FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **2 August 2015**

July was another difficult month for commodity markets with the Rogers International Commodity Index down 11.6%, bringing its 12 month return to -32.0% in US dollars. In fact July was the worst month for West Texas Intermediate (WTI) crude since October 2008 and Brent crude experienced its largest monthly decline this year. While gold and oil have dominated headlines of late, the commodity weakness is actually broadly based, affecting a wide range of commodities.

Given the size of some of the moves in commodities, there is a chance that some of the price action is overdone. Valuation is notoriously difficult to discern in assets such as commodities because they do not produce the income that forms the basis of many valuation models. The commodity-related businesses, however, at least have the potential to produce income in the form of dividends from equity and this is where investment managers often focus when seeking exposure to commodity prices.

Oil producers still appear to be in consolidation mode, with announcements such as Shell's recent statement outlining the need to cut $4bn from operating expenses with the expected cutting of 6,500 jobs. Indeed Shell stated that it was "planning for a prolonged downturn" in oil prices, which explains the size of the cuts. This serves to highlight the challenges oil producers, and companies that supply them, still face and the difficult balance many must strike between protecting their investors over the short term whilst making sufficient investment in the business to drive long term shareholder value.

There are tentative signs of a return of confidence elsewhere in commodity markets, however. An increase in Merger and Acquisition (M&A) activity between industry participants can be interpreted as a sign that industry insiders believe the markets discounting of future difficulties has gone too far and that stocks are overly cheap on a long term view by the market. While oil producers are still struggling, there has been a tentative increase in M&A activity amongst gold miners. Gold has fallen to its lowest level since 2010 and Bloomberg reports that transactions are at a three year high as asset valuations have tumbled on a lower gold price. In their reporting Bloomberg says "deals valued at $9.6 billion were proposed or completed in the six months to June 30, up 7% on the previous half". According to Evolution Mining Executive Chairman, Jake Klein, asset valuations have fallen as much as 70% since 2011. These levels of discounts are starting to attract the attention of other firms in the industry and this explains the rise in M&A activity.

Overall, as valuation driven investors, the key is identifying whether commodity producers can be adequately profitable even on the back of lower commodity prices. Given the increase in M&A activity, perhaps gold producers are now starting to believe that prevailing discounts are sufficient to merit greater investment in gold production, whereas the signs from oil operators is still somewhat more ambivalent. The continued commodity weakness and the impact that this has on stock prices may well provide us an opportunity to increase commodity firm exposure if valuations become sufficiently attractive.

The **Marketplace**

- US economy recovers from Q1 slump, but employment data weak
- US inflation rising above expectations
- Europe settles as relative calm returns to Greece
- Brazil's investment grade status at risk
- Oil enters bear market

Market **Focus**

Global

- Standard & Poor's (S&P) put Brazil's investment grade status on review last week, downgrading the outlook for its sovereign rating from stable to negative. S&P cited risks "stemming from both the political and economic front".

US

- In the US, GDP rose by 2.3% on an annualised basis in the second quarter of this year, versus expectations of a 2.5% rise. The underlying personal consumption number came in above expectations, however, printing +2.9% versus consensus estimates of +2.7%, illustrating how American consumers are gaining confidence in the recovery.
- Significantly, the first quarter GDP estimate was significantly revised from initial estimates of a 0.2% annualised decline, to a rise of 0.6%. Friday's employment cost index print of 0.2% quarter-on-quarter was the smallest increase since 1982, however, demonstrating that there is still little inflationary pressure from the labour force.
- The core US Personal Consumption Expenditure (PCE) inflation index printed +1.8% (above expectations of +1.6%) with the Q1 number being revised up from 0.8% to 1.0%.
- The US Federal Reserve also had their latest Open Market Committee meeting last week. As expected, interest rates were left unchanged at current levels, with their comments confirming what many expect: a first interest rate rise is increasingly likely this year. Fed Chair, Janet Yellen, continues to emphasise that any hike will be data-dependent, however, leaving scope for continued loose policy should economic data releases disappoint.
- Following the Federal Reserve statement, Bloomberg reported that the likelihood of the first hike in September is now 44% based on market expectations, while December is still the more anticipated date with a 73% chance of a rate hike at the end of the year.

Europe

- In Europe, the immediate panic around Greece has somewhat settled, although clear risks remain. In particular, the complicated and conflicted political process in Greece and the euro area as a whole continue to present potential stumbling blocks. The Athens Stock Exchange opened on Monday after a five week hiatus. At the time of writing, it is down 20%.
- In Germany, the latest IFO Business Climate confidence survey printed 0.5 points above its June reading, and above consensus expectations: 108.0 versus 107.2 expected.

Commodities

- Brent crude oil fell into a technical bear market, having now slipped by more than 20% since its June peak of USD 67 a barrel.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 31 July 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	1.2%	2.1%	3.0%	10.5%
United Kingdom	GBP	1.8%	2.5%	3.7%	2.3%
Continental Europe	EUR	-0.1%	4.6%	18.9%	22.4%
Japan	JPY	0.2%	1.8%	19.1%	31.1%
Asia Pacific (ex Japan)	USD	-0.6%	-5.0%	-1.8%	-8.9%
Australia	AUD	2.4%	4.4%	7.6%	5.7%
Global	USD	1.2%	1.8%	4.5%	4.9%
Emerging Market Equities					
Emerging Europe	USD	1.2%	-4.4%	1.6%	-24.6%
Emerging Asia	USD	-1.7%	-7.2%	-2.5%	-7.4%
Emerging Latin America	USD	1.2%	-8.4%	-14.2%	-30.5%
BRICs	USD	-2.0%	-8.4%	-0.8%	-10.7%
MENA countries	USD	-1.7%	0.1%	4.3%	-10.0%
South Africa	USD	0.2%	-5.8%	-3.5%	-8.1%
India	USD	0.3%	1.6%	2.7%	6.3%
Global emerging markets	USD	-0.9%	-6.9%	-4.2%	-13.4%
Bonds					
US Treasuries	USD	0.4%	1.0%	0.8%	3.8%
US Treasuries (inflation protected)	USD	0.4%	0.3%	0.4%	-1.5%
US Corporate (investment grade)	USD	0.3%	0.7%	-0.3%	1.5%
US High Yield	USD	0.5%	-0.6%	1.9%	0.4%
UK Gilts	GBP	0.7%	1.7%	0.9%	10.1%
UK Corporate (investment grade)	GBP	0.4%	1.5%	0.7%	7.6%
Euro Government Bonds	EUR	0.5%	2.3%	1.0%	5.8%
Euro Corporate (investment grade)	EUR	0.2%	1.2%	-0.4%	2.6%
Euro High Yield	EUR	-0.1%	1.3%	2.6%	3.3%
Japanese Government	JPY	0.0%	0.3%	-0.5%	2.5%
Australian Government	AUD	0.3%	1.6%	1.8%	7.5%
Global Government Bonds	USD	0.6%	0.6%	-2.8%	-6.1%
Global Bonds	USD	0.6%	0.5%	-3.0%	-5.8%
Global Convertible Bonds	USD	0.3%	-0.3%	1.2%	-3.1%
Emerging Market Bonds	USD	0.6%	0.6%	1.6%	-1.5%

* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 31 July 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	1.2%	5.6%	-1.5%	8.4%
Australian Property Securities	AUD	3.8%	5.7%	10.1%	16.3%
Asia Property Securities	USD	-1.4%	-2.1%	7.9%	0.5%
Global Property Securities	USD	0.5%	2.0%	1.2%	2.3%
Currencies					
Euro	USD	0.0%	-1.5%	-9.2%	-18.0%
UK Pound Sterling	USD	0.7%	-0.6%	0.3%	-7.5%
Japanese Yen	USD	0.0%	-1.1%	-3.4%	-16.8%
Australian Dollar	USD	0.3%	-5.2%	-10.6%	-21.4%
South African Rand	USD	-0.3%	-4.0%	-8.7%	-15.5%
Swiss Franc	USD	-0.3%	-3.2%	2.9%	-5.9%
Chinese Yuan	USD	0.0%	0.0%	0.0%	-0.5%
Commodities & Alternatives					
Commodities	USD	-1.7%	-11.6%	-12.3%	-32.0%
Agricultural Commodities	USD	-1.8%	-9.5%	-10.3%	-12.9%
Oil	USD	-4.4%	-17.9%	-8.9%	-50.8%
Gold	USD	-0.3%	-6.5%	-7.5%	-14.6%
Hedge funds	USD	0.0%	0.0%	1.2%	-0.2%

* Estimate

Source: Bloomberg

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Important notes