FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **6 September 2015**

Multi-asset investors currently tend to have a low allocation to government fixed income, but they have kept some allocation on the premise that this asset class is the ultimate safe haven. In August, however, the benefit to investors was only modest because bonds did not do much to help while equities sold off. This is partly, at least, a consequence of their expensiveness: as yields crunch lower there is limited scope to rally.

A good question to ask therefore is: Is it unusual for US treasuries to do very little (+0.05%) in a month that saw the S&P return -6.1%? We have undertaken some basic analysis of the US treasury and equity markets to see if last month was an outlier. In the 89 months that have produced a negative total return for the S&P 500 since October 1995 (an average return of -3.8%) the JP Morgan US Government Bond Index (GBI) has gained an average of 0.8%. This represents an average return differential between the bond and equity market of 4.6% of which the equity market loss (i.e. -3.8%) equates to 82.3% of the differential. A number above 50% implies that the equity loss is greater than the bond market's gain and a number greater than 100% implies that bonds and equity both lost value in the same month.

Turning to more 'extreme' months, which we have classified as falls greater than 5% for the S&P, there have been 27 months in the last 20 years that have seen the equity market fall to this extent. In these months the average total return for the S&P was -7.8% and the average gain from the fixed income market was 1.3%. On average this represents a total return differential between the bond and equity market of 9.1% of which the equity market loss equates to 85.3% of the differential. This is relatively similar to the broader result of 82.3%. Last month 99.2% of the total differential between equity and fixed income was due to the equity market return because, over the month, the fixed income market was essentially flat.

Bonds did a poor job of 'rescuing' us last month from equity market falls, but over the past 20 years there have been a number of instances where bonds have been less helpful still. Returning to every negative month for the S&P over the past 20 years, there are 24 months where the bond market also provided a loss and therefore may be considered a 'worse' contribution from fixed income than August 2015. Finally, there is only one month in the past 240 where the S&P has lost value and the bond loss was greater than that of the equity market (March 2004).

Overall, while we remain confident that bonds are expensive today, despite their richness they modestly protected value in August. Furthermore, over the past 20 years bonds have, on average, generated a positive return when equity has sold off. While the efficacy of the insurance is questionable looking forward, August's returns profile was not exceptional compared to recent history.

The **Marketplace**

- Oil falls after 3-day 27% rally
- China sees weak manufacturing print
- Equity markets wobble
- US unemployment falls to pre-crisis low
- ECB announces prospect of more easing

Market **Focus**

Global

- Equity markets reacted sharply to the continuation of negative news out of China, the so-called Wall Street fear gauge, the Vix implied volatility index, rose 13% as markets digested the news.

US

- In the US, factory output fell significantly, with the Institute of Supply Management's (ISM's) manufacturing number hitting a two-year low, from a July level of 52.7 to 51.1 in August.
- The ISM's non-manufacturing print declined by 1.3 points, but at 59.0 it was above expectations of 58.8 and helped boost sentiment slightly towards the end of the week.
- The key US economic print was the non-farm payrolls number, however, as it is seen as a key metric in determining whether the Federal Reserve (Fed) will raise interest rates in September.
- The print of 173,000 new jobs last month came in below expectations, but with the August number often needing revising and with an upward, aggregate revision of 44,000 new jobs to June and July's number, the overall unemployment rate fell from 5.3% in July to 5.1% in August, signifying the lowest level since 2008.
- The relative strength of these numbers put pressure on US equities as it increased the possibility of the Fed starting to wind back its extraordinarily loose monetary policy that it has kept in place since the financial crisis.

Europe

- In Europe, President of the European Central Bank (ECB) struck a dovish tone last week underlining the diverging policies between it and the Fed. The ECB cut its inflation and growth forecasts, while Mr Draghi committed to further stimulus (over and above the current quantitative easing programme) if necessary.

China

- The official Chinese manufacturing PMI print fell 0.3 points to 49.7 in August signifying a move below 50 and indicating a contraction in activity for a critical sector in the world's second largest economy.

Commodities

- Oil started the week officially in a bull market after rallying 27% in three days, but the benchmark Brent crude index ended the week down by 0.9% after concerns around the economic slowdown in China continued.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 4 Sep. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-3.4%	-3.4%	-5.8%	-2.4%
United Kingdom	GBP	-3.3%	-3.3%	-5.9%	-9.8%
Continental Europe	EUR	-2.7%	-2.7%	6.6%	5.0%
Japan	JPY	-6.8%	-6.8%	3.7%	13.5%
Asia Pacific (ex Japan)	USD	-4.3%	-4.3%	-15.0%	-22.5%
Australia	AUD	-4.1%	-4.1%	-3.8%	-6.5%
Global	USD	-3.7%	-3.7%	-5.4%	-7.0%
Emerging Market Equities					
Emerging Europe	USD	-3.4%	-3.4%	-8.8%	-33.9%
Emerging Asia	USD	-3.5%	-3.5%	-14.5%	-20.4%
Emerging Latin America	USD	-4.7%	-4.7%	-26.0%	-44.5%
BRICs	USD	-5.4%	-5.4%	-15.5%	-27.8%
MENA countries	USD	-1.4%	-1.4%	-8.4%	-25.6%
South Africa	USD	-6.4%	-6.4%	-16.4%	-23.6%
India	USD	-5.1%	-5.1%	-11.6%	-13.5%
Global emerging markets	USD	-3.8%	-3.8%	-16.0%	-26.6%
Bonds					
US Treasuries	USD	0.3%	0.3%	1.3%	3.5%
US Treasuries (inflation protected)	USD	-0.5%	-0.5%	-0.8%	-2.5%
US Corporate (investment grade)	USD	0.6%	0.6%	-0.3%	0.8%
US High Yield	USD	0.3%	0.3%	0.3%	-2.6%
UK Gilts	GBP	1.1%	1.1%	2.3%	9.2%
UK Corporate (investment grade)	GBP	0.7%	0.7%	0.7%	5.4%
Euro Government Bonds	EUR	0.3%	0.3%	0.5%	3.6%
Euro Corporate (investment grade)	EUR	0.1%	0.1%	-0.9%	0.8%
Euro High Yield	EUR	-0.1%	-0.1%	1.6%	1.8%
Japanese Government	JPY	0.2%	0.2%	-0.1%	2.6%
Australian Government	AUD	0.6%	0.6%	2.9%	8.0%
Global Government Bonds	USD	0.3%	0.3%	-1.9%	-4.6%
Global Bonds	USD	0.1%	0.1%	-2.5%	-4.8%
Global Convertible Bonds	USD	-0.9%	-0.9%	-1.5%	-5.6%
Emerging Market Bonds	USD	-0.2%	-0.2%	0.9%	-2.5%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 4 Sep. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	-4.8%	-4.8%	-10.0%	-3.7%
Australian Property Securities	AUD	-2.9%	-2.9%	2.0%	5.2%
Asia Property Securities	USD	-4.9%	-4.9%	-4.9%	-10.7%
Global Property Securities	USD	-4.1%	-4.1%	-8.1%	-8.5%
Currencies					
Euro	USD	-0.4%	-0.4%	-7.9%	-14.0%
UK Pound Sterling	USD	-1.5%	-1.5%	-2.6%	-7.1%
Japanese Yen	USD	2.3%	2.3%	0.6%	-11.6%
Australian Dollar	USD	-3.7%	-3.7%	-15.4%	-26.1%
South African Rand	USD	-4.1%	-4.1%	-16.6%	-22.6%
Swiss Franc	USD	-0.9%	-0.9%	2.3%	-4.1%
Chinese Yuan	USD	0.3%	0.3%	-2.6%	-3.6%
Commodities & Alternatives					
Commodities	USD	-0.7%	-0.7%	-15.8%	-32.9%
Agricultural Commodities	USD	-1.8%	-1.8%	-14.9%	-14.7%
Oil	USD	-0.9%	-0.9%	-13.5%	-51.3%
Gold	USD	-0.9%	-0.9%	-5.2%	-11.0%
Hedge funds	USD	-0.2%	-0.2%	-1.2%	-3.9%

Source: Bloomberg

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Important notes