FP FINANCIAL PARTNERS

momentum

easton Asset Management

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## Newsflash

A new month and the 94th issue of Viewpoint from **Financial Partners**.

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*Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at The Rex Building, 62 Queen Street, London, EC4R 1EB.*

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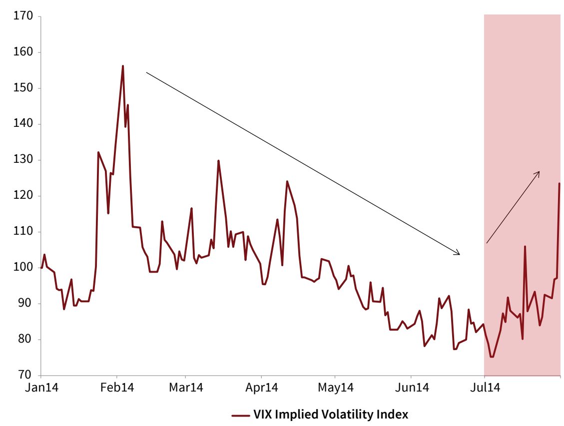
## Market Commentary

A series of largely unrelated events led to increased market nervousness in July, which culminated in a sell-off on Wall Street of circa 2% on the last day of the month. This was the biggest single day fall for three months and broke the pervading calm which has been a key characteristic of markets this year. The sell-off resulted in the MSCI World falling 1.6% in July with only Japan (+2.1% in yen terms) and Asia excluding Japan (+3.5% in US dollar terms) producing positive returns. Global returns translated into US dollar terms were also negatively affected by the strength of the greenback, with the euro falling by 2.2%, sterling by 1.3% and yen by 1.4%, against the US dollar. The Chicago Board Options Exchange (CBOE) VIX index of implied volatility rose sharply, bucking the trend of falling volatility year-to-date.

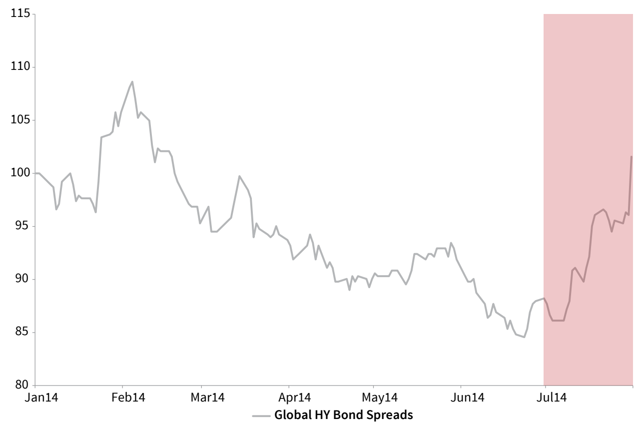
*Figure 1: (CBOE) VIX index of implied volatility*



In contrast, strength in emerging equity markets (EM) early in the month, especially in Asia and Latin America, was enough to keep the MSCI Global Emerging Markets index in positive territory for July. EM equities returned +1.9% bringing their return to +8.2% year-to-date. This puts EM equities well ahead of their developed market counterparts, which have returned 4.5% year-to-date.

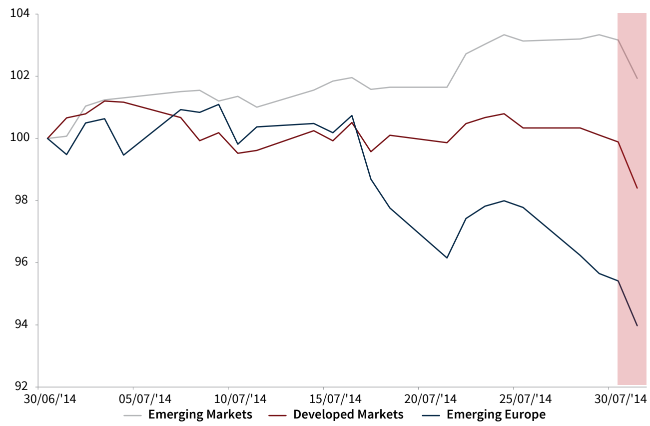
There were some divergent returns from bond markets in July. Whereas European government markets were firm, US Treasuries slipped late in the month on the strong growth numbers and returned -0.2%. However, it was in credit that the most notable returns came. Investment grade credit performed broadly in line with governments but US high yield bonds saw a sharp sell-off and returned -1.3% in the month. July saw large outflows from US high yield exchange traded products (ETFs), with a net outflow of over USD 10 billion which is around 3% of the total assets under management of these funds. Emerging market debt continued to perform satisfactorily, with a small positive return, despite the mini default of Argentina, which markets had been pricing in for some time.

*Figure 2: US High Yield Bond Spreads*




Geopolitics has occupied investors throughout this year, but became an increasing concern during July, following the downing by Russian supported separatists of the passenger plane MH17 over Ukraine. Following this, there was a significant tightening of sanctions imposed on Russia by the US and Europe which may start having a material impact on a number of companies in the West. The Russian market fell by 8.8% in US dollar terms in the July and the rouble depreciated by 4.9% against the US dollar. Equities in emerging Europe were marked down 6.0% over the month.

Figure 3: Equity returns in July for Developed Markets, Emerging Markets and Emerging Europe




The instability in the Middle East also remains a concern. The Israel-Gaza flare up has few wider implications given the small size of these economies and the absence of oil, but a return to civil war in Libya has a clear risk to oil supplies, given that Libya's production had been climbing rapidly back to pre-crisis levels of 1.6 million barrels per day. The push in Iraq by Islamic State, formerly known as Islamic State of Iraq and the Levant (ISIS), has stalled as expected as they approach the southern Shia stronghold, but the US was forced to engage when they turned on Kurdish areas in the north of the country.

July reminded the markets that deep underlying financial problems remain in parts of the world. Most notably, one of Portugal's largest banks, Banco Espirito Santo (BES), fell into serious difficulties as its parent group suffered substantial write-offs and a resultant capital shortfall. Although the scale of the required capital injection is modest in comparison to the bailouts of other banks over the past few years, it provides a salutary reminder of the problems that persist in Europe.

The failure of BES could well have been a factor in pushing

*Source: Bloomberg. Returns in US dollars unless otherwise stated. July 2014.*

government bond yields in Europe lower over the month, as the deflationary impact of excessive debt levels continues to weigh on the recovery. Notably, German 10 year government bond yields fell to all-time lows of 1.1%, just below the levels reached during deepest part of the European crisis in July 2012; this compares with a yield of almost 2% at the beginning of this year. Other government bond yields in Europe also fell, in many cases to all-time lows. Economic news from the euro area provided support for lower yields, as the key German economy showed signs of slowing.

The US economy recovered sharply from its weather induced temporary weakness in the first quarter, with a rebound to 4.0% growth in the second quarter of 2014 (and Q1 growth was revised up from -2.9% to -2.1%). This rebound to significant growth, together with continuing strength in jobs growth, pushed up US Treasury yields and led to concerns that the Federal Reserve (Fed) would bring forward the first interest rate rise. Chair of the US Fed, Janet Yellen, remains broadly dovish, however, referring to ample capacity in the US economy. Moreover, the second quarter numbers for growth hide the fact that nearly half of it came from inventory building, suggesting that underlying growth remains at around the 2-2.5% level, consistent with rates staying lower for some time yet.

The Japanese economy is still feeling the effects of the 3.0% sales tax rise in April, but this did not prevent the equity market from continuing its recovery from the sell-off earlier in the year. Of more significance was stabilisation in the Chinese economy, which showed second quarter growth of 7.5%, in line with the full year expectations.

Markets have finally come out of the long period of low volatility and the combination of negative events this month has caused the long awaited setback. This could well continue in the short term, and we would view that as a healthy correction, removing some of the excessive valuations from some assets and sectors. However, the underlying economic news remains supportive and monetary policy will remain loose for some time yet. While we are getting closer to the day when rates will be increased in the US, the rise will be modest and gradual and should come as no surprise to investors.

*Source: Bloomberg. Returns in US dollars unless otherwise stated. July 2014.*

# **Market** Performance

| Asset Class/Region | Index | To 31 July 2014 | | |
|---|---|---|---|---|
| | | Currency | Month | Year to date |
| **Developed markets equities** | | | | |
| United States | S&P 500 NR | USD | -1.4% | 5.3% |
| United Kingdom | MSCI UK NR | GBP | 0.0% | 1.9% |
| Continental Europe | MSCI Europe ex UK NR | EUR | -2.7% | 3.4% |
| Japan | Topix TR | JPY | 2.1% | 0.2%* |
| Asia Pacific (ex Japan) | MSCI AC Asia Pacific ex Japan NR | USD | 3.5% | 10.8% |
| Global | MSCI World NR | USD | -1.6% | 4.5% |
| **Emerging markets equities** | | | | |
| Emerging Europe | MSCI EM Europe NR | USD | -6.0% | -5.7% |
| Emerging Asia | MSCI EM Asia NR | USD | 3.4% | 10.5% |
| Emerging Latin America | MSCI EM Latin America NR | USD | 1.0% | 8.3% |
| BRICs | MSCI BRIC NR | USD | 3.2% | 8.0% |
| Global emerging markets | MSCI EM (Emerging Markets) NR | USD | 1.9% | 8.2% |
| **Bonds** | | | | |
| US Treasuries | JP Morgan United States Government Bond Index TR | USD | -0.2% | 3.1% |
| US Treasuries (inflation protected) | Barclays Capital U.S. Government Inflation Linked TR | USD | 0.1% | 6.5% |
| US Corporate (investment grade) | Barclays Capital U.S. Corporate Investment Grade TR | USD | -0.1% | 5.6% |
| US High Yield | Barclays Capital U.S. High Yield 2% Issuer Cap TR | USD | -1.3% | 4.1% |
| UK Gilts | JP Morgan United Kingdom Government Bond Index TR | GBP | 1.0% | 4.6% |
| UK Corporate (investment grade) | BofA Merrill Lynch Sterling Non Gilts TR | GBP | 0.5% | 5.2% |
| Euro Government Bonds | Citigroup EMU GBI TR | EUR | 0.9% | 8.0% |
| Euro Corporate (investment grade) | Barclays Capital Euro Aggregate Corporate TR | EUR | 0.5% | 5.3% |
| Euro High Yield | BofA Merrill Lynch Euro High YieldConstrained TR | EUR | -2.6% | 1.9% |
| Japanese Government | JP Morgan Japan Government Bond Index TR | JPY | 0.2% | 1.8% |
| Australian Government | JP Morgan Australia GBI TR | AUD | 0.3% | 5.4% |
| Global Government Bonds | JP Morgan Global GBI | USD | -0.8% | 4.2% |
| Global Bonds | Citigroup World Broad Investment Grade (WBIG) TR | USD | -0.9% | 3.8% |
| Global Convertible Bonds | UBS Global Focus Convertible Bond | USD | -2.0% | 3.3% |
| Emerging Market Bonds | JP Morgan EMBI+ (Hard currency) | USD | 0.1% | 9.5% |

** estimate*

*Source: Bloomberg*

# Market Performance

| Asset Class/Region | Index | To 31 July 2014 | | |
|---|---|---|---|---|
| | | Currency | Month | Year to date |
| **Property** | | | | |
| US Property Securities | MSCI US REIT NR | USD | 0.0% | 17.0% |
| Australian Property Securities | S&P/ASX 200 A-REIT Index TR | AUD | 5.0% | 14.0% |
| Asia Property Securities | S&P Asia Property 40 Index NR | USD | 4.8% | 6.7% |
| Global Property Securities | S&P Global Property USD TR | USD | 1.1% | 12.5% |
| **Currencies** | | | | |
| Euro | | USD | -2.2% | -2.6% |
| UK Pound Sterling | | USD | -1.3% | 2.0% |
| Japanese Yen | | USD | -1.4% | 2.4% |
| Australian Dollar | | USD | -1.5% | 4.2% |
| South African Rand | | USD | -0.7% | -1.9% |
| **Commodities & Alternatives** | | | | |
| Commodities | RICI TR | USD | -5.1% | 0.2% |
| Agricultural Commodities | RICI Agriculture TR | USD | -7.3% | -4.1% |
| Oil | ICE Crude Oil CR | USD | -5.7% | -4.1% |
| Gold | Gold Spot | USD | -3.4% | 6.4% |
| Hedge funds | HFRX Global Hedge Fund | USD | -0.4%* | 1.4%* |
| **Interest Rates** | | | **Current rate** | **Change at meeting** |
| United States | 30 July 2014 | USD | 0.25% | - |
| United Kingdom | 10 July 2014 | GBP | 0.50% | - |
| Eurozone | 3 July 2014 | EUR | 0.15% | - |
| Japan | 15 July 2014 | JPY | 0.10% | - |
| Australia | 1 July 2014 | AUD | 2.50% | - |
| South Africa | 17 July 2014 | ZAR | 5.75% | - |

* *estimate*

# Asset Allocation Dashboard

Positive | Neutral | Negative

| Asset class | View |
|---|---|
| **Equities** | |
| Developed equities | Neutral |
| UK equities (relative to developed) | Neutral |
| European equities (relative to developed) | Neutral |
| US equities (relative to developed) | Negative |
| Japan equities (relative to developed) | Neutral |
| Emerging market equities | Positive |
| **Fixed Income** | |
| Government | Negative |
| Index-linked (relative to government) | Negative |
| Investment grade (relative to government) | Neutral |
| High yield | Negative |
| Loans | Positive |
| Emerging market debt | Positive |
| Convertible bonds | Neutral |
| **Alternatives** | |
| Commodities | Neutral |
| Property (UK) | Neutral |
| **Currencies** | |
| GBP | Neutral |
| Euro | Neutral |
| Yen | Negative |

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