Cave's Quarterly

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Deal Or No Deal?

In the UK the 'Brexit' saga rolled on, as the Conservative party leader, Boris Johnson, tried to suspend parliament for a period of five weeks through a process known as 'prorogation'. The suspension was subsequently reversed by Supreme Court judges who deemed it 'unlawful' and 'void', confirming many in Westminster's belief that Mr Johnson's unusually long prorogation was a very obvious move to cut down the time available for anti-no-deal MPs to debate ahead of the crucial October 31st deadline. Several developments over recent weeks suggest there is fresh momentum towards signing a revised Brexit pact however, with the prime minister working alongside allies in the Democratic Unionist Party (DUP) to promote the idea of an all-Ireland economic relationship, which would seek to replace the contentious backstop arrangement by minimising the scope for border controls across Ireland.

With the thick Brexit fog still lingering, global investors have shunned the UK equity market and we continue to trade at multi-year lows relative to global counterparts. Digging deeper into valuations, the international companies listed on the London Stock Exchange, with significant foreign revenue streams, have seen the value of their repatriated earnings boosted by sterling weakness and the perceived 'dependable growth' stocks (such as the large consumer goods companies) have extended their strong year-to-date gains.

The US-China trade tariff standoff, rising tensions across the Middle East and global central bank monetary policy have all continued to exert significant influence over stock markets in recent months. Whilst trading has been volatile at times, investor appetite for risk assets such as equities and corporate credit has broadly increased, with the US Federal Reserve (the Fed) and the European Central Bank (ECB) indicating that further monetary stimulus will be deployed as they attempt to prevent the current slowdown in global growth from turning into a full-blown economic downturn.

International Equity

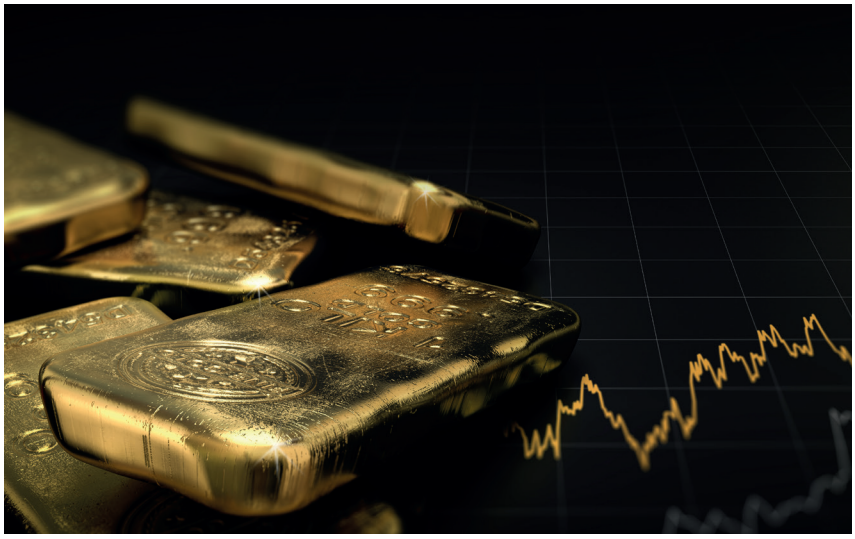
Global trade tensions which began in 2018 show little signs of resolution, with President Trump seeking to correct what he and his administration perceive to be trade injustices working against the US economy. Against this backdrop, global equity markets have seesawed and although negotiations between the US and China appeared to be proceeding amicably throughout the summer, they have since faltered on the issues of intellectual property rights and the state-led support that China provides to its growing technology sector.

The effects of the trade tariffs are yet to impact directly on the US consumer who continues to support economic growth, benefitting from the low cost of debt, low unemployment rates and rising wages. Corporate earnings consequently remain in good health and the S&P500 index trades close to all-time highs, having gained +7%* over the six-month period.

China, meanwhile, has implemented a mix of fiscal and monetary stimulus measures aimed at counterbalancing the effects of the trade war and moving away from big infrastructure projects, to focus on lower financing costs and tax cuts to encourage household spending. Chinese equity markets have been volatile amid concerns of slowing growth in the world's second largest economy; the SSE Composite Index has registered a -2.5%* decline since April.

Whilst China has been the clear focus of the US administration in the short term, there are growing anxieties that these disputes and protectionist policies may broaden to include other export-orientated regions such as Europe. Faced with geopolitical uncertainty, business confidence is low, and companies are deferring plans to invest as confirmed by recent Purchasing Managers' Index (PMI) data, which has evidenced an ongoing slowdown in industrial production, export levels and capital expenditure intentions.

The manufacturing data from Germany (traditionally considered Europe's exporting capital) in particular appears weak, with uncertainty relating to their dominant auto sector weighing heavily on the outlook for the Eurozone economy. In an environment whereby a further escalation in tariffs prompts companies to cut jobs as well as capital expenditure, consumer confidence will no doubt decline and the risk of a recession could intensify as cost pressures squeeze corporate margins. Despite these risks, Europe's leading blue-chip index, the Euro Stoxx 50 has recovered well from a widespread sell-off in August to register a +7%* gain for the six-month period.



Alternatives

In these times of political and economic uncertainty, gold has lived up to its reputation as the ultimate "safe haven" asset, with the price of the precious metal surpassing $1,500 per ounce in early September – its highest level since April 2013. Data released from the World Gold Council shows that central bank demand for gold has been unprecedented in recent years and this, coupled with stuttering global growth and negative interest rates, could help to underpin the gold price by reducing the "opportunity cost" of ownership.

Outlook

In a late cycle environment whereby central banks around the world are pivoting to easing, it remains unclear if the loosening of financial conditions will help to offset broadly slowing growth, increasing geopolitical uncertainty and generally higher levels of volatility. Recessions are notoriously difficult to predict and, even if you could with a degree of accuracy, positioning to gain from such an event is not a given. As such, we seek to reduce exposure to areas of the market where valuations seem excessive against historical norms and add to those where value is present. Portfolios continue to be positioned in a diversified manner, offering exposure to a broad selection of asset classes, and we have confidence in generating attractive returns over the medium-to-long term.

**Performance figures correct to the end of Q3 2019*

Fixed Interest

Strong returns seen in the government bond markets this year have been driven by global central banks pivoting towards easier monetary policy. As expected in September, the US Federal Reserve (the Fed) cut its main interest rate for only the second time since the 2007-08 financial crisis, confirming a dovish policy U-turn after lowering the target range by a further 25 basis points to between 1.75% and 2%. Also wary of recessionary threats, and eager to prevent a broader economic downturn across the Eurozone, the outgoing European Central Bank (ECB) president Mario Draghi, delivered a monetary stimulus package that exceeded market expectations, cutting the ECB's deposit rate to -0.5%, and announcing a new round of quantitative easing.

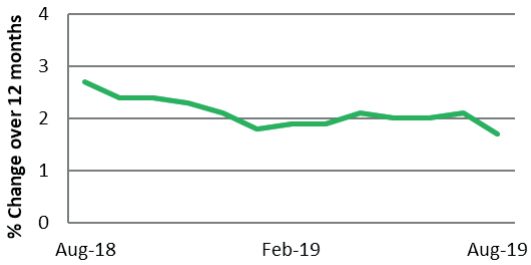
With markets in 'risk-off' mode, government bond prices spiked markedly in August as investors sought refuge in traditional safe haven assets. Consequently, the US 10-year Treasury yield fell to 1.5%, which marked an inversion of the yield curve between 2 and 10 years, not experienced since June 2007. Closer to home, half of the European investment grade bond market now yields below zero and, in the UK, the cost of government debt has tumbled to near record lows with the benchmark 10-year Gilt yield around 0.5%.

Commercial Property

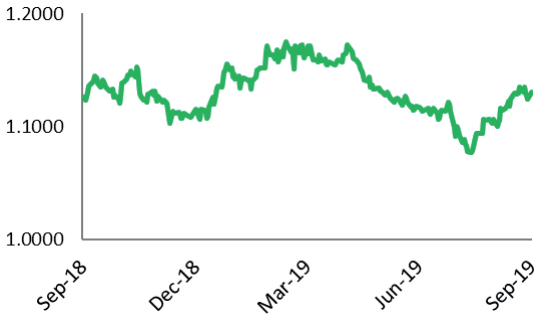
In UK commercial property markets, Brexit continues to act as a major drag on sentiment as the well-established trends remain firmly in place; strong demand growth is evident across the industrial sector and capital values in the prime office space appear robust, but retail woes persist in the face of structural decline, with shoppers continuing their shift towards increased online spending. With long term rent and capital values expected to fall further across both prime and secondary retail, the FTSE UK Property Index has languished over the six-month period under review, delivering a negative -2.6%* total return.

A year in numbers

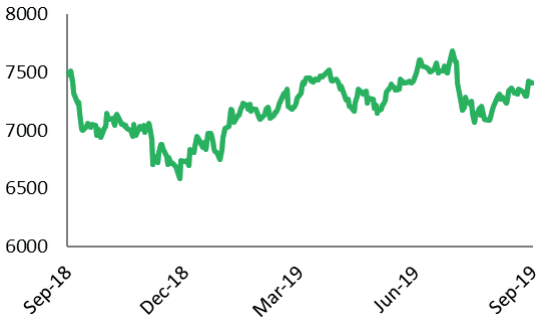
UK Consumer Prices Index (CPI)



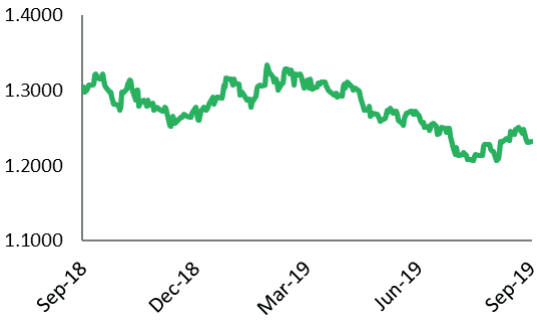
GBP/EUR Exchange Rate



FTSE 100 Index



GBP/USD Exchange Rate



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