FINANCIAL PARTNERS

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Newsflash

A new month and the 113rd issue of Viewpoint from **Financial Partners**.

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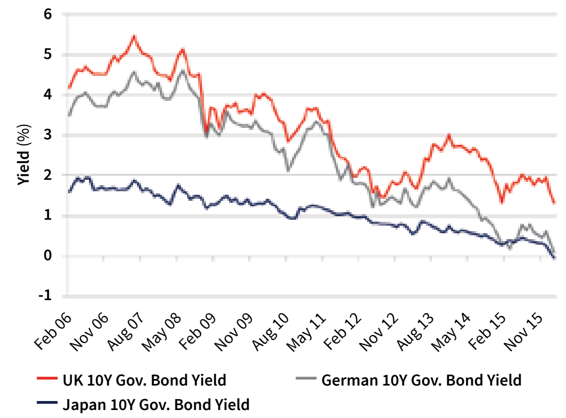
Market Commentary

The market weakness seen in January continued into February with high levels of uncertainty and fear, notably affecting the financial sector and in particular European bank shares. However sentiment began to improve mid-month and markets have since recovered significantly; by month-end the MSCI World index was down by only 0.7% in the month, and is up over 9% from its 11 February low at the time of writing. Global emerging markets fell by just 0.2%.

The global sell-off in the past 3 months was triggered by a combination of factors: China, the collapse in commodity markets, and the strong dollar. These have had negative impacts on global growth and inflation, which spilled over into credit markets. In February, these were compounded by rising concerns that monetary policy is becoming less effective and may even work in the opposite direction to that intended as investors reappraised the longer term profitability of banks in a negative interest rate environment. The European Central Bank, which already had negative deposit interest rates, eased policy further at its meeting on 10 March. Despite growing concerns about the longer term effect and efficacy of such an extent of monetary policy, there is little doubt that it will provide support to asset values.

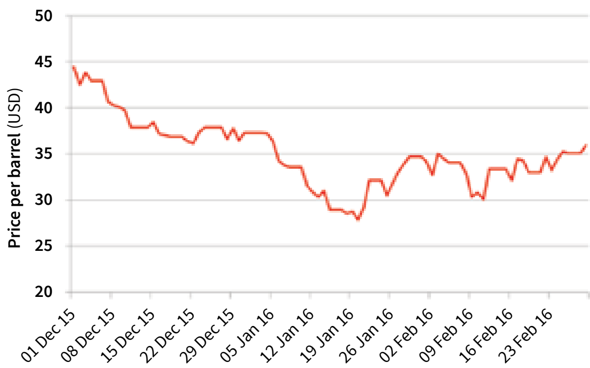
Against this background, safe haven assets continued to perform well. Government bond yields in Europe, Japan and the UK are at, or near, all-time lows, with Japanese 10-year government bonds now having negative yields, following the Bank of Japan's move to negative rates at the end of January. Despite a rise in yields in the second half of the month, as fear factors subsided, returns from government bonds were ultimately strong during February. In contrast credit continued to underperform, suffering from concerns over the slowdown in global growth and rising defaults in certain sectors, including commodities and emerging market debt. The more positive tone in markets as the month progressed, however, saw some recovery in corporate bonds, high yield and emerging market debt.

Figure 1. 10-year government bond yields, over 10 years



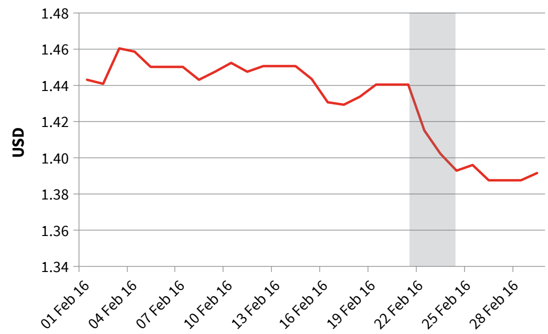
The market recovery from the worst period of performance since the global financial crisis can in part be attributed to a sharp turn in oil. Brent crude, having fallen to a low of circa $28 per barrel in mid-January, has now recovered by over 45%. It is likely that several factors contributed to the turn, including IEA forecasts that shale oil production will fall by 600,000 barrels per day in 2016 and a further 200,000 in 2017. To date, there is no evidence that any production curbs are close to being agreed, with Iraq and Iran not prepared to participate. However the notion of tentative discussions on a production freeze, primarily between Saudi Arabia and Russia, provided a floor to prices. With shale production in decline and investment in high-cost production slashed, the prospect of a better balance between supply and demand is drawing closer. By early 2017 the current oversupply in the oil market is likely to be at or close to an end.

Figure 2. Brent crude price over 3 months



One main political development in February was the UK government's announcement of the EU stay/leave referendum for 23 June, leading to an immediate fall in sterling and a prolonged period of uncertainty for the currency as a result. Despite the government's support for a stay vote, the poll is by no means clear cut. The leave campaign has some high profile cabinet ministers and a vote in favour of leaving would inevitably result in some short term selling of UK assets while the full implications are worked out. Although longer term the UK will prosper whether in or out, uncertainty is never the friend of investors in the short term.

Figure 3. British pound against the US dollar in February



It is evident that some of the post-crisis structural headwinds, in particular the high levels of debt globally, will keep growth subdued for some time. Similarly, the structural slowdown in China and the severe cyclical downturn in many emerging countries and commodity markets have sent a negative pulse across the developed world, slowing growth further and increasing risks of deflation. These risks have re-priced very quickly into bond and equity markets however, and more recent data from developed economies has held up reasonably well; the US, UK, Europe and Japan should continue to grow modestly through 2016. Furthermore, some of the big factors hitting markets in the past year, including the oil rout, are showing signs of stabilising. For these reasons we believe that market fears in recent months are overdone. Central banks have become more accommodating and have made it clear that they will take further action to prevent economies falling into a deflationary spiral. While there are risks posed to the financial system by a slowdown in growth and deteriorating credit conditions, banks across the world are in a much stronger capital position than ahead of the global financial crisis, such that it is extremely unlikely that today's problems will cause a global systemic crisis. With valuations across many markets at much improved levels after the sharp falls of the past nine months, we believe that this represents a good opportunity to add to equity positions.

Source: Bloomberg. Returns in US dollars unless otherwise stated. February 2016.

Market Performance

Asset Class/Region	Index	To 29 February 2016	
		Currency	Year to date
Developed markets equities			
United States	S&P 500 NR	**USD**	-5.2%
United Kingdom	MSCI UK NR	**GBP**	-1.5%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-8.9%
Japan	Topix TR	**JPY**	-16.1%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-8.7%
Global	MSCI World NR	**USD**	-6.7%
Emerging Market Equities			
Emerging Europe	MSCI EM Europe NR	**USD**	-1.6%
Emerging Asia	MSCI EM Asia NR	**USD**	-8.5%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-1.0%
BRICs	MSCI BRIC NR	**USD**	-11.8%
Global emerging markets	MSCI EM (Emerging Markets) NR	**USD**	-6.6%
Bonds			
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	3.2%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	2.7%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	1.2%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-1.0%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	5.4%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	0.9%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	2.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	1.1%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	-1.7%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	3.5%
Australian Government	JP Morgan Australia GBI TR	**AUD**	2.9%
Global Government Bonds	JP Morgan Global GBI	**USD**	4.4%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	3.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-4.5%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	2.6%

Source: Bloomberg   ** estimate*

Market Performance

Asset Class/Region	Index	To 29 February 2016	
		Currency	Year to date
Property			
US Property Securities	MSCI US REIT NR	**USD**	-3.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	3.0%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-6.8%
Global Property Securities	S&P Global Property USD TR	**USD**	-4.2%
Currencies			
Euro		**USD**	0.2%
UK Pound Sterling		**USD**	-5.6%
Japanese Yen		**USD**	6.7%
Australian Dollar		**USD**	-2.0%
South African Rand		**USD**	-2.5%
Commodities & Alternatives			
Commodities	RICI TR	**USD**	-5.7%
Agricultural Commodities	RICI Agriculture TR	**USD**	-4.5%
Oil	Brent Crude Oil	**USD**	-3.5%
Gold	Gold Spot	**USD**	16.7%
Hedge funds	HFRX Global Hedge Fund	**USD**	-3.1%
Interest Rates			
United States		0.50%	
United Kingdom		0.50%	
Eurozone		0.05%	
Japan		-0.10%	
Australia		2.00%	
South Africa		6.75%	

Source: Bloomberg

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)	Positive
Investment grade (relative to government)	Positive
High yield	Positive
Loans	Positive
Emerging market debt	Neutral
Convertible bonds	Positive
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Neutral
Yen	Negative

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