GOLDLAKECAPITAL

Q4 2019 MARKET REVIEW – 24 January 2020

All asset classes performed strongly in 2019, supported by Central Banks policies to keep interest rates low for longer. Markets reacted positively to the US Federal Reserve policy reversal in early 2019. The US Federal Reserve which had been increasing interest rates in 2018 reversed its policy in early 2019 following the sharp market sell off at the end of 2018. The US Federal Reserve ended up reducing interest rates three times in 2019.

De-escalation of trade tensions between the US and China towards the end of the year and signs that the global economy was stabilising led to a strong rally in equities and other risk assets. In the UK, a disorderly Brexit was avoided in October and the decisive results of the UK general election in December finally removed the political gridlock.

Interest rates to stay lower for longer

In recent communication, the US Federal Reserve Board indicated that they can still see slack in the job market despite the unemployment rate being at historical low levels. There is also evidence that the economic recovery is finally having an impact on the poorer in society with people struggling to get back in employment now getting the opportunity to do so. Any premature rise in interest rates may jeopardise the chances of those in long term unemployment. As inflation has remained subdued despite a strong economy, the objective of maintaining economic growth and reaching full employment have been prioritised. For these reasons, the Federal Reserve Board is cautious about raising interest rates too soon and seems prepared to maintain interest rates low for longer and to tolerate higher inflation rates. This is a significant change in policy from 2018 when the Federal Reserve Board was keen to normalise interest rates and reduce the Federal Reserve balance sheet.

De-escalation of trade tensions between the US and China

The signature of a 'phase one' trade agreement between the US and China on 15 January 2020 signals a de-escalation of the trade tensions between the two countries. The Phase one agreement calls for China to increase purchases of US commodities, manufactured goods and services by $200bn over the next two years compared to 2017 levels. The deal also commits China to take step to crack down on the theft of US technology and to avoid currency manipulation. US demands regarding Chinese state subsidies and alleged cyber theft are due to be included in a phase two agreement to be negotiated in the coming months. In the meantime, most of the existing tariffs imposed by both countries remain. Stock markets have reacted positively to the agreement given the alternative which would have been an escalation of trade tensions and additional tariffs imposed by both sides. However, there is already some doubt about the feasibility of some of the demands in particular China's ability to significantly increase purchases of US commodities and agricultural products given that existing tariffs make the US goods uncompetitive. Both countries will look for signs that phase one is being implemented before starting on phase two of the negotiations which are likely to be more complex.

Decisive UK general election

A disorderly Brexit was avoided on 31 October 2019. The UK general election in December gave a strong and decisive majority to Boris Johnson and the Conservative party, thereby removing the political gridlock of the past three years. Boris Johnson's message of 'Getting

Brexit done' was a success, helping the Conservative party gain traditional Brexit supporting Labour seats in the North of England. The clear majority means that there is a strong government able to push its agenda. It also means a stronger and clearer negotiating partner for the European Union (EU).

Recent announcements seem to indicate that the government is currently set on a 'hard' Brexit, modelled on the existing trade deal between the European Union and Canada. The current UK government wants to be able to diverge from EU regulations including social and environmental standards. The government's insistence that a trade deal be agreed by the end of 2020 gives little time for negotiations. Until the end of 2020, the UK remains, for economic purposes, in the European Union. The economic impact and expected disruptions will only start to become clear after the end of the transition period. The UK will need to make difficult choices between retaining a comprehensive access to the EU market or being able to diverge from EU rules and regulations in order to exploit opportunities elsewhere. We expect business uncertainty to remain until there is clarity about the future UK and EU trade and economic relationship.

After the strong market performance of 2019, there is reason to be cautious given that the underlying economic situation and political reality have not changed significantly since 2018. The recent Phase 1 trade agreement between the US and China have not resolved the long-term issues between the two countries and have kept in place a significant share of the existing tariffs. In the UK, Brexit is now going to happen but the long-term social and economic consequences of the UK leaving the European Union are yet to emerge. For these reasons, we continue to maintain our current defensive investment strategy.