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Newsflash

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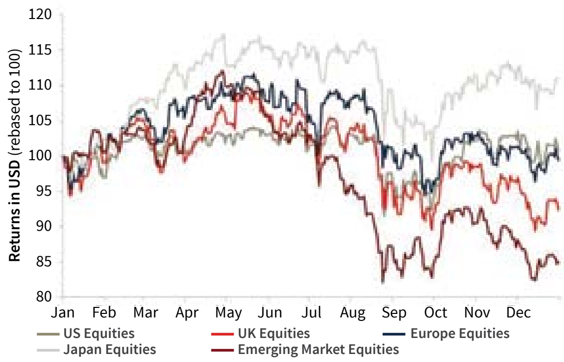
Market Commentary

In what has become an increasingly volatile, uncertain and difficult market environment, with significant economic and political headwinds, 2015 proved to be a very tough year for investors. Without question we have entered the most challenging stage of the cycle since early 2009, when the global financial crisis was at its peak. Indeed, there were few hiding places for investors, with all major asset classes producing either negative or barely positive returns and only one major equity market – Japan – showing a meaningful return in USD terms of 11%. Japanese equities rose by 9.0% in dollar terms in the final quarter. Elsewhere returns from markets were mediocre at best, with commodities and emerging equity markets seeing significant falls.

Figure 1: Equity market returns

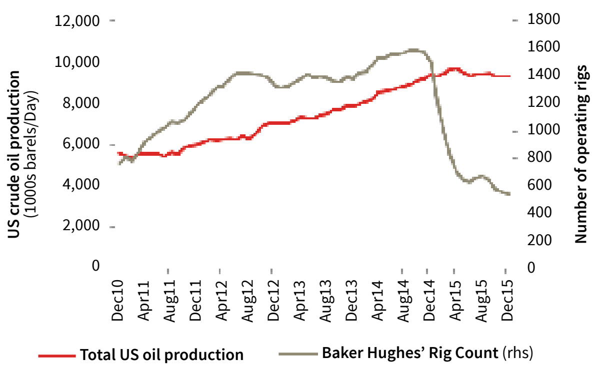


While the European Central Bank (ECB) over delivered with its Quantitative Easing (QE) and the Bank of Japan maintained its massive asset purchase programme, all eyes as the year progressed were on the US Federal Reserve (Fed). In December it embarked on its first rate increase in almost a decade, but still left rates at exceptionally low levels. Markets took the increase in their stride, and the real focus of investors is how quickly the Fed will move to normalise policy. A great deal rests on this and there is no question that policy moves will remain a driving force for markets in 2016.

Arguably, however, it was not the US but China that, for the first time in history, had the greatest impact on financial markets through the year. The bursting of China's stock market bubble mid-year, bungled attempts on the part of policy makers to support the market, and then a surprise devaluation of the Chinese yuan in August, all combined to focus investor attention on the sharp slowdown in growth. Moreover, policy makers seem ill-equipped to react to the resultant problems. With China accounting for close to 40% of the the growth in the world economy over the past decade, and as it consumes close to half of the world's key commodities, the realisation that all is not well in the Chinese economy sent shock waves through global markets.

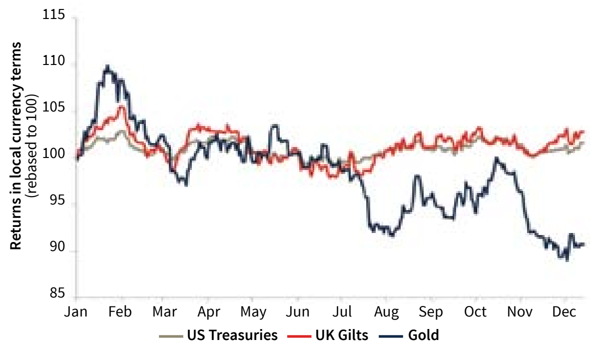
The extent of the oil price fall was exacerbated by OPEC's (or rather Saudi Arabia's) decision to keep pumping at high levels of capacity, in a bid to undermine the increasing production of non-OPEC countries, and in particular US shale oil. The dramatic increase in US shale production over the past five years by some 4-5 million barrels per day has put pressure on other producers and weakened OPEC's previously dominant position. There is little doubt that the fall has gone much further and faster than anyone anticipated, and with US production having dropped only modestly and global stock piles at exceptionally high levels, the prospect is for a continuation of low oil prices for some time ahead.

Figure 2: US oil production rises as rig count falls



With the global economy struggling for growth, the developed world wrestling with structural problems (and the unwinding of a credit boom), commodity producers facing an existential crisis, and geo-political risks in the Middle East on the rise, safe haven investments might have been expected to perform well. In the event global government bonds underperformed equities and produced a negative return of -2.6%, although US dollar strength accounted for some of this, government bonds in the US, Europe and Japan struggled to produce returns higher than 1% in local currency terms. The problem is that yields are already at exceptionally low levels, and with the prospect of higher rates in the US, there is little room for further falls in rates along the yield curve. Gold, the other traditional safe haven asset, entered the fifth year of its bear market and dropped a further 10% in 2015.

Figure 3: Safe-haven assets



Finally, credit and in particular high yield bonds suffered a difficult year, with negative returns and widening credit spreads amidst rising concerns about debt levels and defaults among commodity producers and especially energy companies. These sectors of the fixed income market have produced very good returns since the global financial crisis, but the surge in issuance during the good years, the tougher conditions across much of the corporate world, and the prospect of rising US rates, have all dented confidence.

Many of the woes that developed during the year have spilled over into markets in the New Year. However, some perspective needs to be retained at a time of a rising chorus of worry. The global economy has softened but is still growing, and the US, UK, Europe and Japan should continue to grow modestly through 2016. Furthermore, volatility and nervousness across markets could well result in policy being kept looser for longer. We remain in an environment where returns are likely to be subdued, and against a background of low yet steady growth in the developed world, valuations are now at increasingly attractive levels.

Source: Bloomberg. Returns in US dollars unless otherwise stated. December 2015.

Market Performance

Asset Class/Region	Index	To 31 December 2015	
		Currency	Year to date
Developed markets equities			
United States	S&P 500 NR	**USD**	0.7%
United Kingdom	MSCI UK NR	**GBP**	-2.2%
Continental Europe	MSCI Europe ex UK NR	**EUR**	10.7%
Japan	Topix TR	**JPY**	12.1%*
Asia Pacific (ex. Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-9.4%
Global	MSCI World NR	**USD**	-0.9%
Emerging Market Equities			
Emerging Europe	MSCI EM Europe NR	**USD**	-14.7%
Emerging Asia	MSCI EM Asia NR	**USD**	-9.8%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-31.0%
BRICs	MSCI BRIC NR	**USD**	-13.5%
Global emerging markets	MSCI EM (Emerging Markets) NR	**USD**	-14.9%
Bonds			
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	0.9%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-1.7%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	-0.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-4.4%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	1.2%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	0.7%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	1.7%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	-0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	1.0%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	1.3%
Australian Government	JP Morgan Australia GBI TR	**AUD**	2.5%
Global Government Bonds	JP Morgan Global GBI	**USD**	-2.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-3.2%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-0.2%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	1.8%

Source: Bloomberg   ** estimate*

Market Performance

Asset Class/Region	Index	To 31 December 2015	
		Currency	Year to date
Property			
US Property	Securities MSCI US REIT NR	**USD**	1.3%
Australian Property	Securities S&P/ASX 200 A-REIT Index TR	**AUD**	8.9%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	1.5%
Global Property Securities	S&P Global Property USD TR	**USD**	0.1%
Currencies			
Euro		**USD**	-10.3%
UK Pound Sterling		**USD**	-5.4%
Japanese Yen		**USD**	-0.5%
Australian Dollar		**USD**	-10.8%
South African Rand		**USD**	-25.2%
Commodities & Alternatives			
Commodities	RICI TR	**USD**	-26.1%
Agricultural Commodities	RICI Agriculture TR	**USD**	-14.6%
Oil	ICE Crude Oil CR	**USD**	-35.0%
Gold	Gold Spot	**USD**	-10.4%
Hedge funds	HFRX Global Hedge Fund	**USD**	-3.5%*
Interest Rates			
United States		0.50%	
United Kingdom		0.50%	
Eurozone		0.05%	
Japan		0.08%	
Australia		2.00%	
South Africa		6.25%	

Source: Bloomberg * *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)	Positive
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Positive
Emerging market equities	Neutral
Fixed Income	
Government	Neutral
Index-linked (relative to government)	Neutral
Investment grade (relative to government)	Positive
High yield	Positive
Loans	Neutral
Emerging market debt	Positive
Convertible bonds	Positive
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Positive
Yen	Neutral

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