Newsletter

January 2020

INDEX House View

First of all, happy new year!

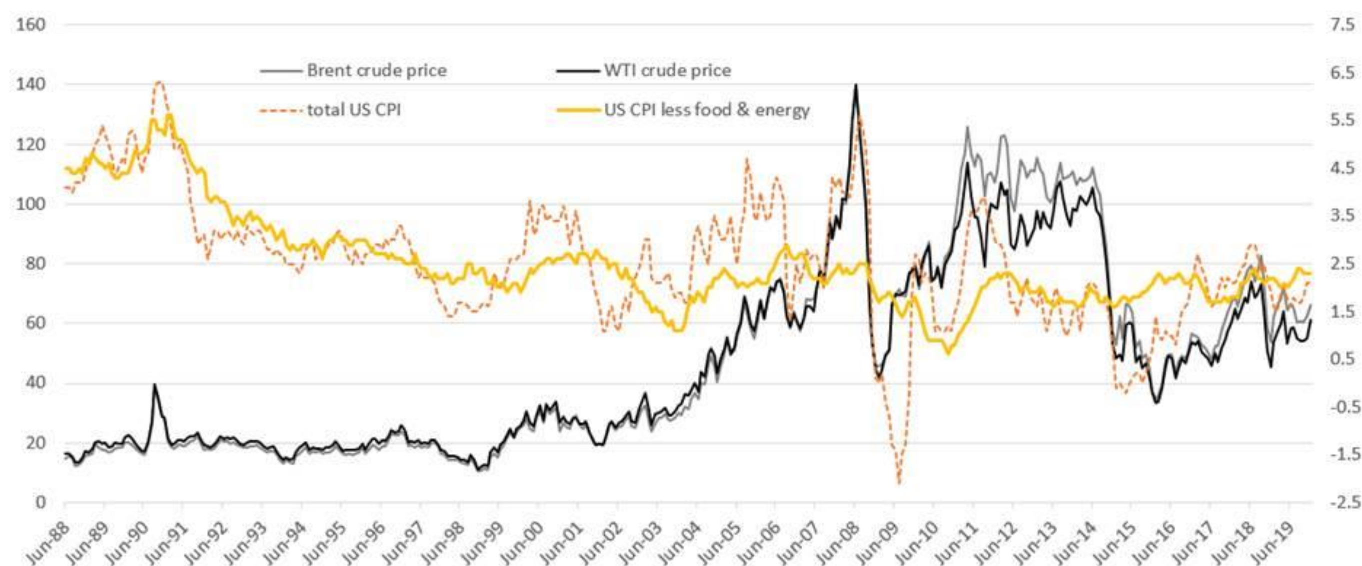
The new decade kicked off with an unexpected event on the international stage: the killing of Qaseem Soleimani, commander of the most regionally active Quds force and major general in the Islamic Revolutionary Guard Corps. The incident has triggered surprise among US allies, confusion among American law makers and shock in the Middle East, where Iranian influence has been growing steadily since the toppling of Saddam Hussein in 2003. Markets' attention is now fixed on trying to understand (1) whether there is a plan behind what seems a typically Trumpian instinctive move, which is diametrically opposite to Trump's own previous intention to disengage in "endless wars" in the region, and (2) what are the economic and financial repercussions of a probable conflict in the region. In general, investors do not like unpredictability, and the US administration is, unsurprisingly, providing plenty of exactly that.

From an economic perspective, disruptions in Middle Eastern balance is largely associated with uncertainty in oil supply. Retaliation from Iran could translate into further attacks on Saudi pipelines or infrastructure, considering past military choices of the Islamic Republic. Would a larger scale of last year's attacks produce a more substantial and longer shutdown of oil supplies? Our answer is that today we are very far away from an oil market where the OPEC dominated, or from a US dependence on Gulf oil, or even from a limited amount of producing countries. Today, the oil market is awash with supply and reserves from many producing countries, so a sudden drop in Saudi production would quite likely be immediately filled by many other cash-thirsty countries with ready inventories (Libya, Russia, without considering the vast exporting capabilities of the US). If this interpretation is close to reality, then oil price should see the traditional 1-day or 1-week spike and then come back to its long-term trajectory – that means downward.

The main topic related to oil price movements is indeed inflation. Markets are ultimately worried by oil price spikes pushing up inflation in the US, which in turn would force the FED to reign in an over-heating economy by hiking rates. At the same time, hiked rates are bad news for the mare magnum of debt held at every level of Western economies, where already feeble earnings risk to be erased by an increase in debt servicing cost.

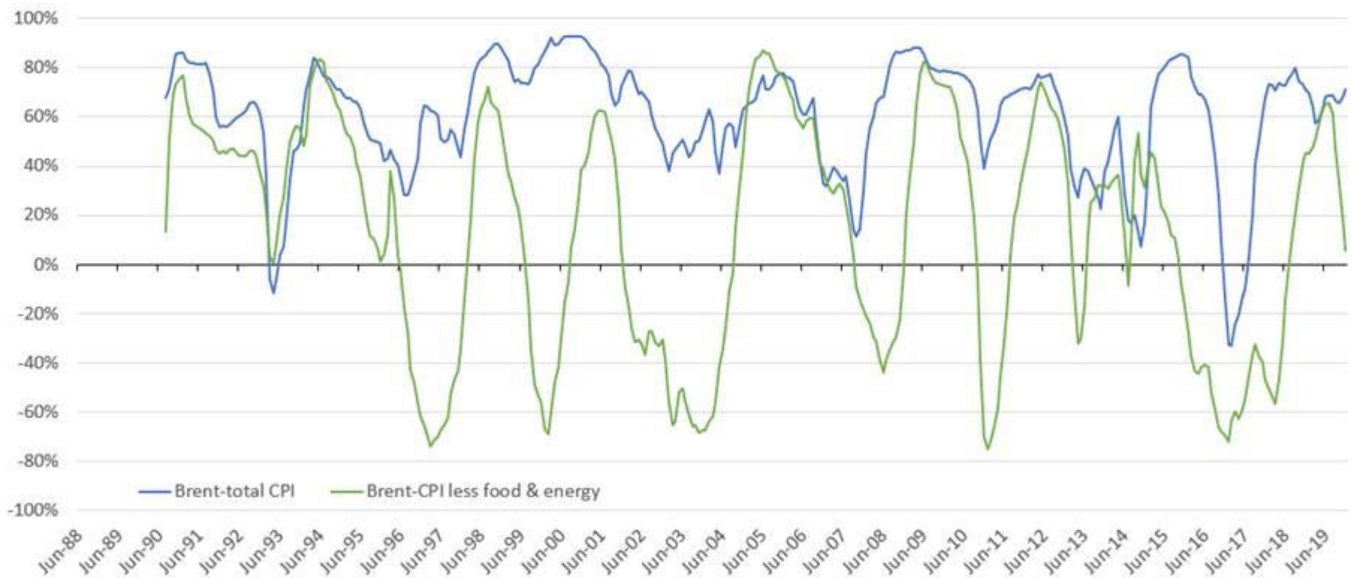
In order to have a clearer picture of the extent to which oil price drives inflation in the US, we plotted price trends (first graph) and correlation (second graph) together. It emerges that correlation with the total CPI (inflation index including all products purchased) is almost constantly positive, while correlation with inflation ex-food and energy is much weaker – becomes negative often, which suggests forces other than crude oil are at play. In numerical terms, the intensity is even clearer, as crude oil and total inflation show an average correlation of 61% since June 1988 (that is 32 years), while crude oil and inflation ex-food & energy show only 13% over the same period. This means that there is indeed a strong influence of crude oil prices on US inflation.

Crude oil prices & inflation indexes



Continues below

26-month correlations



Lack of visibility on the evolution of the Middle Eastern situation adds to the uncertainty generated by existing global and regional challenges. While markets have been dangerously optimistic during 2019 and probably are still so, chances are that the current geopolitical environment will contribute in making markets more nervous as we enter 2020. This provides stronger ground to the idea that equities and bonds will find it rather difficult to replicate 2019's performance, but expectations for 2020 are still positive. Perhaps as a measure of how optimistic global investors have been and continued to be, commodities were the least appreciated asset class – commodities tend to do well when there is a flight to safe haven assets, such as gold.

We remain optimistic that buying opportunities will materialize during 2020 in selected equity and fixed income sectors, while we consider an allocation to gold as the strongest insurance against sudden drops in an already stretched market confidence.

For further details, please contact:

INDEX & Cie Limited
Index Tower, 20th Floor, # 2001
Dubai International Financial Center
PO Box 507069, Dubai, UAE
www.indexcie.com

Tommaso Leodari
Chief Investment Officer
Email: tl@indexcie.com

Disclaimer

The information herein contained, including any opinions and any terms and conditions presented (the "Information") has been prepared and distributed by INDEX & Cie Ltd. (the "Asset Manager"), and is directed at, and related financial products or services are only available to wholesale clients (non-retail customers) who qualify as either Professional Clients (as defined in DFSA's Rulebook, Glossary Module ("GLO") or Market Counterparties (cf. GLO) under the Rules (cf. GLO) enacted by the Dubai Financial Services Authority ("DFSA"). This document is being furnished to the intended recipient solely for information purposes and no other Person (cf. GLO) shall act upon the Information. Any investment carries its own risks; the investor must be aware of the risks posed by an investment (cf. GLO) and is fully responsible for the risks incurred. The Information is not and cannot be understood as impartial investment research. The Asset Manager does not guarantee the accuracy or completeness of the information and the opinions expressed herein are the Asset Manager's opinions at the moment they are conveyed only and are subject to change without prior notice. The Asset Manager is not under any obligation to update or keep current the Information and the opinions expressed herein. Neither the Asset Manager nor any of its officers directly responsible for the Information (or a close relative - cf. GLO - of the latter) have a financial interest or material interest that relates to any on the investments herein recommended or suggested, nor the Asset Manager either, as far as the Asset Manager is aware of, any Asset Managers associate (cf. GLO) owns (unless stated otherwise elsewhere in this document) 1% or more of the total issued share capital of any of the Issuers (cf. GLO) mentioned herein. The Asset Manager does not act as a corporate broker to any of the Issuers (cf. GLO), although one of the Asset Manager's associates may act or have acted as such. The Asset Manager has not undertaken any corporate business with or for any of the Issuers over the past 12 months, nor has in the pipeline any future relevant corporate finance business initiative involving the latter, nor is a market maker (cf. GLO) in any of the investment recommended. None of the Issuers herein mentioned has a material shareholding in the Asset Manager. This document cannot be reproduced, in whole or in part, in any form or by any means, without the Asset Managers specific authorization and any distribution of the information on behalf of the Asset Manager is strictly prohibited. Neither this document nor any copy hereof may be sent or taken or transmitted into or distribute, directly or indirectly, in any jurisdiction other than the Dubai International Financial Center. Any failure to comply with this restriction may constitute a violation of the laws of the jurisdiction where the document is being redistributed. This document does not constitute or form part of, and should not be construed as any offer or sale or subscription of or solicitation of or invitation to make any offer to purchase or subscribe for any financial products or services and neither this document nor any part of it shall form the basis of or be relied on in connection with or act as an inducement to enter into any contract or commitment whatsoever. The Asset Manager does not accept any kind of liability for losses or damages which may arise from the use of this document or its contents, nor for the unlawful reproduction and/or redistribution of the same. The Asset Manager is duly licensed and Regulated by the DFSA.