Weekly Digest

Week ending **9 August 2015**

Post global financial crisis (GFC) we have, collectively, become accustomed to the extraordinarily low levels of yield available from fixed income securities. Indeed the yields available on ten-year US government debt is approximately half of what it was at the end of 2005 and the rate available presently on the German ten-year is a mere 20% of the prevailing rate at the end of 2005. A similar story can be discerned in the credit markets. Yet equity market dividend yields (i.e. the dividend payment as a proportion of the share price) have not moved in sympathy. Indeed, for many major markets, the dividend yields available at the end of 2014 were greater than at the end of 2005.

Clearly, the levels of prevailing equity market yields in isolation is not a reliable method of assessing market cheapness, but it is interesting to see that equity investors can now receive a multiple of a region's 30-year sovereign yield, whereas pre-crisis the dividend income would likely have been a fraction of it. At the end of last year the dividend yield available to US investors was 0.7 times the 30-year bond yield, whereas ten years earlier the income was 0.4 times. Furthermore, in the UK, equity investors received a dividend income 1.3 times that of 30-year bond yields at the end of 2014, whereas ten years previously the ratio had been 0.6 times. Germany is perhaps even more notable with the end of 2014's ratio at 1.9 times whereas ten years previously it was a half.

Markets have rallied substantially from their post GFC lows and in order to maintain a strong yield their dividends have had to increase by a commensurate amount. The key question today is whether companies are overstretching to enable them to pay the sorts of yields that are prevailing in the market. Dividend pay-out (DPO) ratios can give us a flavour of this because it considers the amount of earnings paid out to shareholders. The US, UK and German markets have all seen their DPO ratio rise over the past decade. However, in the US and Germany the rise is modest (31.5% from 27.4% and 34.8% from 23.3% respectively) whereas the UK's pay-out ratio has increased from 37.1% pre crisis to over 56.0% at the start of this year. This is in part due to the larger weight of the resources and energy sectors in the UK, which have seen substantial reductions in their earnings of late, but it is also likely a symptom of the cult of equity income over here.

Income funds are spectacularly popular at the moment, especially in the UK, but we should always bear in mind that income is only one component of a total return. In time, we may find that companies that do not chase yield buyers and instead invest in long term, value accretive projects have returns that outstrip those fixated on providing a honeypot for investors via their dividend policy. It is reasonable for DPO to increase in the absence of attractive business opportunities, but they should not be increased simply to attract potential investors and we must tread carefully where firms feel constrained by the need to maintain or grow their dividend in the belief that failure to do so is interpreted as a negative signal in the market. Total return investors should welcome income, but not for the sake of it.

The **Marketplace**

- US jobs data prints broadly in line with expectations
- Expectations of UK rate hike dampened
- Emerging market currencies suffer
- Weak economic data fuels hope for Chinese stimulus
- The price of oil tumbles as the US rig count increases

Market **Focus**

Global

- Developed market equities fell by 1.0% last week, as emerging market stocks declined by 1.8%.
- Emerging market currencies continue to suffer against a strengthening dollar as expectations of the first interest rate rise in the US since the financial crisis heighten.

US

- US Treasuries added 0.3%, while US high yield suffered (down by 0.8%) as interest rate fears and a decline in oil weighs on the asset class.
- In the US, the latest non-farm payrolls release estimated that 215,000 new jobs had been created in July, which was only marginally below the 225,000 expected. There were also upward revisions to previous estimates (+14,000 in June and May combined), illustrating steady and continued growth in the US employment numbers.
- The Treasury market remained largely unaffected by the release, with the yield on shorter term notes increasing marginally, while longer-dated Treasuries saw yields drop, as the price of oil and therefore inflation expectations continued to fall.

Europe

- In the UK, expectations of a first rate hike were dampened, however. The Bank of England downgraded its short-term inflation forecasts, and only one member of its Monetary Policy Committee voted for a rate rise in last week's monthly meeting. Sterling fell by 0.8% against the dollar.

China

- In China, economic data prints continue to disappoint. Exports fell by 8.3% year-on-year in July versus predictions of -1.5%, while imports declined 8.1% (in line with expectations). The July Producer Price Index (PPI) number printed its lowest level since 2009 reading -5.4% year-on-year versus consensus forecasts of -5.0%.
- The Chinese equity market has added 4.9% today (Monday 10 August), in the hope that the weak data will lead to further stimulus by the governing Communist Party.

Commodities

- Oil fell by 6.9% and gold declined by 0.2%.
- Oil prices continue to be under pressure, as Baker Hughes reported an increase in the number of oil rigs operating in the US for the third consecutive week, stoking fears of increasing oversupply in the market. The price of Brent crude hit a 6-month low of $48.6 a barrel on Friday.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 7 August 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-1.2%	-1.2%	1.8%	10.4%
United Kingdom	GBP	0.4%	0.4%	4.1%	4.5%
Continental Europe	EUR	0.2%	0.2%	19.2%	26.4%
Japan	JPY	1.2%	1.2%	20.5%	36.0%
Asia Pacific (ex Japan)	USD	-1.7%	-1.7%	-3.5%	-8.8%
Australia	AUD	-3.9%	-3.9%	3.4%	3.8%
Global	USD	-1.0%	-1.0%	3.4%	5.7%
Emerging Market Equities					
Emerging Europe	USD	-4.7%	-4.7%	-3.2%	-25.0%
Emerging Asia	USD	-1.3%	-1.3%	-3.7%	-7.2%
Emerging Latin America	USD	-4.1%	-4.1%	-17.8%	-33.6%
BRICs	USD	-1.3%	-1.3%	-2.1%	-10.7%
MENA countries	USD	-2.3%	-2.3%	1.9%	-13.6%
South Africa	USD	-0.2%	-0.2%	-3.7%	-7.2%
India	USD	0.8%	0.8%	3.4%	9.2%
Global emerging markets	USD	-1.8%	-1.8%	-5.9%	-13.8%
Bonds					
US Treasuries	USD	0.3%	0.3%	1.1%	3.3%
US Treasuries (inflation protected)	USD	-0.3%	-0.3%	0.1%	-2.4%
US Corporate (investment grade)	USD	0.1%	0.1%	-0.2%	1.0%
US High Yield	USD	-0.8%	-0.8%	1.1%	-0.4%
UK Gilts	GBP	0.7%	0.7%	1.6%	9.5%
UK Corporate (investment grade)	GBP	0.3%	0.3%	1.0%	7.0%
Euro Government Bonds	EUR	-0.3%	-0.3%	0.7%	5.4%
Euro Corporate (investment grade)	EUR	0.1%	0.1%	-0.3%	2.4%
Euro High Yield	EUR	-0.3%	-0.3%	2.3%	3.9%
Japanese Government	JPY	-0.1%	-0.1%	-0.6%	2.3%
Australian Government	AUD	-0.5%	-0.5%	1.4%	6.5%
Global Government Bonds	USD	-0.4%	-0.4%	-3.2%	-6.9%
Global Bonds	USD	-0.4%	-0.4%	-3.4%	-6.5%
Global Convertible Bonds	USD	-0.5%	-0.5%	0.6%	-2.6%
Emerging Market Bonds	USD	-0.6%	-0.6%	1.0%	-0.8%

* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 7 August 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	-0.3%	-0.3%	-1.8%	8.8%
Australian Property Securities	AUD	-2.0%	-2.0%	7.8%	16.4%
Asia Property Securities	USD	0.0%	0.0%	7.9%	3.9%
Global Property Securities	USD	-0.1%	-0.1%	1.1%	3.7%
Currencies					
Euro	USD	-0.2%	-0.2%	-9.4%	-18.0%
UK Pound Sterling	USD	-0.8%	-0.8%	-0.6%	-8.0%
Japanese Yen	USD	-0.3%	-0.3%	-3.7%	-17.0%
Australian Dollar	USD	1.5%	1.5%	-9.2%	-20.0%
South African Rand	USD	0.4%	0.4%	-8.4%	-14.7%
Swiss Franc	USD	-1.8%	-1.8%	1.1%	-7.6%
Chinese Yuan	USD	0.0%	0.0%	0.0%	-0.7%
Commodities & Alternatives					
Commodities	USD	-2.3%	-2.3%	-14.3%	-33.5%
Agricultural Commodities	USD	0.3%	0.3%	-10.0%	-13.1%
Oil	USD	-6.9%	-6.9%	-15.2%	-53.9%
Gold	USD	-0.2%	-0.2%	-7.7%	-16.7%
Hedge funds	USD	-0.3%	-0.3%	1.0%	0.3%

* Estimate

Source: Bloomberg

For more information, please contact your adviser or alternatively contact:

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Important notes