FP FINANCIAL PARTNERS

Weekly Digest

Week ending **15 November 2015**

The recent poor performance of Emerging Markets (EM) equity has received a lot of coverage lately. The crux of the commentary is that EM, as the producers of the world, are under mounting pressure as global growth cools. Indeed last week the International Monetary Fund (IMF) noted that "Growth remains fragile and could be derailed …In an environment of declining commodity prices, reduced capital flows to emerging markets, and higher financial market volatility, downside risks to the outlook remain elevated, particularly for emerging economies."

Where there is negativity, there can be opportunities for patient investors. EM prospects hinge on global growth and an investor that is bullish on growth would likely see a great opportunity in EM today. Macro forecasting is notoriously difficult, however, and even when one predicts a macroeconomic outcome correctly, it does not necessarily inform the direction of asset prices. The historical divergence between China's growth and the performance of its stock market underlines this. Rather we look for valuations that appear attractive in a variety of economic scenarios and then judge these expected returns in relation to the riskiness of a particular asset class.

While the recent market focus has been on EM equities, there is a whole suite of assets to choose from, like EM debt markets (EMD). There are a number of sub-sectors within EMD that provide differing exposures to global investors. For example, prospective EMD investors can decide whether they would like exposure to the markets through local currency or through hard currency, and whether they would like to invest in the debt of corporates or governments.

All EM allocations have risk, however, and all potential returns need to be judged with this in mind. Today also demonstrates an interesting valuation bifurcation between the stocks of 'quality' companies which are expensive and other firms which are cheap. If the quality companies are over-priced or the cheap stocks are 'value-traps' then performance will disappoint.

Furthermore, when looking at EMD, it is important to note that leverage in EM is high – according to Goldman Sachs the ratio of debt to GDP is now 110% which is the highest level on record. The proportion of debt in local currencies rather than in dollars is much higher than previously, however, reducing the risks relating to repayment. Local currency EMD benefits from the ability of most governments to print their own currency, meaning that repayment risk is somewhat reduced, but the 'local' debt does therefore come with increased FX risk. Hard currency debt, on the other hand, brings the risk that the debtor may not be able to buy sufficient amounts of the hard currency to repay the creditor, but there is no direct FX translation risk.

According to our valuation models, both EM equity and EMD are attractive asset classes. EM Revenues will inevitably be weighed upon by commodity and consumer weakness but this also be should be reflected in the historical price movements in these equities. As long as conditions do not become materially worse for EM there should be profit to be made, but there are still number of unpredictable factors which are likely to weigh on EM assets in the short term. As a result, while we are alive to the opportunity and (modestly) overweight to these markets now, we do not feel compelled to take a large position yet. This is especially the case when other positions in the portfolios are taken into account. High yield debt, for example, now has a reasonable sensitivity to the energy and materials markets, as does the UK equity market. What we need to avoid is the appearance of diversification in the portfolios while ending up concentrating sensitivity to a small number of risk influences such as energy and resource prices.

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

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The **Marketplace**

- Global equities falter
- China sees inflation drop
- Japan falls into recession
- The price of oil tumbles
- Copper hits multi-year low

Market **Focus**

Global

- Global equities fell by 2.9% last week, while emerging markets declined by 3.7%. Global growth concerns continue to occupy markets, while strong employment numbers in the US has heightened expectations of December rate hike.
- US Treasuries added 0.3% while UK gilts rose by 0.6% in sterling terms, in a broadly risk-off week for markets.
- The International Monetary Fund (IMF) looks set to include the Chinese renminbi within its 'Special Drawing Rights' basket of currencies, granting the RMB official reserve currency status, and highlighting the increasing role that China is playing in the world's financial markets.
- Japan has fallen back into recession, with its economy shrinking for a second consecutive quarter. GDP contracted by 0.8% quarter-on-quarter in Q3 (versus expectations of -0.2%), according to preliminary numbers.

United States

- In the US, the Producer Price Index (PPI) printed -0.4% versus expectations of +0.2%.

China

- In China, the latest Consumer Prices Index (CPI) number printed -0.3% month-on-month, reducing the year-on-year inflation print from 1.6% to 1.3%. The PPI number remained unchanged at -5.9% month-on-month, marking the 44th consecutive month of declines.
- Chinese industrial production fell to +5.6% in October, from +5.7% in September and below expectations of 5.8% growth. Retail sales surprised on the upside, however, printing +11.0% year-on-year versus expectations of +10.9%

Commodities

- Brent crude fell to $43.6 a barrel signifying a drop of 8.0% last week alone. The price is edging closer to the recent August lows, although there has been a small bounce at time of writing. The fall in price can be contributed to the aforementioned growth concerns and a continuing supply glut.
- The price of copper touched $4,800 a tonne last week – a price not seen since July 2009.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 13 Nov. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-3.6%	-2.6%	-0.5%	0.7%
United Kingdom	GBP	-3.6%	-3.7%	-4.2%	-5.2%
Continental Europe	EUR	-2.8%	-1.3%	11.4%	14.0%
Japan	JPY	1.4%	1.8%	14.7%	16.3%
Asia Pacific (ex Japan)	USD	-3.1%	-2.7%	-9.9%	-12.2%
Australia	AUD	-2.9%	-2.9%	-2.4%	-2.8%
Global	USD	-2.9%	-2.9%	-1.6%	-1.8%
Emerging Market Equities					
Emerging Europe	USD	-2.7%	-2.8%	-7.7%	-21.4%
Emerging Asia	USD	-3.7%	-2.8%	-8.6%	-9.3%
Emerging Latin America	USD	-2.1%	-1.3%	-25.8%	-31.2%
BRICs	USD	-2.9%	-1.7%	-10.4%	-13.6%
MENA countries	USD	-0.7%	-2.0%	-12.1%	-21.8%
South Africa	USD	-5.9%	-8.7%	-18.4%	-21.2%
India	USD	-2.4%	-4.7%	-9.4%	-12.5%
Global emerging markets	USD	-3.7%	-3.1%	-12.3%	-15.3%
Bonds					
US Treasuries	USD	0.3%	-0.8%	0.7%	1.8%
US Treasuries (inflation protected)	USD	0.1%	-1.0%	-1.7%	-2.3%
US Corporate (investment grade)	USD	0.2%	-0.7%	-0.4%	0.6%
US High Yield	USD	-1.4%	-1.7%	-1.5%	-3.4%
UK Gilts	GBP	0.6%	-0.3%	0.8%	4.8%
UK Corporate (investment grade)	GBP	0.5%	0.0%	0.1%	2.9%
Euro Government Bonds	EUR	0.9%	-0.4%	1.9%	4.2%
Euro Corporate (investment grade)	EUR	0.4%	0.1%	-0.3%	0.4%
Euro High Yield	EUR	0.0%	0.4%	2.8%	2.8%
Japanese Government	JPY	0.0%	-0.1%	0.4%	2.4%
Australian Government	AUD	-0.9%	-1.9%	1.3%	5.1%
Global Government Bonds	USD	0.5%	-1.8%	-3.4%	-3.3%
Global Bonds	USD	0.4%	-1.6%	-3.7%	-4.0%
Global Convertible Bonds	USD	-1.5%	-1.1%	0.1%	-0.5%
Emerging Market Bonds	USD	-0.6%	-1.0%	2.5%	0.8%

* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 13 Nov. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	-2.4%	-4.4%	-4.1%	-0.6%
Australian Property Securities	AUD	-4.5%	-4.8%	4.3%	6.9%
Asia Property Securities	USD	-0.8%	-3.0%	1.0%	-1.4%
Global Property Securities	USD	-2.1%	-4.3%	-3.2%	-2.3%
Currencies					
Euro	USD	0.3%	-2.1%	-11.0%	-13.7%
UK Pound Sterling	USD	1.2%	-1.2%	-2.2%	-3.0%
Japanese Yen	USD	0.4%	-1.6%	-2.4%	-5.2%
Australian Dollar	USD	1.2%	-0.2%	-12.8%	-18.3%
South African Rand	USD	-1.5%	-3.9%	-19.5%	-22.0%
Swiss Franc	USD	-0.1%	-1.8%	-1.2%	-4.2%
Chinese Yuan	USD	-0.4%	-0.9%	-2.6%	-3.9%
Commodities & Alternatives					
Commodities	USD	-4.0%	-6.5%	-21.6%	-30.8%
Agricultural Commodities	USD	-1.9%	-3.6%	-14.3%	-14.7%
Oil	USD	-8.0%	-12.0%	-23.9%	-44.0%
Gold	USD	-0.5%	-5.1%	-8.5%	-6.8%
Hedge funds	USD	-0.8%	-0.8%	-2.4%	-2.7%

* Estimate

Source: Bloomberg

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

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Important notes