Sanctum
Wealth Management

with
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Out of Control

- **President Trump's unprecedented intervention raises the stakes massively with Iran**
- **The President has gambled with the world's well being**
- **A spike in oil prices raises the risk of higher inflation and lower global growth**
- **Gold is the obvious winner**
- **Massive Australian bush fires highlights again the substantial risks from climate change**
- **We expect investors to accelerate their move to pro-ESG strategies**

Not for the first time, a US President may be underestimating the complexity of the Middle East. The very measured responses from even allies of the US to the killing of Qasem Soleimani suggests that there has been a grave misjudgement made in the White House. For the President to subsequently tweet that he has 52 Iranian sites including cultural monuments in mind for further retaliation beggars belief.

The more worrying trend is that the current US leadership is disengaging from, or disrupting, several global geopolitical theatres. World order needs consistency in decision-making by our world leaders, and the US is not playing its part. On the Korean peninsula, Kim Jong Yun has

decided that the only way to respond to the scale of US sanctions is to continue development of a nuclear capability. Iran has been boxed in ever since the US reneged on the limited lifting of sanctions. If Iran were to gain a nuclear weapon, it could only presage nuclear proliferation in the Middle East. The global nuclear non-proliferation treaty is up for review this year at a conference in November where hope springs eternal for an agreement to be found. Unfortunately, the more likely outcome is a failed conference and a severe risk of nuclear proliferation.

The markets view the immediate risks as two-fold, firstly the threat of inflation from persistently higher oil prices and secondly a dip in global growth.

The oil price is up some 20% over the past three months. We should expect inflation to print higher in many countries as we go through January and February. The impact on markets will depend on whether investors see the spike as likely to persist.

The impact of higher inflation would be to curtail growth as consumers lose real spending power. Less growth and the geopolitical problems could lead to the loss of momentum in the New Year equity market rally. The S&P500 from its high of 3254 is vulnerable to a set back to the 3100 level (-5%), taking us back to the levels of early December. A more significant setback with marked investor profit-taking could see the S&P500 around 2900 in a 10% unwind.

The best outcome is that investors may are sanguine about geopolitical events with the thought that if there is any setback in growth, the Fed is always on high alert to cut interest rates or expand quantitative easing. The only counter-argument to more relaxed Fed policy is that the Fed might be reluctant to cut interest rates if inflation is materially higher due to an oil price shock.

Gold is at a six-year high at $1571. The reasons for further rise in the gold price were already in place with ongoing central bank buying, and signs of significant investor demand with COMEX open interest at their highs. A prolonged confrontation between Iran and the United States, and the possibility of higher inflation would play to a higher gold price. Gold has $1600 per oz in its sights, which would take it to the low end of the trading range seen in the big bull market of 2011-13 when the metal hit a high of $1900.

ESG - Voting with our feet: investors to take the lead, not governments.
We already believed that ESG issues would have a bigger impact on financial markets in 2020 after the exponential growth in interest in 2019. The Australian wildfires only drive home even more strongly the need for investors to vote with their wealth to bring about change. We can’t wait for governments to respond. Waiting for the policymakers to accelerate the development of strategies to bring about change could be catastrophic. We can only hope that investors vote with their feet and redirect their investments towards ESG aware investments that penalise industries and companies that are slow to adapt to significant challenges we face. We expect to see funds with a specific ESG aware investment process to take an increasing share of money flows.

Climate change does not per se create bush fires – they have always been part and parcel of life in the Australian bush; however, climate change has put those bush fires on a scale never seen. Australia witnessed its hottest year on record with average temperatures nearly two degrees

hotter than normal. Australia has already suffered the most destructive bush fires ever. Fifteen million acres of Australia are now thought to have burnt; equivalent to three times the land damaged in the 2018 California wildfires. Ecologists at the University of Sydney estimate that up to 480 million animals may have perished.

The effect of the bush fires could be felt for many years to come.
Bushfires release carbon dioxide, a greenhouse gas, into the atmosphere. The gas, which makes up only a small percentage of the total gases in the atmosphere, is exceptionally good at trapping heat. In just three months, Australia's fires are estimated to have released 350 million metric tons of carbon dioxide. Experts warn a century or more will be needed to absorb the carbon dioxide released. (Source cnet.com)

Australia already has one of the highest levels of per capita greenhouse gases in the world due to the heavy burning of coal and the use of liquefied natural gas. The political pressure for change will be immense in the wake of the fires. Australia is still one of the most substantial suppliers of coal. Often the development of coal projects requires government approvals. In the summer, the Australian government approved a very controversial coal mine in the state of Queensland. Voter pressure could curtail such developments. Indeed, by contrast, the New Zealand Prime Minister has pushed through landmark climate legislation that commits the country to slash carbon emissions to zero by 2050.

Australia's natural resources could have very depleted future value if the markets take a more substantially negative view of coal and oil. Mark Carney, the outgoing governor of the Bank of England and future UN special envoy for climate action and finance, recently warned of the risk in the financial markets of what is called stranded assets. He warned that up to 80% of coal assets and up to half of the developed oil reserves would need to be left undeveloped for the world to hit its target of allowing temperatures to rise by less than two degrees over coming decades.

If we could only focus on 'normal' news, there are reasons to be more upbeat. The economic data in Asia continues point to modest improvement. China, Korean and Taiwan economic data releases last week pointed to an improvement in the manufacturing sector. It appears that the impact of the trade war has in large part worked its way through the pipeline. Inventories have adjusted and companies are more settled after the disruption earlier in 2019. Both Korea and Taiwan's manufacturing sector purchasing managers' surveys improved in December. Improvements were broad-based, and both surveys showed better new orders.

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