Global Market Strategy – July 2016

La Esperanza entre La Pesadilla…..
(Hope amid the nightmare…)

We had better get used to it, Britain is out of the EU, and while many questions as to what extent will remain unanswered for many months, the UK and Europe have to move to another chapter.

There is a lot in the balance. Henry Kissinger, now 93, has said it is vitally important that the UK remains close to the EU in order to keep political and economic fallout to a minimum, both in the coming months and in future decades. 75 years of European stability and predominant peace should not be taken for granted, and there is a risk they are being. It could explain the additional damp-squib of an election result in Spain, three days following the Brexit vote. After months of non-government, the country re-ran their general election, and *Podemos,* the populist party which was expected to do well enough at the very least to be able comfortably to claim the right to co-govern with Mariano Rajoy's *Party Popular,* ended up losing ground to *PP,* the conclusion being that so unnerved were the Spanish by the UK's vote, they couldn't bring themselves to create more instability by fully unseating the incumbent.

Initial panic and furore following Brexit has subsided, judging from the dramatic bounce-back of the equity markets, indeed such has been the change in bearish sentiment that the FTSE100 index ended up for June by 0.9%. Yet the ramifications from the vote have been, are and could be considerable.

Banking stocks and house-builders were hit hard the day after, and the pound sterling has taken a hammering. The pound initially fell 10%, and to a 31 year low against the dollar, before rebounding slightly to finish the month at $1.3370 and €1.2030. When Mark Carney began speaking of injecting up to £250bn of additional liquidity into the markets in order to assist bank lending and ward off the threat of recession, and then of reducing interest rates in the UK to zero, the currency came under further pressure. Traders are talking of sterling falling to an initial short-term floor of $1.20. The danger of that is while it may be favourable for UK exporters, increased flight to the dollar as a safe haven could be damaging for US stocks if it becomes exaggerated (and hence a further need for money stimulus from the Fed). The swaps market is now pricing in a rate rise in the UK not for another five years.

As you would expect, gold and silver have benefitted from 'easy-money' talk, and they will benefit further if the ECB speaks in a similar way to the Bank of England. Superficially, gold has been fairly stable in US dollar terms, currently trading at £1331, but considering this level has held in the face of a strengthening dollar, it's performance has been strong. Most gold mining shares are now up over 100% in the last year. In the last month, silver has risen from just under $16 per troy ounce to over $19. Fresnillo, a Mexican silver mining company, has risen 74% in June alone. Talk in December last year of four US rate rises in 2016 seems a long, long way away now. Credit Suisse have raised their end year target for gold to $1500, but more analysts are jumping on the silver bandwagon, claiming the silver/gold ratio is strongly in the former's favour.

Gold Miners Index, 6 months (Source: Financial Times)

It has been said for some time we are in a stock-pickers market, and undoubtedly some stocks have performed exceptionally, but on a year to year basis it is hard to find a winner in the international indices. The only one is Argentina, up 23.58%

Commodities as a whole have had a better run of things. In the last six months, while global equities as measured by Bloomberg are down 3%, oil is up 34%, soya is up 44%, sugar up 32%, and zinc is up 29%. Nicole Elliott, technical analyst at the FT.com, believes sugar, cocoa, coffee and orange juice all have significant upside: sugar to 30c from its current 20.87c; cocoa to $3600 from $3062; coffee $2.20 from $1.45; and orange juice $2 from its current $1.75

Fresnillo share performance, 3 months (Source: Financial Times)

Favoured investment plays:

Nil risk: USD cash (in preference to Euro cash)
Cautious risk: AAA Corporate / Government bonds (short duration)
Balanced risk: Managed / Multi-asset funds / Long-Short Absolute Return funds
Market risk: UK**,** European equity
Adventurous risk: **Japan, Asia,** US equity, UK/European/US smaller company sector
Speculative risk: Timber, Water, Technology, **China, India,** Other EM, **Gold and gold miners, Silver, Cocoa, Orange Juice, Sugar, Coffee**

Disclosure:

Nicholas Chappell has the following personal investment exposure: Technology (US) 10%, US smaller cos 2%, (Other) US equity 8%, UK smaller cos 10%, (Other) UK equity 4%, Iberia 1%, European Telecoms 1%, (Other) European equity 7%, India 1%, Japan 10%, China 5%, (Other) Asia 14%, Energy 3%, Pharmaceuticals 8%, Long-Short Hedge 5%, Gold miners 11%

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