Weekly Digest

Week ending **7 February 2016**

Tightropes and turbulence

What a difference a couple of months make. When the US Federal Reserve (Fed) put up interest rates the feeling amongst market commentators was, on the whole, that they 'may as well'. The US economy was growing reasonably, employment was decent and while there were some concerns over the state of growth in Emerging Markets in particular, these seemed too remote to impact the US interest rate policy meaningfully. This week the US Federal Reserve Chair, Janet Yellen, will be addressing lawmakers in Washington and investors will be looking for any sign that the Fed may mothball the March hike; a rate increase that was priced in at a 50% probability at the start of the year but today the market gives no greater than a 10% probability of taking place. The Fed has recently signalled that interest rates will likely take place at a slower rate than had been communicated last year. This has also been reflected in market pricing. On the face of it, there are not many powerful forces pushing for a hike presently: the sharp sell-off in markets year to date has weighed on confidence; inflation remains subdued, not least due to oil's continued weakness, and other major central banks are committed to loose monetary policy.

For the market, at least, the prospect of negative interest rates in the US is no longer out of the question. Last month the Bank of Japan joined the European Central Bank (amongst others) in applying zero interest rates to certain reserves that are deposited at the central bank. The probability (implied from LIBOR rates) of US rates falling below zero by the end of 2017 (their floor in the post financial crisis environment) has increased to approximately 13%. This newfound dovishness both on the part of the market and the Fed explains, in part at least, why the dollar is starting to lose a little value compared to other currencies. The greenback was strong in 2015 and consensus was for this to continue throughout 2016, but in February it has fallen back to levels last seen in early November 2015.

The current climate remains a difficult one for central banks. Their committees continue to walk a tightrope between doing too little and presiding over economies that slump from one false dawn to another (or worse) on the one hand and doing too much and over indebting and destabilising the economy on the other. Ultimately there is only so much central banks can do to influence the economy and other actors, be they state, corporate or individual need to step up to provide activity. Governments are not awash with cash presently and so there seems little that can be done on the fiscal side to stimulate the economy. Therefore, consumer confidence remains all important as it is the activity of consumers, especially in the developed world, that will drive economies forward. Central banks are doing what they can to keep consumers employed and spending. Meanwhile markets are now pricing in a lot of bad news, so for long term investors this could be an interesting time to increase portfolio risk, although it will not be without the assumption of additional portfolio volatility in the short term.

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

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The **Marketplace**

- Equities fall as growth concerns linger
- US unemployment falls to 4.9%
- US services sector disappoints
- Japanese 10-year yield hits 0.01%
- Gold rallies amid dollar weakness

Market **Focus**

Global

- Global equities fell by 2.4% last week, as equities in the UK, Europe and US declined between three and four percent in local currency terms.
- US treasuries added 0.5%, while sovereign bonds in the UK and Europe declined by 0.1% and 0.2% in local currency terms respectively.
- In Japan, the 10-year government bond yield continued to fall, following the Bank of Japan's shock announcement that it had decided to adopt a negative interest rate. The yield reached 0.01% on Friday.

US

- The latest non-farm payrolls numbers showed that the US economy added 151,000 jobs in January, which was below expectations of +190,000, but nonetheless resulted in the overall unemployment rate falling from 5.0% to 4.9%. The dollar strengthened on the news, after a week of depreciation against major rivals.
- Average hourly earnings saw a significant increase of 0.5% month-on-month (versus forecasts of +0.3%), and the aggregate number of hours worked in the US also increased. Year-on-year earnings have now increased by 2.5% in the US.
- The ISM non-manufacturing index fell from 55.8 in December to 53.5 in January, which is its lowest level since the beginning of 2014 and below analysts' expectations of 55.1. The print reinforced fears that pressures in the US manufacturing sector are spilling over into its services sector.

Commodities

- Gold had its best week since July 2013 as dollar weakness and a broad risk-off environment boosted the price of the precious metal. Gold added 5% last week, ending the period at 1,173.8 an ounce.
- Oil experienced another choppy week, as it continued to fall at the start of the week, proceeded to rally on the back on declining dollar strength, only to decline again on Friday. Over the week, the price of Brent crude fell by 2.0%.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 5 Feb. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	-3.1%	-3.1%	-7.9%	-7.5%
United Kingdom	GBP	-3.8%	-3.8%	-6.0%	-12.1%
Continental Europe	EUR	-4.8%	-4.8%	-10.9%	-9.6%
Japan	JPY	-4.4%	-4.4%	-11.5%	-1.0%
Asia Pacific (ex Japan)	USD	-0.6%	-0.6%	-8.4%	-19.5%
Australia	AUD	-0.6%	-0.6%	-6.0%	-10.3%
Global	USD	-2.4%	-2.4%	-8.3%	-10.1%
Emerging Market Equities					
Emerging Europe	USD	-1.1%	-1.1%	-3.9%	-19.0%
Emerging Asia	USD	-0.5%	-0.5%	-7.8%	-19.7%
Emerging Latin America	USD	0.5%	0.5%	-4.1%	-32.1%
BRICs	USD	-1.5%	-1.5%	-11.4%	-25.7%
MENA countries	USD	3.4%	3.4%	-8.3%	-25.4%
South Africa	USD	-0.8%	-0.8%	-4.5%	-34.8%
India	USD	-0.9%	-0.9%	-7.9%	-20.9%
Global emerging markets	USD	-0.3%	-0.3%	-6.8%	-22.9%
Bonds					
US Treasuries	USD	0.5%	0.5%	2.8%	1.6%
US Treasuries (inflation protected)	USD	0.0%	0.0%	1.5%	-2.7%
US Corporate (investment grade)	USD	0.1%	0.1%	0.5%	-2.5%
US High Yield	USD	-1.1%	-1.1%	-2.7%	-8.3%
UK Gilts	GBP	-0.1%	-0.1%	3.7%	1.5%
UK Corporate (investment grade)	GBP	-0.6%	-0.6%	0.6%	-2.0%
Euro Government Bonds	EUR	-0.2%	-0.2%	1.7%	1.0%
Euro Corporate (investment grade)	EUR	-0.2%	-0.2%	0.4%	-1.1%
Euro High Yield	EUR	-0.7%	-0.7%	-1.9%	-2.3%
Japanese Government	JPY	0.5%	0.5%	2.0%	3.9%
Australian Government	AUD	0.5%	0.5%	1.9%	2.0%
Global Government Bonds	USD	2.0%	2.0%	3.6%	0.6%
Global Bonds	USD	1.6%	1.6%	2.7%	-0.4%
Global Convertible Bonds	USD	-0.2%	-0.2%	-4.7%	-5.4%
Emerging Market Bonds	USD	0.2%	0.2%	0.9%	1.4%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 5 Feb. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	-2.0%	-2.0%	-5.3%	-11.4%
Australian Property Securities	AUD	1.2%	1.2%	2.2%	-1.8%
Asia Property Securities	USD	-0.8%	-0.8%	-9.1%	-9.9%
Global Property Securities	USD	-0.7%	-0.7%	-5.7%	-11.0%
Currencies					
Euro	USD	3.0%	3.0%	2.8%	-2.8%
UK Pound Sterling	USD	1.8%	1.8%	-1.6%	-5.4%
Japanese Yen	USD	3.7%	3.7%	2.9%	0.6%
Australian Dollar	USD	-0.2%	-0.2%	-3.0%	-9.3%
South African Rand	USD	-0.8%	-0.8%	-3.4%	-29.5%
Swiss Franc	USD	3.2%	3.2%	1.2%	-7.0%
Chinese Yuan	USD	0.0%	0.0%	-1.2%	-4.9%
Commodities & Alternatives					
Commodities	USD	-2.5%	-2.5%	-6.3%	-28.7%
Agricultural Commodities	USD	-0.8%	-0.8%	-2.4%	-12.3%
Oil	USD	-2.0%	-2.0%	-8.6%	-39.8%
Gold	USD	5.0%	5.0%	10.6%	-7.2%
Hedge funds	USD	-0.5%	-0.5%	-3.4%	-7.2%

* Estimate

Source: Bloomberg

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