



# VIEWPOINT

## Newsflash

A new month and the 96<sup>th</sup> issue of Viewpoint from **Financial Partners**.

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## Table of Contents

Market commentary	1 – 3
Market performance	4 – 5
Asset allocation dashboard	6
Contact	7
Important notes	8

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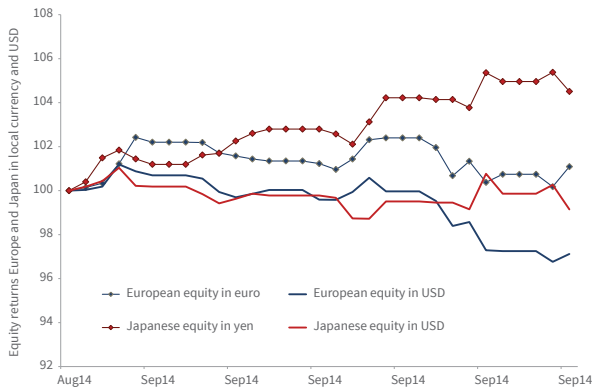
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## Market Commentary

As we move into the final quarter of the year, several interrelated themes are playing out in markets. First, slowing global growth; second, divergent performance among economies, especially between the US and other developed markets; third, divergent expectations for central bank behaviour and fourth, sizeable shifts in relative pricing with a strong US dollar and weak commodity prices. All four of these themes have far reaching implications for asset prices, and are – in our opinion – of greater importance to asset allocation than current events in the Middle East and Ukraine.

Evidence of slowing growth and a continuing surge in the US dollar were key factors weighing on markets in September. Developed equity markets declined by 2.7% in US dollar terms and have returned 3.9% year to date, while emerging markets (EM) fell by 7.4% to take their year to date returns to 2.4%. Within EM, Brazilian equities slumped by circa 12% in local currency terms and by 20% in US dollar terms, as the general downdraft affecting markets was amplified by fears that this month's presidential elections will return the incumbent as opposed to a more market and investor-friendly opposition candidate. Continental Europe returned 1.1% in euro terms and Japan returned 4.5% in yen terms, but the strength of the greenback wiped out these returns when converted into US dollars. The euro depreciated by 3.8% against the US dollar while the yen fell by 5.0% over the month. US stocks were down by 1.4% and UK equities lost 2.9% in sterling terms (with the pound also falling by 2.3%).

Figure 1: Equity returns Europe and Japan in local currency and USD



The US economy remains on track for reasonable growth this year and next, and although there has been some recent evidence of a slowdown – for example, in construction and manufacturing spend – the data still points to a stable increase in output. This means that the Federal Reserve (Fed) can be expected to end its asset purchasing programme in October as planned. The Fed is also starting to be more aggressive on its guidance regarding the pace of interest rate increases once they start, increasing its forecast rates for 2015 and 2016 by 0.25% and introducing a new target of 3.75% by 2017. This led to falls in US Treasuries, which returned -0.6% over the month.

In contrast, the European Central Bank (ECB) moved to a more aggressive easing programme in the face of weakening growth and falling inflation across the continent. The ECB cut 0.10% off its main refinancing rate, taking it to -0.20%, and announced a EUR 1trillion target increase in the size of its balance sheet, which would take it back to early 2012 levels of EUR 3 trillion. It will start a 'private' quantitative easing (QE) programme in October, lasting at least 2 years and buying at least EUR 400 billion of asset backed securities (ABS) and covered bonds. Mario Draghi, President of the ECB, noted that the bank stands "ready to adjust the size and composition" of its asset purchases if necessary, hinting at the possibility of government bond purchases. Euro government bonds rose as a result and remain the outstanding asset class year to date in 2014.

Figure 2: Balance sheet change at developed market central banks

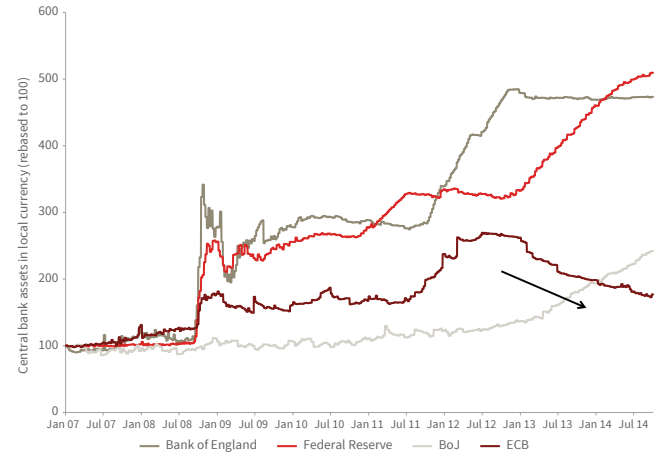
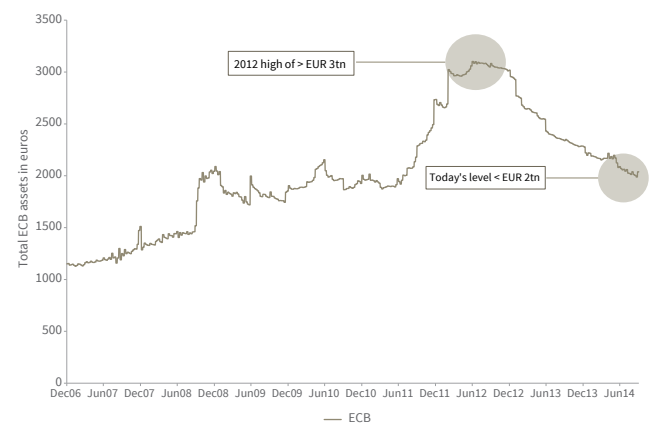


Figure 3: Total assets in euros at the European Central Bank



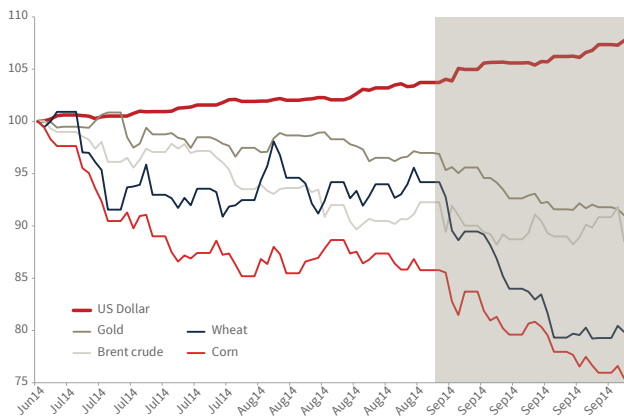
The prospect of rising short-term rates and weaker global growth is also having an impact on credit markets. Investment grade bonds returned -1.4%, and high yield bonds were down by 2.1% in the US and 5.0% in Europe. There have been substantial flows out of high yield bond funds over the past month, and investors appear to be re-pricing default risk back towards more normal levels.

As the dollar continued its strong run and global growth softened, most other commodity markets came under pressure too. Precious metals were weak, with gold falling by 6.1%, while soft commodity prices fell sharply

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

as record harvests put pressure on prices. Perhaps most importantly the oil price continued to fall, down by 5.8%, to bring its cumulative decline over the past four months to approximately 13%. These falls will keep inflation, which is already falling, at very subdued levels, and importantly give central banks greater room for manoeuvre going forward.

Figure 4: US dollar strength vs. commodity weakness



Markets are correcting as they adjust to reduced growth expectations, an increasingly difficult environment for earnings growth and the challenge of the first increase in US interest rates since June 2006. This weakness is likely to continue in the short term. However, markets will be supported by investors' search for yield and the prospect of very loose monetary policy for a long time ahead. While valuations of some markets are a cause for some concern, equities in our view are still reasonably supported by the fundamentals.

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

## Market Performance

Asset Class/Region	Index	To 30 September 2014		
		Currency	Month	Year to date
<b>Developed markets equities</b>				
United States	S&P 500 NR	USD	-1.4%	7.8%
United Kingdom	MSCI UK NR	GBP	-2.9%	0.9%
Continental Europe	MSCI Europe ex UK NR	EUR	1.1%	6.6%
Japan	Topix TR	JPY	4.5%	3.8%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-7.2%	3.6%
Global	MSCI World NR	USD	-2.7%	3.9%
<b>Emerging markets equities</b>				
Emerging Europe	MSCI EM Europe NR	USD	-5.8%	-12.1%
Emerging Asia	MSCI EM Asia NR	USD	-5.8%	5.2%
Emerging Latin America	MSCI EM Latin America NR	USD	-13.3%	1.3%
BRICs	MSCI BRIC NR	USD	-9.1%	1.3%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-7.4%	2.4%
<b>Bonds</b>				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.6%	3.7%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-2.7%	4.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-1.4%	5.6%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-2.1%	3.5%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-0.7%	7.6%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-0.5%	7.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.1%	10.1%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.2%	6.7%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-5.0%	-4.1%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.1%	2.2%
Australian Government	JP Morgan Australia GBI TR	AUD	-0.5%	6.1%
Global Government Bonds	JP Morgan Global GBI	USD	-3.0%	1.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-2.7%	1.6%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-3.8%	-0.6%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-2.6%	7.2%

\* estimate

Source: Bloomberg

FP Viewpoint

Page 4

## Market Performance

Asset Class/Region	Index	To 30 September 2014		
		Currency	Month	Year to date
<b>Property</b>				
US Property Securities	MSCI US REIT NR	USD	-6.1%	13.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-5.4%	9.7%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-6.1%	-1.9%
Global Property Securities	S&P Global Property USD TR	USD	-6.2%	6.7%
<b>Currencies</b>				
Euro		USD	-3.8%	-8.1%
UK Pound Sterling		USD	-2.3%	-2.1%
Japanese Yen		USD	-5.0%	-4.0%
Australian Dollar		USD	-6.4%	-1.9%
South African Rand		USD	-5.5%	-6.9%
<b>Commodities &amp; Alternatives</b>				
Commodities	RICI TR	USD	-6.6%	-7.3%
Agricultural Commodities	RICI Agriculture TR	USD	-7.5%	-12.3%
Oil	ICE Crude Oil CR	USD	-5.8%	-13.5%
Gold	Gold Spot	USD	-6.2%	0.2%
Hedge funds	HFRX Global Hedge Fund	USD	-0.8%	1.2%
<b>Interest Rates</b>			<b>Current rate</b>	<b>Change at meeting</b>
United States	17 September 2014	USD	0.25%	-
United Kingdom	4 September 2014	GBP	0.50%	-
Eurozone	4 September 2014	EUR	0.05%	-
Japan	4 September 2014	JPY	0.10%	-
Australia	2 September 2014	AUD	2.50%	-
South Africa	18 September 2014	ZAR	5.75%	-

\* estimate

**Asset Allocation Dashboard**
■ Positive    ■ Neutral    ■ Negative

Asset class	View
<b>Equities</b>	
Developed equities	●
UK equities (relative to developed)	●
European equities (relative to developed)	●
US equities (relative to developed)	●
Japan equities (relative to developed)	●
Emerging market equities	●
<b>Fixed Income</b>	
Government	●
Index-linked (relative to government)	●
Investment grade (relative to government)	●
High yield	●
Loans	●
Emerging market debt	●
Convertible bonds	●
<b>Alternatives</b>	
Commodities	●
Property (UK)	●
<b>Currencies</b>	
GBP	●
Euro	●
Yen	●

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