FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **16 August 2015**

It is increasingly rare, in this era of bold but staged central banking, to be surprised by the actions of a major central bank. Last week the People's Bank of China achieved just such a feat, by allowing the yuan to devalue.

It is clear that China is underwhelming compared to its aggressive year-on-year growth targets. Furthermore key economic indicators show a slowing rate of growth. In the face of a slowdown, it is sensible to allow some devaluation of a currency to enhance the competitiveness of exports against rivals. In this instance however the efficacy of this move is questionable.

Firstly, while important symbolically, the size of the move is relatively small. The yuan had been managed up consistently by 33% over ten years, whereas the fall of circa 3% over a few days is sharp but not large. Furthermore, China's economy is less export led than many believe, as Monday's FT notes: "Net exports subtracted 3 per cent from annual growth in Chinese Gross Domestic Product on average from 2004 to 2014. Meanwhile, investment contributed an average of 52 per cent of growth each year". This sounds rather more like a society enriched (and therefore importing more) by government largesse rather than exports. It could also be the first step to making imports less attractive, in an attempt to improve China's domestic demand, which would explain the reaction from stocks such as BMW and Apple.

There is no doubt that China has seen its competitiveness eroded over recent years by lower cost rivals such as Cambodia, Vietnam and Indonesia, but this is an almost necessary consequence of the government's aim to generate a consumption led economy which requires a large and (relatively) comfortable middle class. It seems unlikely, therefore, that China is aiming for a currency war in the Asia region at least: a move of this magnitude will not materially alter their competitiveness, especially when the costs of reallocating production is taken into account. Furthermore, the efficacy of devaluation is reduced substantially when their currencies devalue in sympathy almost immediately.

One possible reason why China may be devaluing, which has received less coverage than the currency-war thesis, is that China is becoming increasingly worried about deflation. While their currency was pegged to the (strong) US dollar they had seen substantial falls in a number of key input costs - such as energy - which are denominated in US dollars. The New York Times reminded us last week that "Chinese entities have borrowed over $1.6 trillion in foreign currencies" and while devaluation of the yuan makes serving this debt more difficult at least an inflationary environment would ensure that the real value of outstanding local debt does not also increase. Indeed, China's domestic debt has increased materially during its investment boom and while China still retains substantial reserves, China's recent reluctance to use them may be driven by longer term economic concerns on the part of the government.

The **Marketplace**

- China moves to devalue currency
- Asian currencies suffer
- Greek parliament votes through bailout deal
- US stocks decline on fears of China slowdown
- WTI crude near 6-year low

Market **Focus**

Global

- US stocks bucked the trend last week, adding 0.7% while other major developed markets saw declines. Emerging market equities fell by 2.3%.
- Global government bonds added 0.5%, with US Treasuries falling by 0.1%. US corporate credit fell by 0.4% while US high yield declined by 0.6%, as investors moved away from riskier asset classes.

US

- Stocks suffered globally, as investors digested the news from China, but Google announcing a major shareholder-friendly restructuring buoyed US indices. The US market also drew encouragement from Warren Buffet's Berkshire Hathaway completing its largest ever corporate takeover.

Europe

- In Europe, the Greek government approved the latest bailout deal, but many of Prime Minister Tspiras' MPs rebelled and voted against the measures. An early election is now increasingly likely.

China

- Last week saw the People's Bank of China (PBoC) move to devalue the yuan. The central bank cut the currency reference rate, which fixes the currency to the US dollar, for a consecutive 3-day period lowering the peg by 1.9%, 1.6% and 1.1% on each day, respectively.
- The central bank expressed its desire to move increasingly towards letting the market determine the rate, but confused markets on Wednesday when it subsequently intervened before close to help boost the yuan. At the end of the week, however, the currency had fallen by 2.8% against the dollar.
- Repercussions of the move were felt across Asia, with the Indonesian Rupiah and Malaysian Riggit falling by 2.0% and 3.9%, respectively. Commodities also suffered, as the PBoC's decision heightens concerns that the Chinese slowdown is greater than official figures are projecting.

Commodities

- Baker Hughes reported a fourth week of oil rigs coming online in the US, halting the trend of a tumbling rig count which started in November last year. This stoked fears of steadily increasingly supply from the US while demand, notably in China, slows. The news pushed West Texas Intermediate (WTI) crude close to a 6-year low. Brent crude fared better, but had a volatile week of trading. It ended the week having added 0.9%.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 14 August 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	0.7%	-0.5%	2.5%	8.5%
United Kingdom	GBP	-2.0%	-1.6%	2.0%	0.8%
Continental Europe	EUR	-2.8%	-2.5%	15.9%	20.9%
Japan	JPY	-0.9%	0.3%	19.4%	33.5%
Asia Pacific (ex Japan)	USD	-2.5%	-4.2%	-5.9%	-12.5%
Australia	AUD	-2.0%	-5.9%	1.3%	0.9%
Global	USD	-0.1%	-1.1%	3.3%	3.6%
Emerging Market Equities					
Emerging Europe	USD	0.0%	-4.7%	-3.2%	-28.2%
Emerging Asia	USD	-2.4%	-3.6%	-6.0%	-11.1%
Emerging Latin America	USD	-2.5%	-6.5%	-19.8%	-35.8%
BRICs	USD	-1.3%	-2.6%	-3.4%	-13.6%
MENA countries	USD	-0.4%	-2.7%	1.5%	-14.6%
South Africa	USD	-4.1%	-4.3%	-7.6%	-14.2%
India	USD	-2.5%	-1.8%	0.9%	3.5%
Global emerging markets	USD	-2.3%	-4.1%	-8.1%	-17.5%
Bonds					
US Treasuries	USD	-0.1%	0.2%	1.0%	3.0%
US Treasuries (inflation protected)	USD	-0.3%	-0.6%	-0.2%	-2.8%
US Corporate (investment grade)	USD	-0.4%	-0.3%	-0.5%	0.4%
US High Yield	USD	-0.6%	-1.4%	0.5%	-1.9%
UK Gilts	GBP	-0.4%	0.3%	1.2%	8.5%
UK Corporate (investment grade)	GBP	-0.4%	-0.2%	0.6%	6.2%
Euro Government Bonds	EUR	0.2%	-0.1%	0.8%	4.9%
Euro Corporate (investment grade)	EUR	-0.1%	0.0%	-0.4%	2.1%
Euro High Yield	EUR	-0.1%	-0.3%	2.2%	3.4%
Japanese Government	JPY	0.2%	0.1%	-0.3%	2.4%
Australian Government	AUD	0.3%	-0.1%	1.7%	6.6%
Global Government Bonds	USD	0.5%	0.2%	-2.7%	-6.7%
Global Bonds	USD	0.5%	0.1%	-2.9%	-6.4%
Global Convertible Bonds	USD	0.0%	-0.5%	0.7%	-3.4%
Emerging Market Bonds	USD	0.0%	-0.7%	0.9%	-2.0%

* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 14 August 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	1.3%	1.0%	-0.5%	7.6%
Australian Property Securities	AUD	-0.8%	-2.8%	7.0%	13.3%
Asia Property Securities	USD	-2.1%	-2.1%	5.6%	0.9%
Global Property Securities	USD	0.3%	0.2%	1.4%	2.0%
Currencies					
Euro	USD	1.3%	1.1%	-8.2%	-16.9%
UK Pound Sterling	USD	0.9%	0.1%	0.4%	-6.3%
Japanese Yen	USD	-0.1%	-0.4%	-3.7%	-17.1%
Australian Dollar	USD	-0.5%	1.1%	-9.6%	-20.8%
South African Rand	USD	-1.5%	-1.1%	-9.8%	-17.7%
Swiss Franc	USD	0.7%	-1.1%	1.8%	-7.2%
Chinese Yuan	USD	-2.8%	-2.9%	-2.9%	-3.7%
Commodities & Alternatives					
Commodities	USD	-0.2%	-2.5%	-14.5%	-32.4%
Agricultural Commodities	USD	-0.5%	-0.2%	-10.5%	-12.0%
Oil	USD	0.9%	-6.1%	-14.5%	-51.9%
Gold	USD	1.9%	1.8%	-5.9%	-15.1%
Hedge funds	USD	-0.4%	-0.9%	0.4%	-1.1%

* Estimate

Source: Bloomberg

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