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Newsflash

A new month and the 99th issue of Viewpoint from **Financial Partners**.

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Market Commentary

December brought with it a spike in volatility, with global bonds falling by 0.7% while global equities declined by 1.6%. In the US, December's ISM manufacturing numbers surprised on the downside, printing 55.5 versus consensus expectations of 57.5. The new orders numbers were also weak, declining from 66.0 in November to 57.3 in December. In China, the HSBC/Markit Chinese Purchasing Managers? Index (PMI) suggest that the Chinese economy is slowing, with the print falling to 49.6 indicating a contraction in activity for the first time in six months. A key trend for 2014 continued in December, as the US dollar remained on its upward trajectory to reach eight year highs against a basket of major currencies, adding 2.2% over the month.

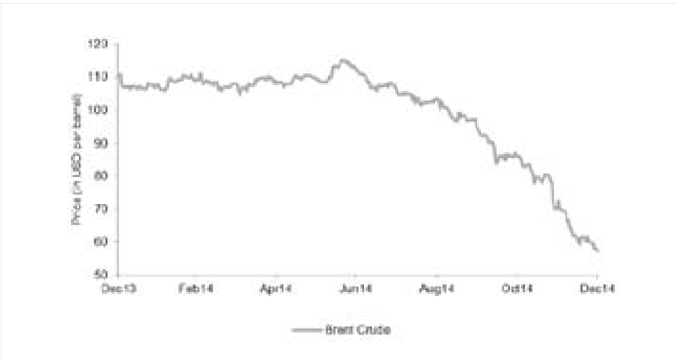
Over the past year, central banks continued to play a major role in markets. In the US, the Federal Reserve (Fed) ended its programme of Quantitative Easing (QE). The prospect of this extraordinary monetary policy coming to an end had disconcerted investors, but the event had been well flagged, and by October, market prices had adjusted to reflect QE ending. Furthermore, the Fed committed for the foreseeable future to keep interest rates at historically low levels.

In Europe, the European Central Bank (ECB) is likely to finally implement its own programme of sovereign bond buying in 2015, on top of its purchases of private debt which started last year. Mario Draghi, President of the ECB, started the New Year by outlining the ECB's intentions to "alter the size, speed and composition" of its current bond-buying programme.

The Bank of Japan also continued with its expansionary policy, with its balance sheet now swollen to 60% of Japanese GDP.

Oil remains an important theme in the market, and 2014 saw the asset class fall by 48.3%, inevitably weighing on the energy sector. Last year saw crude oil's biggest annual decline since 2008. At time of writing, Brent crude is hovering around USD 50 a barrel, almost a third of its 2008 peak of USD 139.8 a barrel. Looking at demand dynamics behind this fall, it is clear that activity is slowing, or at risk of slowing, in a number of key economic areas, while supply continues to increase; the US is producing oil at its highest levels for decades while OPEC has recently declined to cut production despite price falls.

Figure 1: The falling price of oil in 2014

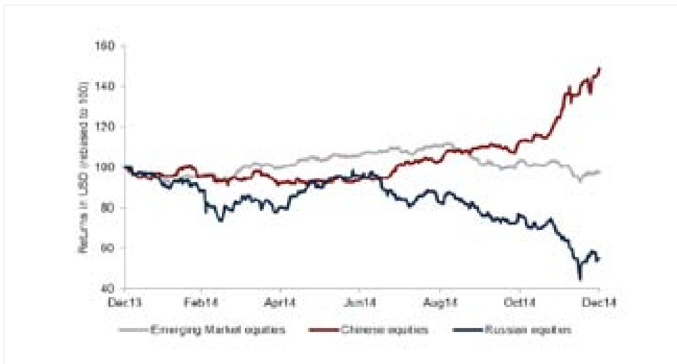


Last year markets also witnessed a significant rise in geopolitical risk, as tensions flared in Ukraine and the Islamic State movement overtook swathes of Iraq and Syria. Undoubtedly, the New Year will continue to bear witness to significant uncertainty in these regions. In Greece, current polls suggest that the leftist, anti-austerity Syriza party will win the upcoming general election, which is scheduled for 25 January. The snap-election, a result of the current Greek parliament failing to elect a new president, could lead to a confrontation between Greek policy makers and the EU, as the Syriza party looks to renegotiate the Greek bailout conditions. Baring this in mind, the possibility of Greece leaving the euro in a so called "Grexit" is now increasingly a concern.

Despite December's falls, global equities returned 4.9% in 2014, largely due to the strong performance of US stocks. The S&P 500 index added 13.0% despite the energy stocks struggling in the second half of the year. Japan also made it into figures in yen terms, but the fall of the currency against USD led to a negative return of -3.0% in dollar terms. Other major economies such as Europe and the UK also made it into positive territory in local currency terms, but the strength of the greenback meant that these too produced negative returns in USD (-6.6% and -5.5% respectively).

A combination of geopolitical risk, energy shocks and underwhelming economic prospects weighed on emerging markets stocks in 2014. In fact the MSCI Emerging Market (EM) index finished the year in negative territory (-2.2%) for a second consecutive year, the first time this has happened in twelve years. Most notably the Russian index fell 42.1% in US dollar terms, thanks in large part to the weakness of the rouble. Bucking the EM trend, Chinese equities enjoyed a stellar second half of the year to bring their 2014 return to +58.0% in yuan terms. It is interesting to observe these levels of gains against a deteriorating economic background, illustrating the importance of investing for valuations rather than macro-economic trends.

Figure 2: Divergent returns in the emerging world



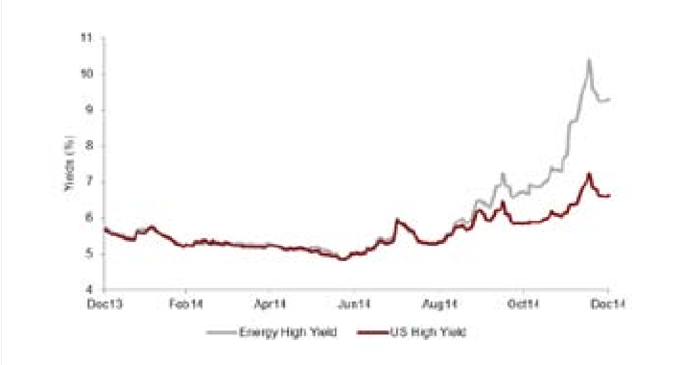
Despite the US Treasury yield drifting up in the latter half of December, global bond markets enjoyed a strong year. In the US, 10-year Treasuries started the year with a yield of circa 3% and finished at circa 2%. US Treasuries gained 6.1% over the year and UK Gilts gained 14.1% in sterling terms.

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

European government bonds performed similarly to those in the UK. From these levels the upside is limited and the ability of bonds to provide a meaningful diversification to the equity market had lessened. Emerging market bonds also performed reasonably well, with a return of 6.2% for the year, which is in line with the US Treasury market. The year was a good one for property securities, with global property markets returning 13.6% to keep pace with the US equities. Besides oil, other commodities also suffered last year: agricultural commodities fell by 6.9% and gold drifted off by 1.4%.

US high yield bonds provided modest gains despite being weighed on heavily by the energy sector in the second half of the year. This was sufficient for the US high yield market to lag the higher quality investment grade index - in fact the return from high yield was only a third of the investment grade bonds, and less than half of that from "risk free" US Treasuries. Similarly, in both the UK and Europe, investment grade corporate debt was unable to keep pace with the double digit gains from the government component, but not by much. Despite these returns from global government bonds, the performance when translated into USD was a mere +0.7% for the year.

Figure 3: Yields on US high yield bonds and its energy subcomponent



Against this backdrop, while global equities may be considered moderately expensive today, we still believe that they offer reasonable value compared to the range of realised historical valuations and indeed are attractive compared to most other asset classes. Furthermore, global central bank policy continues to be loose, which should support equity prices. In fixed income, it is difficult to make the case for holding duration - i.e. interest rate risk - for anything other than a risk diversification tool. Nevertheless, with the possibility of government yields going lower from here, we are wary of taking too negative a view on duration in our multi-asset funds. Credit is more appealing, although it is important to be cognisant of liquidity risks that may arise in market sell-offs.

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

Market Performance

Asset Class/Region	Index	To 31 December 2014		
		Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	-0.3%	13.0%
United Kingdom	MSCI UK NR	GBP	-2.3%	0.5%
Continental Europe	MSCI Europe ex UK NR	EUR	-2.2%	6.4%
Japan	Topix TR	JPY	-0.1%	10.3%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-2.1%	2.8%
Global	MSCI World NR	USD	-1.6%	4.9%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-15.7%	-30.0%
Emerging Asia	MSCI EM Asia NR	USD	-1.9%	4.9%
Emerging Latin America	MSCI EM Latin America NR	USD	-9.2%	-12.3%
BRICs	MSCI BRIC NR	USD	-5.3%	-2.9%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-4.6%	-2.2%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	0.3%	6.1%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-1.0%	4.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.1%	7.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-1.4%	2.5%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	1.4%	14.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.2%	12.3%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.1%	13.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.5%	8.4%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	-0.2%	5.7%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	1.2%	4.8%
Australian Government	JP Morgan Australia GBI TR	AUD	1.9%	11.3%
Global Government Bonds	JP Morgan Global GBI	USD	-0.4%	0.7%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-0.7%	0.8%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-1.6%	-1.1%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-2.5%	6.2%

** estimate*

Source: Bloomberg

Market Performance

Asset Class/Region	Index	To 31 December 2014		
		Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	1.7%	28.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	2.9%	20.4%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.0%	-0.5%
Global Property Securities	S&P Global Property USD TR	USD	-0.4%	13.6%
Currencies				
Euro		USD	-2.8%	-12.0%
UK Pound Sterling		USD	-0.4%	-5.9%
Japanese Yen		USD	-1.2%	-12.6%
Australian Dollar		USD	-3.9%	-8.4%
South African Rand		USD	-4.4%	-9.3%
Commodities & Alternatives				
Commodities	RICI TR	USD	-8.7%	-22.2%
Agricultural Commodities	RICI Agriculture TR	USD	-0.5%	-6.9%
Oil	Brent Crude	USD	-18.3%	-48.3%
Gold	Gold Spot	USD	1.5%	-1.7%
Hedge funds	HFRX Global Hedge Fund	USD	-0.8%	-0.6%
Interest Rates			**Current rate**	**Change at meeting**
United States	14 January 2015	USD	0.25%	-
United Kingdom	14 January 2015	GBP	0.50%	-
Eurozone	14 January 2015	EUR	0.05%	-
Japan	4 April 2013	JPY	0.10%	-
Australia	2 December 2014	AUD	2.50%	-
South Africa	14 January 2015	ZAR	5.75%	-

* *estimate*

Asset Allocation Dashboard

Positive | Neutral | Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Positive
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	Neutral
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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