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Weekly Digest

Week ending **10 January 2016**

Last week China's official sector demonstrated with unwitting eloquence the uneasy relationship between politics and the markets. Every major investment market is subject to a form of state control thanks to regulators and occasional administrative intervention, but the events in China again underline the discomfort and, arguably, inexperience of Beijing when it comes to free markets. Present criticism leveled at China's official sector is largely dividable into two categories. The first relates to the ill-conceived and quickly scrapped 'circuit breaker' and the second relates to undue market influence. But interventions of this sort are not the sole preserve of China.

On the subject of the 'circuit breakers', Beijing set the trigger point too narrowly, but then showed maturity by reversing the policy in short order when it was patently failing. Policy U-turns are inevitable from time to time, such as when the former European Central Bank President, Jean-Claude Trichet famously increased and then reduced interest rates within a matter of months in 2008. Indeed many a market commentator is fond of trotting out the phrase "When the facts change, I change my mind…" which is often attributed to Keynes, but Beijing's adoption of this approach has attracted scorn.

Turning to the subject of 'market influence'; Beijing has taken a number of steps since 2014 to boost and then shore up the Chinese stock market. Today these face some pretty stern criticism, but are they drastically worse than Quantitative Easing (QE)? As the Sunday Times noted this weekend,"[China's] meddling...drew in millions of small investors, many of whom suffered severe losses", which stands in contrast to QE which has (thus far) no real casualties. But at their heart is surely a shared aim: namely the support of asset prices with a view to steady the ship until economic conditions improve or animal spirits return? China has also been criticised for its recent exchange rate adjustments and for maintaining an 'inappropriate' exchange rate with the US dollar, but controlling an FX rate is not unusual. Normally it is a relatively benign act, but only a year ago the Swiss National Bank's surprise decision to scrap the Swiss franc's cap against the euro caused an upset.

Perhaps the real issue is, as Mohammed el-Erian noted, that China was "admired for decades for possessing a clear long-term economic vision and applying consistent policies". In a closed economy (and during times of plenty) Beijing could more or less control internal markets. Unfortunately when acting in a global marketplace their ability to control is reduced substantially and this may be only now becoming apparent in Beijing. How much of this is simply a communication issue? Where the West has shown itself to be above reproach is in the openness and quality of communication to the market. Perhaps, above all else, the real issue is that we had expected too much from China. In future there is likely to be a healthier dose of circumspection from all sides and, one hopes, greater transparency from China to help calm the waters and influence the path of markets even where control is impossible.

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

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The **Marketplace**

- Global equities tumble
- China uncertainty weighs on markets
- US jobs report surprises on upside
- Price of Brent crude falls to lowest level since 2004
- Gold continues its year-to-date rally

Market **Focus**

Global

- Global equity markets had their worst five days since 2011 last week, as markets opened 2016 on a sour note. Notably it was the worst start to a year since the inception of many market indices. Developed markets fell by 6.1%, while emerging markets returned -6.8%.
- The VIX index, known as the Wall Street 'Fear Gauge', spiked to its highest level since September last year.
- The market volatility stems largely from the continued uncertainty surrounding the Chinese economy, and confusion around the decision-making at the People's Bank of China and the securities regulator.

US

- In the US, non-farm payrolls continued to surprise on the upside, with an additional 292,000 jobs being added, versus consensus forecasts of +200,000. The US dollar and Treasury yields rose on the news, but eased back down as investors focused on the volatility seen across markets.

China

- The central bank had allowed the yuan to depreciate for eight consecutive sessions, sparking nervousness about the state of the economy, but reversed this apparent downward trend on Friday when it adjusted the fix higher in a reaction to market volatility.
- The securities regulator also added to the sense of disarray, as it suspended the 'circuit-breaker' rules introduced only last year. These enabled the stock market to suspend trading if and when the market fell by more than 7%. Last week these additional restrictions seemed only to add to the panic, however, causing the policy U-turn.

Commodities

- The price of Brent crude continued to fall last week, and at time the of writing the price is $32.9 a barrel, its lowest level since 2004.
- As a safe-haven asset, gold continued its year-to-date rally, rising to a two-month high and is now trading at $1,104 an ounce. Gold has now returned 4.0% year-to-date.

James Klempster, CFA & Scott Gordon

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Asset Class/Region	Currency	Currency returns			
		Week ending 8 Jan. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	-5.9%	-5.9%	-5.9%	-5.4%
United Kingdom	GBP	-5.3%	-5.3%	-5.3%	-7.5%
Continental Europe	EUR	-6.7%	-6.7%	-6.7%	3.0%
Japan	JPY	-6.5%	-6.5%	-6.5%	7.1%
Asia Pacific (ex Japan)	USD	-7.1%	-7.1%	-7.1%	-15.4%
Australia	AUD	-5.8%	-5.8%	-5.8%	-2.8%
Global	USD	-6.1%	-6.1%	-6.1%	-6.1%
Emerging Market Equities					
Emerging Europe	USD	-5.1%	-5.1%	-5.1%	-22.1%
Emerging Asia	USD	-6.4%	-6.4%	-6.4%	-15.7%
Emerging Latin America	USD	-8.4%	-8.4%	-8.4%	-36.0%
BRICs	USD	-7.2%	-7.2%	-7.2%	-21.1%
MENA countries	USD	-6.4%	-6.4%	-6.4%	-19.0%
South Africa	USD	-10.1%	-10.1%	-10.1%	-33.8%
India	USD	-5.3%	-5.3%	-5.3%	-12.9%
Global emerging markets	USD	-6.8%	-6.8%	-6.8%	-20.9%
Bonds					
US Treasuries	USD	0.8%	0.8%	0.8%	0.8%
US Treasuries (inflation protected)	USD	0.4%	0.4%	0.4%	-2.1%
US Corporate (investment grade)	USD	0.6%	0.6%	0.6%	-1.0%
US High Yield	USD	-0.3%	-0.3%	-0.3%	-4.8%
UK Gilts	GBP	1.7%	1.7%	1.7%	1.0%
UK Corporate (investment grade)	GBP	1.1%	1.1%	1.1%	0.7%
Euro Government Bonds	EUR	0.5%	0.5%	0.5%	1.8%
Euro Corporate (investment grade)	EUR	0.2%	0.2%	0.2%	-0.6%
Euro High Yield	EUR	-0.4%	-0.4%	-0.4%	0.5%
Japanese Government	JPY	0.4%	0.4%	0.4%	0.9%
Australian Government	AUD	0.5%	0.5%	0.5%	2.5%
Global Government Bonds	USD	1.1%	1.1%	1.1%	-1.3%
Global Bonds	USD	0.8%	0.8%	0.8%	-2.0%
Global Convertible Bonds	USD	-2.3%	-2.3%	-2.3%	-1.8%
Emerging Market Bonds	USD	-0.2%	-0.2%	-0.2%	1.8%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 8 Jan. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	-2.9%	-2.9%	-2.9%	-6.3%
Australian Property Securities	AUD	-2.4%	-2.4%	-2.4%	2.7%
Asia Property Securities	USD	-4.9%	-4.9%	-4.9%	-2.7%
Global Property Securities	USD	-4.1%	-4.1%	-4.1%	-6.0%
Currencies					
Euro	USD	0.6%	0.6%	0.6%	-7.4%
UK Pound Sterling	USD	-1.5%	-1.5%	-1.5%	-3.8%
Japanese Yen	USD	2.6%	2.6%	2.6%	2.0%
Australian Dollar	USD	-4.6%	-4.6%	-4.6%	-14.4%
South African Rand	USD	-5.2%	-5.2%	-5.2%	-29.0%
Swiss Franc	USD	0.8%	0.8%	0.8%	2.4%
Chinese Yuan	USD	-1.5%	-1.5%	-1.5%	-5.7%
Commodities & Alternatives					
Commodities	USD	-4.2%	-4.2%	-4.2%	-26.9%
Agricultural Commodities	USD	-1.5%	-1.5%	-1.5%	-15.6%
Oil	USD	-10.0%	-10.0%	-10.0%	-34.2%
Gold	USD	4.0%	4.0%	4.0%	-8.7%
Hedge funds	USD	-1.5%	-1.5%	-1.5%	-5.0%

* Estimate

Source: Bloomberg

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Important notes