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VIEWPOINT

Newsflash

A new month and the 95th issue of Viewpoint from **Financial Partners**.

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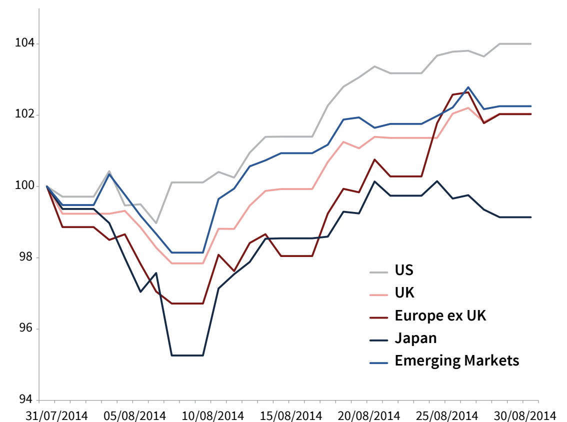
Market Commentary

Despite an unfavourable and deteriorating geopolitical backdrop, markets produced strong returns in August, led by the US and a resurgent US dollar. The US equity market returned 3.9% with the S&P 500 index passing through 2,000 points for the first time in history – three times its March 2009 lows.

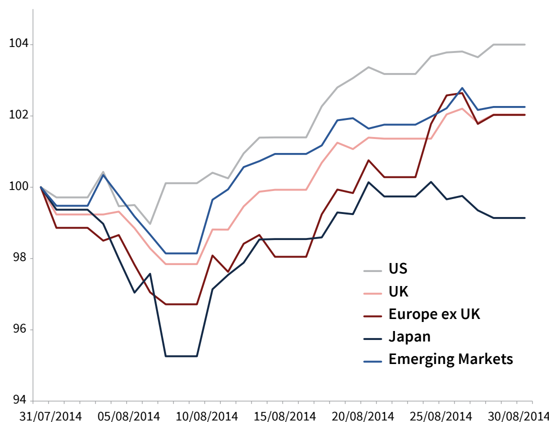
Figure #1: Performance of the S&P 500



Overall the MSCI World index added 2.2% last month, with Europe and the UK both gaining 2.0% in local currency terms, although the majority of these returns were wiped out when converted into US dollar terms due to the strength of the greenback. Japan fell by 0.9% in yen terms, and by 2.0% in US dollars. Japan's economy is struggling to regain momentum after shrinking by 6.8% in the second quarter,as a result of April's 3.0% sales tax hike. The MSCI Global Emerging Markets

index also performed well last month, returning 2.3%. Brazilian equities were the stand out performer, adding 9.8% in Brazilian real terms, on the back of rising expectations for a change of government in the October presidential elections.

Figure #2: Performance of global equity indices

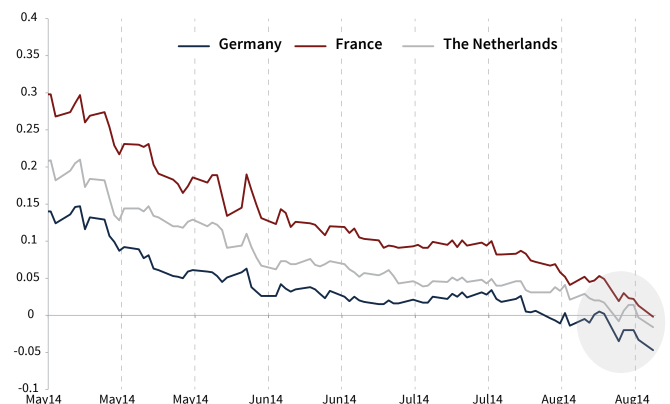


The key economic factor affecting markets at present is the divergent performance of the US and euro area economies. In the US, second quarter GDP growth was revised up to 4.2% from 4.0% previously, and most indicators point to continuing growth of around 3% to 4%. The labour market also remains buoyant, with stronger than anticipated payrolls data. The Institute for Supply Management's (ISM) Manufacturing Index registered 59.0 in August, up from 57.1 in July and 55.3 in June, while the Services Index climbed to its highest level since 2005. Furthermore, consumer confidence is at new highs and the housing sector is recovering following a weak first quarter. Despite this strength, inflation remains subdued, with the July Consumer Price Index (CPI) printing a core inflation rate of 1.9% year-on-year.

In contrast, the recovery in Europe appears to be stalling. Composite euro area GDP was flat in the second quarter, with growth falling into negative territory for two key economies, Germany (-0.2%) and Italy (-0.2%). Only peripheral Europe managed decent growth, as it continues to recover from an austerity induced recession. It is noteworthy, however, that peripheral euro area GDP remains far below its 2009 peak. Inflation in the euro area fell to a mere 0.3% in August.

Against this backdrop, government bond markets continued to strengthen. Europe led the way, with yields on most Eurozone government bonds falling sharply as the growth outlook for the region deteriorated and the European Central Bank (ECB) moved closer to full scale quantitative easing. Euro government bonds returned 1.9% in euro terms during August, bringing year-to-date returns to 10%. German 10-year government bond yields fell to 0.9% and 2-year government bond yields fell below zero in eight European countries, including for the first time France. UK gilts also performed well, as inflation remained subdued with the headline Consumer Price Index (CPI) printing 1.6%. This creates an environment in which the Bank of England is able to keep interest rates lower for longer, as wage growth also remains weak. Gilts returned 3.5% in sterling terms, and yields fell below 2.4% on the UK 10-year government bond. US Treasuries did less well but still produced a return of 1.2% over the month.

Figure #3: 2-year European government bond yields



The search for yield also saw US corporate credit perform well, returning 1.4%, and US high yield bonds recover somewhat following their sharp correction in July, rallying by 1.6%. In contrast, European high yield bonds fell by 1.0% in euro terms as worries about the state of the euro area economy offset the impact of falling government rates.

Elsewhere, geopolitical risk remains heightened. Initial progress by Ukrainian forces in pushing back rebels in the east of the country, was halted by intervention from Russian forces, which in turn led to calls for tougher sanctions against

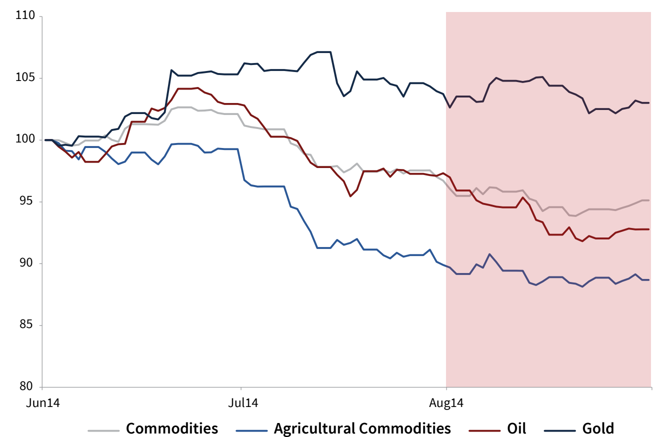
Source: Bloomberg. Returns in US dollars unless otherwise stated. August 2014.

Russia from the US and Europe. Emerging European equities declined by 1.0%, amidst growing fears over growth, with several major European companies reporting falling export volumes to Russia as the effect of sanctions comes to be felt more acutely.

In the Middle East, Israel and Gaza also moved to a long term ceasefire, while the Islamic State movement in Iraq was halted by US air support to Kurdish and Iraqi forces. The terror threat remains an immensely difficult situation for the West and while it is unlikely to have a material impact on the global economy it will be a force for instability in the Middle East for a long time to come.

The other notable feature of the month was continued downward pressure on the oil price, despite events in Eastern Europe and the Middle East. Brent crude oil ended the month at USD 100 per barrel from USD 115 only two months ago. Other commodity markets were also weak, with gold flat and agricultural commodities generally remaining under pressure. These moves are generally positive for the global economy, as they will keep inflation low and give central banks room for manoeuvre as they maintain very loose monetary policy.

Figure #4: Performance of selected commodities



Markets have bounced back post their midyear correction and will be supported by the search for yield and the prospect of loose monetary policy for a long time ahead. The US Federal Reserve and the Bank of England are set to be the first banks to tighten policy, while the ECB and the Bank of Japan are expected to persist with loose policy for longer in the face of weak domestic demand. While some asset classes, especially fixed income markets, appear to be fully valued, we continue to uncover opportunities in other areas, including select parts of the equity markets.

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

Market Performance

Asset Class/Region	Index	To 29 August 2014		
		Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	3.9%	9.4%
United Kingdom	MSCI UK NR	GBP	2.0%	3.9%
Continental Europe	MSCI Europe ex UK NR	EUR	2.0%	5.5%
Japan	Topix TR	JPY	-0.9%	-0.7%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	0.8%	11.7%
Global	MSCI World NR	USD	2.2%	6.8%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-1.0%	-6.7%
Emerging Asia	MSCI EM Asia NR	USD	1.1%	11.7%
Emerging Latin America	MSCI EM Latin America NR	USD	7.9%	16.9%
BRICs	MSCI BRIC NR	USD	3.2%	11.5%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	2.3%	10.6%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.2%	4.4%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.6%	7.1%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.4%	7.1%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.6%	5.7%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	3.5%	8.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.8%	8.2%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.9%	10.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.2%	6.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-1.0%	0.9%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.4%	2.2%
Australian Government	JP Morgan Australia GBI TR	AUD	1.2%	6.6%
Global Government Bonds	JP Morgan Global GBI	USD	0.6%	4.8%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.5%	4.4%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	0.0%	3.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	0.4%	10.0%

** estimate*

Source: Bloomberg

Market Performance

Asset Class/Region	Index	To 29 August 2014		
		Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	2.9%	20.4%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	1.7%	15.9%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.2%	4.4%
Global Property Securities	S&P Global Property USD TR	USD	1.2%	13.8%
Currencies				
Euro		USD	-1.9%	-4.4%
UK Pound Sterling		USD	-1.7%	0.3%
Japanese Yen		USD	-1.3%	1.1%
Australian Dollar		USD	0.5%	4.7%
South African Rand		USD	0.4%	-1.5%
Commodities & Alternatives				
Commodities	RICI TR	USD	-1.0%	-0.8%
Agricultural Commodities	RICI Agriculture TR	USD	-1.1%	-5.2%
Oil	ICE Crude Oil CR	USD	-4.3%	-8.2%
Gold	Gold Spot	USD	0.4%	6.8%
Hedge funds	HFRX Global Hedge Fund	USD	0.9%*	1.8%*
Interest Rates			**Current rate**	**Change at meeting**
United States	30 July 2014	USD	0.25%	-
United Kingdom	7 August 2014	GBP	0.50%	-
Eurozone	7 August 2014	EUR	0.15%	-
Japan	8 August 2014	JPY	0.10%	-
Australia	5 August 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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