Realm Investment Management
Market Update - August 2019

For UK investors, July was another positive month, with continuing weakness in the Pound helping to lift overseas assets. There was much for the markets to digest in July with a new Prime Minister in the UK and the ramifications for Brexit, the European Central Bank giving clear signals that further easing is on the way and the US Federal Reserve cutting interest rates for the first time in more than a decade. In fact, the 0.25% cut, announced by the Fed on the last day of July, seemed to disappoint the markets, as a 0.50% cut was hoped for. Further disappointment at the end of last week came from US President Trump who surprised markets by announcing further tariffs on Chinese goods imported into the US and this has set August off on a weak note.

U.K.

Boris Johnson won the Conservative party leadership contest and is now in charge of our negotiations with our European Partners. The Pound fell further on his appointment as fears of a no-deal Brexit were seen to have increased and the currency markets responded accordingly. As we move towards the October 31st deadline Johnson will hope that the threat of a no-deal outcome will improve his chances of re-negotiating better terms with the EU. Many see a no-deal exit as unlikely unless a general election were to provide a mandate for it, and Johnson's recent public spending promises may be a clue that he is preparing to do just that.

In regard to our monthly UK Market Chart, which as usual is shown below, we conclude that the UK stock market is holding up reasonably well given all of this uncertainty. On this longer-term timeframe our Breadth indicator has remained neutral (black bar) whilst our Price Momentum indicator has improved.

U.S.

Regarding the U.S./China trade dispute, we wrote in last month's update "a trade deal would clearly be welcomed, not least because the current uncertainty may well be stalling capital investment". Well, hopes for improvement in negotiations took a knock at the end of last week when President Trump announced an additional 10% tariff on another $300 billion of Chinese imports from 1st September. This came just two days after trade talks were resumed. The likeliest reason for the new tariffs seems to be U.S. frustration with the Chinese - last Thursday the President tweeted that "China agreed to buy agricultural product from the U.S. in large quantities but did not do so". Another reason, which some observers have commented on, could be the President's disappointment with his own Central Bank, who in his mind are not cutting interest rates fast enough. As mentioned, the Federal Reserve cut US interest rates by 0.25% on the last day of July, yet Trump wanted more. Since Fed Chairman Jerome Powell cited trade tensions as a reason for last week's 0.25% cut, some observers believe that Trump may have decided, in an effort to force the Fed into further cuts, to slap further tariffs on China. Whatever his reasoning may have been, what is clear is that the markets did not react well. We know Trump has often cited the success of the US stock-market as proof of his tenure. We think it reasonable to assume that he will soften his approach.

On the Fundamental side, more than 60% of S&P500 companies have now reported second quarter earnings and more than 75% of them have beaten estimates, albeit these estimates were lowered as analysts became more pessimistic. Leading indicators continue to suggest that an imminent recession in the U.S. is unlikely although July PMI data suggests manufacturing is weakening.

See below, our U.S. Market Chart through end of July. Again, this is a monthly, or longer-term view. Our U.S. Breadth Indicator remained neutral, but our Momentum Indicator ticked higher. As mentioned, this chart is through end of last month and how much of an impact the weakness at the start of this month will have, remains to be seen. You can also see from the chart that the U.S. market (unlike many other regions) is currently close to its highs, underlining its relative strength.

EUROPE

In July Christine Lagarde was nominated to take over from Mario Draghi as ECB leader at the start of November. She has made it clear in the past

that she supports his views on monetary policy and it is therefore seen as unlikely that she will change course. The ECB's Governing Council therefore sent a strong signal at its July meeting that fresh stimulus will be forthcoming. European economic results came in weaker than expected last month adding pressure for that decision to be made quickly. For example, German purchasing managers' index in July showed the sharpest contraction in years and industrial production registered its largest annual decline in almost a decade.

OVERSEAS EQUITIES

As you will gauge from our comments above, we continue to favour the U.S. equity market over all other regions. Both our Relative Strength and Fundamental analysis indicates that the region remains the strongest across the globe.

The same analysis tells us that Europe and Emerging Markets have been relatively improving, which we feel justifies our current exposure, and that we should maintain our under-weight position on Japan as it continues to remain weak. Currently we have no direct exposure to China.

Chinese stocks continue to struggle and the Chinese GDP figure of 6.2% shocked the markets last month - it being the lowest for almost three decades. However, the Chinese government is continuing with its policy of support including infrastructure spending, monetary stimulus and income tax cuts.

BONDS

Bond sectors remained strong through July. Best performing Bond sectors were Global Bonds +2.8% (helped by Sterling weakness) and Index Linked Gilts +2.24% both of which we hold in significant proportion across all our portfolios. As we wrote last month "Bonds have rallied strongly this year and in a technical sense are overbought but we don't see any weakness yet". We see no change in this view and perhaps with recent weakness in Stocks, the argument for Bonds has increased, particularly given the recent evidence that the Central Banks are likely to cut interest rates and with fears of escalating trade wars, bonds are increasingly being bought as a safe-haven protection.

SUMMARY

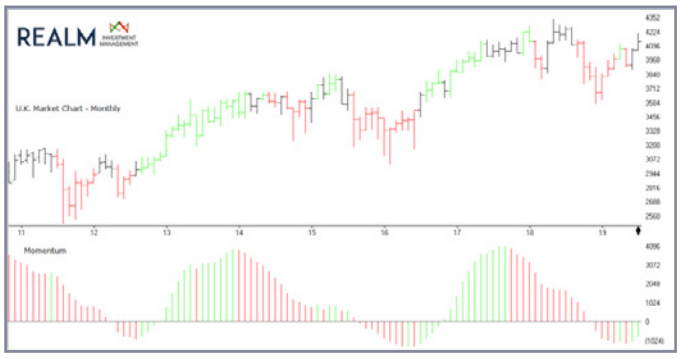
Our portfolios were up strong in the month of July but the first few trading days of August have given back some of those gains as the trade tensions between the U.S. and China have escalated. As yet, we don't see any cause for concern as the retracement in equities is well within the bounds of normal volatility. If we were to see further weakness our portfolios have a high level of diversification which should mitigate some of the risk. As mentioned above, we have a reasonably high exposure to bonds (more below), multi-asset funds and a significant holding in a long-short equity fund (Polar Capital UK Absolute Equity Fund) which rallied nearly 4% last week as equities sold-off.

Traditionally bonds have tended to move inversely to equities which offers a diversification benefit in the event of a stock market sell-off. However, for some time now bonds have been moving in tandem with equities which can be a concern as their protective element would be lost in a market decline. Interestingly though, in the first few days of August when equities sold off, bonds rallied strongly which is an encouraging sign that bonds retain their safe-haven status.

As UK investors we witnessed a currency advantage in July as the Pound fell significantly following the appointment of Boris Johnson as the new Prime Minister. As explained before, this may seem counter intuitive, but a large element of our portfolios is invested overseas (both equities and bonds) and these assets therefore gained as the Pound fell.

We hope you have found this latest update of interest. Thank you for reading.

U.K. MARKET CHART - MONTHLY



U.S. MARKET CHART - MONTHLY