names. But that could be more of a haircut than a permanent loss.

From our perspective, an important aspect of this story is the ownership structure. A great deal of retail companies are owned through private equity arrangements. When private equity firms take over a company, their management focus is usually on the capital structure, as they want to make the financial structure flexible enough to deliver dependable profits. Once these stable profits are achieved, the management has incentive to take on high levels of debt – as a way of generating as much cashflow from a single asset as possible. The debt leverage is then amplified by the tendency of private equity firms to trade companies amongst themselves – each time the new owners finding a way to increase the leverage.

Often this borrowing takes the form of a covenant, where the conditions on the borrower are usually tied to how well their revenues perform. Typically, if revenues fall below a certain level, the payback terms become harsher. This is one of the reasons that financial problems can spiral out of control so quickly for private equity owned companies, as we've seen with many retailers.

The dangers of high debt leverage are not unique to the UK. Throughout the easy credit period of the past few years, firms have often done extremely well out of gearing up their profits by increasing their borrowing. Now that monetary policy is on a tightening path in the developed world, financial difficulties are to be expected. In our view, UK firms (particularly retailers) are most in danger due to the slow pace of growth here relative to the US, Europe and Japan. In particular, consumer demand – often the driving force of the UK economy – has been weak.

Taking a wider view, it's likely that companies which are private equity owned could be the area where we'll see more problems than elsewhere – across all sectors and regions. At this stage of the business cycle, this shouldn't be too surprising. Still, it gives pause for thought and we may have to get used to hearing and reading about more bankruptcies than recently, but without this necessarily being a symptom of a faltering economy.

## BoJ charts its own course

Japanese monetary policy is important not just to the Japanese economy, but also to global growth and asset prices. Recently, given positive growth and rising inflation in Japan, there have been rumours circulating in markets that just like in the US the easy money policy may be about to end. We are not so worried.

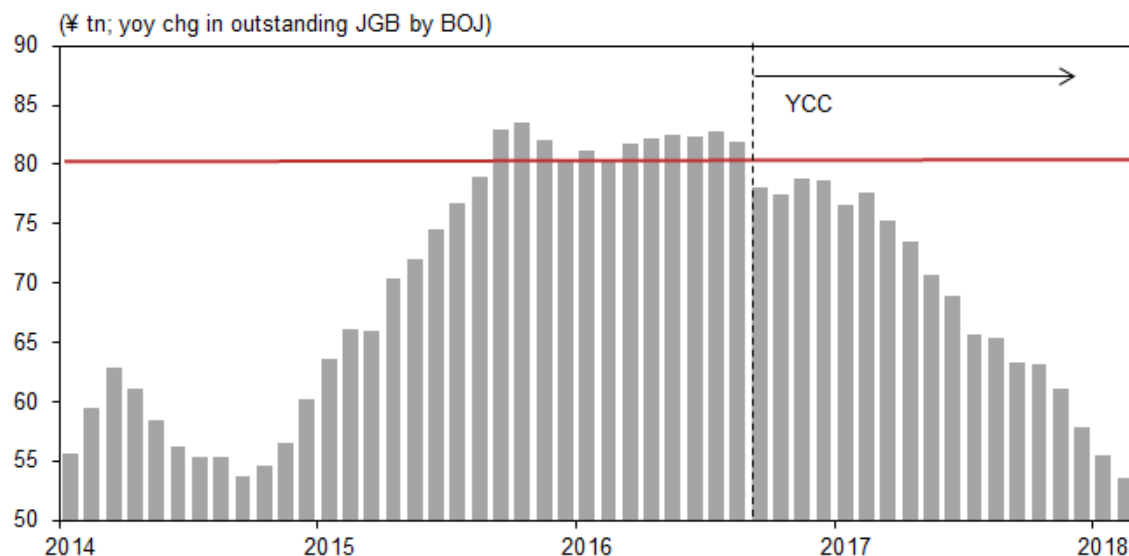
Bank of Japan (BoJ) Governor Kuroda spoke on Friday at a parliamentary confirmation hearing for his second term. He repeated that there is a need to pursue monetary easing while inferring that the BoJ does not intend to keep rates unchanged forever and will consider normalizing policy next year if their inflation target is achieved.

Kuroda added that he believed the chances are high that the 2% inflation target will be achieved around that time. He highlighted the importance of wage growth in driving inflation, and noted that inflation expectations are turning around. Still, he said, it will take time to change the public's deflationary mindset, and that persistent monetary easing is still needed.

As the reports of his comments came out, the Yen went yet stronger against the dollar, trading at around Y105.50/\$. This compares to a month ago when \$1 could buy you over Y110.



“Quantitative Easing” (or “Expansion” of the monetary base) involves purchasing assets (Japanese government bonds – JGBs – for the most part), with the monetarist idea that the excess cash created by the central bank to pay for the purchases will find its way into the economy and stimulate growth. As we know, this has tended to mean that long-term bond yields have moved lower. However, after initially indicating that it might add ¥80tn to its holdings in 2017, the BoJ decided to explicitly target 10-year rates to remain at around 0% rather than buy a monetary amount of assets. It was always possible that the BoJ would be forced to buy even greater amounts of bonds from the private sector but, in fact, the policy resulted in fewer purchases than the initial guidance. As the chart below shows, BoJ holdings have increased by just over ¥50 trillion in the last 12 months.



Current JGB net issuance remains around ¥30 trillion per year, meaning the float of bonds continues to decline; the BoJ owns over 46% of all JGBs in circulation. There is a similar dynamic in Europe, where the ECB’s balance sheet also continues to expand, soaking up the available float of bonds, although this is felt more in the corporate bond market.

The ECB has started the process of moving towards *effective* tightening by gradually reducing its volume of further purchases. Given Kuroda’s comments and the apparent downward path in bond purchases, should we therefore read between the lines and expect some sort of tightening from the BoJ?

The short answer is no. Japanese monetary policy is highly likely to remain accommodative in the medium-term, in relation to the Japanese economy.

Kuroda was giving testimony because of his reappointment to the governorship. His relationship with the re-elected Prime Minister Abe is strong, built on the BoJ governor’s dovishness. Goldman Sachs summarised it well in a recent article: “We believe that Yield Curve Control is more likely to remain in its present form until after the upcoming consumption tax hike in October 2019... The Abe administration sees securing the fiscal space and favourable market environment that result from the ultra-low interest rate policy as essential to going ahead with the next consumption tax rate hike. We should note that the largest beneficiary of ultra-low rates is the government, owing to its ever-increasing debt burden. We see a strong possibility that the recent bout of yen appreciation and stock market correction has strengthened the government’s resolve to maintain current policy”. We would agree.

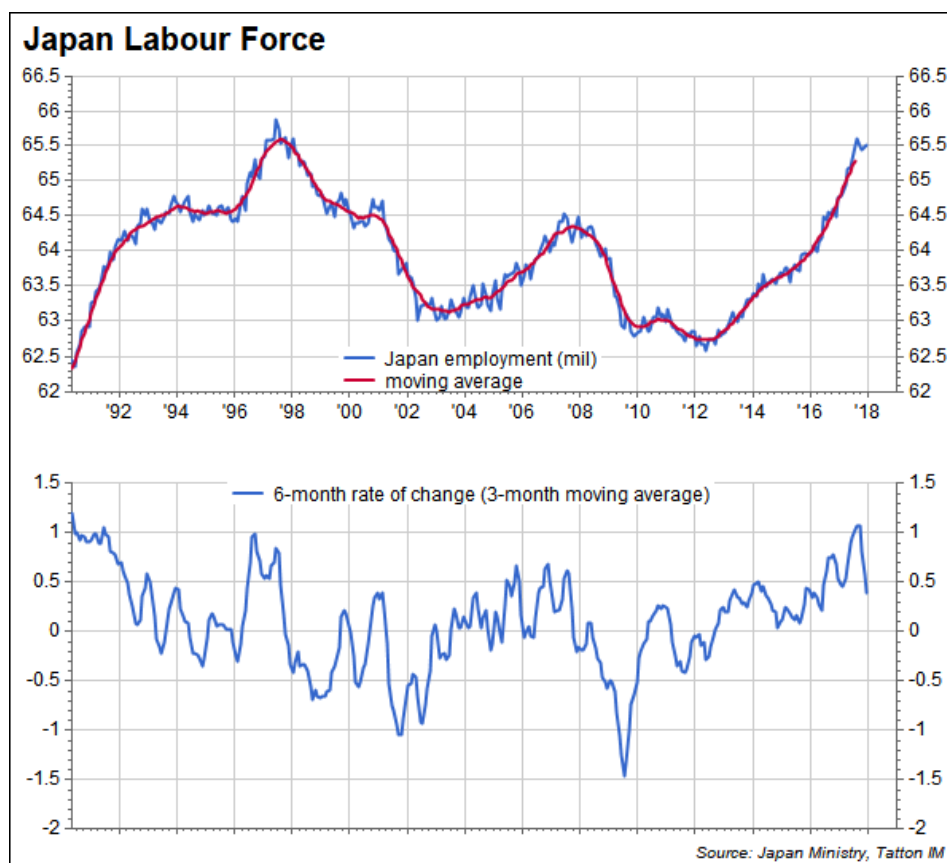
Further evidence comes from the new appointments to the BoJ board; they are even more dovish than those they replace. One of the two new deputy governors, Professor Wakatabe has advocated increasing the JGB purchases. Goldmans Sachs noted “In a recent Bloomberg interview (December 14, 2017), Mr. Wakatabe stressed the need for additional easing, proposing a raise in the inflation target to 3%, from 2% currently, and expanding the JGB purchase amount to ¥90 tn a year, from the current guideline of ¥80 tn (see Q4). In the past, he has also advocated for revision of the BOJ Act to explicitly include an inflation target. In this sense, he could be called a reflationist hawk”. Which certainly sounds more impressive than ultra-dovish!

Meanwhile, the other, Mr Amamiya, is a BoJ incumbent under Kuroda and noted as a “reflationist”.

It is possible that a reversal of the recent Yen strength, towards Y120/\$ could prompt a reassessment of easy monetary policy. However, should that happen, the strengthening dollar would have other global impacts which could slow global growth, and so the BoJ would be reluctant to tighten in that environment.

Should the Yen continue to strengthen against the dollar, it is more likely that the new BoJ board could push for further easing, even if global growth continued to be strong. Indeed, bouts of Yen strength have been somewhat associated with growth/risk assets such as equities having a weaker phase. This may be because Japanese investors have had higher equity weights than in the past but tend to get cold feet if economic growth slows and/or equity volatility picks up. For example, this was evident in the global slowdown of 2015/2016.

Another factor preventing a nearer-term policy change relates to the peaking of a recent spur to Japanese growth. We noted last year that, despite constant warnings that Japanese demographics portend long-term economic slowdown, recent trends have actually pushed growth the other way.



Those who left the workforce earlier in life have been returning, especially among women. However, the trend may be running out of steam a bit (See chart on previous page):

If we felt that the BoJ had a similar position to that of the ECB (I.e. to initiate tightening), we would be more worried about this development, at least in growth terms.

As for Japan's influence on global growth and asset prices, this should remain a positive. However, while it has been a large component of global stimulus, it may not be big enough by itself. The US' Federal Reserve Balance sheet has shown the first signs of contraction in recent weeks, while the ECB is gently signalling less accommodation. These moves may have a greater impact on global growth than continued BoJ dovishness. Indeed, if the Yen were to reverse its recent direction, that would probably offset their monetary stimulus.

Still, we think domestic demand is likely to be well-supported in the near and medium term. Japanese consumers will remain resilient, and so an early policy tightening is unlikely from the Bank of Japan.

That leads us to be confident that domestically-focussed Japanese equity should retain its place and return potential in portfolios.

## Emperor Xi?

It's 'political risk' with Chinese characteristics this week. Over the weekend, the government in Beijing announced an amendment to the constitution which removes the two-term Presidency limit, paving the way for Xi Jinping to rule the country past 2023. Along with the recent weak economic data – with China underperforming all the other major emerging markets over the last four weeks – some media outlets blamed Beijing's 'Xi forever' message for negative investor sentiment on China. The FTSE China index fell around 3% over the last week, putting it 11% down over the past month. For context, the MSCI emerging market index fell by only 0.6% this week.

The announcement came with the now customary internet censorship push. Particular highlights were the letter "N" being inexplicably banned by government censors, along with Winnie the Pooh – due to jokes about Xi's likeness to the bear. But in truth, the constitutional change doesn't come as too much of a surprise. At the Communist party conference back in October, the new politburo standing committee – the seven members comprising China's most powerful decision-making body – was announced, with five new members. Only Xi himself and premier Li Keqiang retained their positions. Importantly, there was no obvious successor to the presidency lined up among the new recruits. Because of this, it was largely assumed that Xi would stay beyond the end of his second term in 2023.

While not so surprising in that respect, the effective confirmation of this fact is still extremely significant. Ever since the ascendancy of Deng Xiaoping following Mao's death, a system of collective leadership and (informal) checks and balances has stopped the country's leaders from amassing total central control. In recent years, this has resulted in a functioning but factional leadership style, with the two main factions being the "Youth League Clique" – those brought through the ranks by former leader Hu Jintao – and the "Princelings" – officials who are descendants from past prominent members. This was most noticeable in the 2012-17 government, where Xi (a princeling) and Li (a youth-leaguer) held the top two positions.

Li still holds the premiership, along with a great deal of power, but the days of collective leadership are over. During his tenure, Xi has amassed such centralised power in his leadership that he is now widely recognised as the most powerful Chinese leader since Mao. He is head of the party, the state and the military, and holds more senior titles than any other leader in China's modern history. And now, he has paved the way to "leadership for life" – if he so chooses (though Chinese officials were quick to point out that the removal of the two-term limit doesn't mean we will have Xi forever).

'Emperor Xi' is somewhat of a double-edged sword. As mentioned, some have already claimed that the minor (by emerging market standards) sell-off in Chinese assets was motivated by worries over Xi's power – though how much of this is down to politics and how much is down to economic performance (admittedly, in China these two things don't come apart so easily) is debatable. Others make the argument that China's paramount leader tightening his grip brings more stability and certainty over political conditions, making it a boon for the economy.

It certainly bolsters the government's position in driving through key policies – namely the anti-corruption drive, environmental policy and taming China's burgeoning credit and shadow-banking sector. According to the FT, the number of anti-corruption punishments handed out in January was 44% higher than a year earlier. This comes after December saw the highest number ever, with 7,329 cadres being punished at the end of last year.

All those policies are ones that do need to be addressed; no one denies that tackling widespread corruption, combating dangerous levels of pollution and reining in an unstable private debt bubble are good goals. But the danger of centralised leadership is that it can often make policy changes erratic, leading to a greater chance of error. One only need look at Mao's tenure to see that. As Willy Lam, political analyst at the Chinese University in Hong Kong says "For Xi Jinping, whatever he says is the law. There are no longer any checks and balances." A few years ago, for example, Beijing's sudden devaluation of the Renminbi caused major market upset, and we have mentioned frequently in these pages how their 'whack-a-mole' approach to tackling the shadow banking sector risks the same.

The centralisation of power isn't just happening in the President's office. Media reports this week point to Xi's key economic advisor Lui He being named vice premier and put in charge of the financial and industrial sectors. But Hui is also – according to media reports – the frontrunner to take over the governorship of the People's Bank of China (PBoC). This particular titbit seems to have gone under the radar, but it could be very worrying for investors, since it would seem to blur any line there was between regulatory and monetary policy.

Beyond the potential for policy errors though, there are other downsides. For many years now, the Chinese currency has been subject to significant selling pressures – partly due to wealthy citizens wanting to get their capital offshore for fear of a government clampdown. Officials have had to institute extremely stringent laws on selling Yuan in order to stop a large devaluation, but many of China's wealthy and worried have still found ways to move money abroad (understandably, given that corruption charges carry the death penalty in China). The consolidation of Xi's power means more anti-corruption purges are likely, which means a greater chance of capital flight. This could present a real problem for the central bank, who might have to whittle down China's considerable foreign exchange reserves to stop a dangerous currency plunge.

Finally, what about the US? At the Davos conference last month, Xi cut the figure of a champion of globalisation and political stability – contrasted with the newfound nationalist populism in the US (Trump) and the UK (Brexit). The irony of the head of the world's largest command economy preaching about the benefits of the liberal world order was apparently lost on the audience in the Swiss alps. China has been the focus of most of President Trump's trade-related ire, with the US recently slapping tariffs and other restrictions on some Chinese imports. This week, the aforementioned Liu He has travelled to Washington to try diffuse the trade tensions between the world's two largest economies.

An all-out trade war between the US and China could be very damaging to the global economy, but a resolution to the disputes doesn't look all that likely at the moment. One could at least hope that, with Chinese policy now fully coordinated under a single decision-maker, an agreement might be reached a little sooner.

# PERSONAL FINANCE COMPASS

## Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7083.0	-2.2	-161.4	⬇️
FTSE 250	19411.1	-2.0	-390.0	⬇️
FTSE AS	3907.0	-2.1	-84.5	⬇️
FTSE Small	5704.5	-0.4	-22.8	⬇️
CAC	5131.6	-3.5	-185.8	⬇️
DAX	11905.7	-4.6	-578.1	⬇️
Dow	24272.4	-4.1	-1037.6	⬇️
S&P 500	2660.1	-3.2	-87.2	⬇️
Nasdaq	6702.2	-2.8	-194.4	⬇️
Nikkei	21181.6	-3.2	-711.1	⬇️

## Global Equity Market - Valuations

MARKET	DIV YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.1	14.4x	13.4x	17.1x
FTSE 250	2.8	16.8x	13.8x	17.0x
FTSE AS	3.8	14.5x	13.4x	16.7x
FTSE Small	3.1	10.0x	-	-
CAC	3.0	15.5x	14.2x	15.6x
DAX	2.6	15.0x	12.5x	15.7x
Dow	2.1	19.6x	16.4x	15.3x
S&P 500	1.8	20.6x	16.8x	17.6x
Nasdaq	1.0	26.5x	20.5x	20.3x
Nikkei	-	-	-	-

## Top 5 Gainers

COMPANY	%	COMPANY	%
SKY	24.2	ITV	-9.9
BURBERRY GROUP	6.6	RIO TINTO	-9.0
SHIRE	6.0	FRESNILLO	-8.4
PERSIMMON	4.5	GLENCORE	-7.8
INTL CONSOLIDATED	4.2	BHP BILLITON	-6.6

## Top 5 Losers

## Currencies

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.38	-1.44	OIL	63.5	-5.7
USD/EUR	1.23	0.11	GOLD	1320.2	-0.6
JPY/USD	105.50	1.32	SILVER	16.5	-0.4
GBP/EUR	0.89	-1.50	COPPER	311.4	-3.7
CNY/USD	6.35	-0.13	ALUMIN	2147.0	-1.7

## Commodities

## Fixed Income

GOVT BOND	%YIELD	% 1W	1 W YIELD
UK 10-Yr	1.456	-4.3	-0.07
US 10-Yr	2.855	-0.4	-0.01
French 10-Yr	0.906	-2.9	-0.03
German 10-Yr	0.638	-2.3	-0.02
Japanese 10-Yr	0.068	28.3	0.02

## UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.5
3-yr Fixed Rate	1.7
5-yr Fixed Rate	2.0
Standard Variable	4.29
Weighted Average Interest Rate (BoE)	-
Nationwide Base Rate	2.50
Halifax Standard Variable	3.99

\* 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, just send me an email.

**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.**

Lothar Mentel

