FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **23 August 2015**

The performance of the markets is presenting investors with an interesting paradox at the moment. On the one hand, corporations are now in good shape, generating solid profits and with large cash reserves. Merger and acquisition activity was at its highest level in five years last quarter. Consumers are feeling reasonably positive once more and slack in developed world labour markets looks to have all but disappeared, which is a positive sign for wage negotiation. Furthermore, the falls in energy prices have kept a lid on inflation, which is benefitting consumers and (most) corporations alike. Finally, the banking sector, an important source of liquidity in the real economy, is now better capitalised and thus should be greasing the wheels of commerce nicely.

Yet even a cursory glance at the screens last week would suggest that at this juncture the market is fragile, with a number of other signs also underlining the current level of discomfort. Firstly, Barclays' analysis suggests that investors are dashing to cash: "money market inflows of $91bn the past six weeks signal considerable risk aversion… equity positioning has declined … corroborating the view that cash levels have been increased." The rise in the VIX index (the CBOE's measure of implied volatility from options pricing) tells a similar story. On Friday alone the 'Wall Street fear gauge' jumped close to 50%, to its highest level since December 2011. Indeed, as Deutsche Bank note: "Amazingly, last week's 119% surge in the index (albeit from a low base) was the largest in the history with data going back to 1990."

This recent nervousness seems to have China at its epicentre, but central bank policy is also playing its part. For example, one of the reasons for the yuan devaluation was that the dollar was strengthening on the back of US hike speculation. While the Federal Reserve (Fed) is mandated to focus on the US, it is not myopic and will be concerned that its moves – or rather its potential moves – are causing this much global volatility, which in turn may have significant feedback effects domestically. Presently the market's activity seems akin to the 'Taper Tantrum' with markets responding badly to the prospect of the Fed's action. Looking forward, the Fed is committed to increasing rates, but there is still debate surrounding the timing of such a move as the probability of a Fed hike has fallen from 54% at the start of August to 34% today according to Bloomberg data, as market jitters have increased.

The past month has been a salutary reminder that both macroeconomic events and trends are difficult to predict and that there is not a direct, linear relationship between economic news and the performance of markets. For example, it was only a few months ago that markets rallied on patchy US economic data on the premise that monetary policy would have to be looser for longer. Now the market appears fixated on the bad news coming out of China. All in all, periods like this are a reminder of the importance to stay focused on valuation levels, and of the need to invest with conviction in areas that look cheap in a variety of possible economic scenarios. Remember to take advantage of diversification as it is the closest thing to a free lunch afforded to us by the markets. Conviction is important, but so is the avoidance of over-concentration of particular portfolio risks.

The **Marketplace**

- Global markets tumble
- Fears of Fed hike and China slowdown weigh on markets
- Germany falls into bear market; commodities hit financial crisis lows
- China PMI data disappoints
- European PMI data surprises on upside

Market **Focus**

Global

- Developed equity markets fell by 5.3% last week, with European stocks losing 6.4% in euro terms. The US market ended the week down by 5.7% with the S&P 500 seeing the worst daily drop in price since 2011 on Friday. Emerging markets also tumbled, falling by 5.9% over the week.
- Global government bonds added 1.4%, with Treasuries gaining 0.8% and UK gilts rising by 1.3% in sterling terms, as investors sought safety.
- At time of writing, global equity markets continue on their downward spiral with fears of a slowdown in China and an impending interest rate rise by the US Federal Reserve causing jitters across the world. The German equity market is trading in bear market territory, having now fallen over 20% from its April 2015 highs.

US

- In US, the August PMI estimate printed lower than expected at 52.9 and showing a decline of 0.9 points versus expectations of no month-on-month change. While in Europe, the August PMI estimate rose by 0.2 points to exceed expectations of it staying flat. The index rose to 54.1 in Europe, well above the level of 50.0 which separates contraction from growth in the manufacturing sector.

China

- Last week also saw disappointing data prints from China, reinforcing the notion that the Chinese economy is slowing a lot quicker than many had anticipated. The August Purchasing Manager Index (PMI) estimate printed 47.1 versus expectations of 48.2. The measure fell 0.7 points compared to July and is now at its lowest level since March 2009.
- Emerging market currencies also continue to fall on the back on the People's Bank of China's recent move to let the yuan devalue against the US dollar.

Commodities

- The rout in commodities also intensified as copper fell below USD 5,000 per tonne for the first time since the global financial crisis and Brent crude tumbled 7.3% last week.
- Gold rose by 4.1% as sentiment turned and currencies continued to weaken.

James Klempster, CFA & Scott Gordon

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

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Asset Class/Region	Currency	Currency returns			
		Week ending 21 August 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-5.7%	-6.2%	-3.4%	0.4%
United Kingdom	GBP	-5.4%	-7.0%	-3.5%	-6.2%
Continental Europe	EUR	-6.4%	-8.7%	8.6%	10.9%
Japan	JPY	-5.5%	-5.2%	12.9%	24.1%
Asia Pacific (ex Japan)	USD	-5.5%	-9.4%	-11.1%	-17.8%
Australia	AUD	-2.3%	-8.1%	-1.0%	-3.3%
Global	USD	-5.3%	-6.3%	-2.1%	-3.4%
Emerging Market Equities					
Emerging Europe	USD	-6.0%	-10.4%	-9.0%	-33.9%
Emerging Asia	USD	-6.2%	-9.5%	-11.8%	-16.6%
Emerging Latin America	USD	-5.3%	-11.5%	-24.1%	-41.4%
BRICs	USD	-6.1%	-8.6%	-9.3%	-20.7%
MENA countries	USD	-5.7%	-8.2%	-4.2%	-20.4%
South Africa	USD	-4.6%	-8.7%	-11.9%	-17.8%
India	USD	-4.3%	-6.0%	-3.5%	-2.8%
Global emerging markets	USD	-5.9%	-9.8%	-13.6%	-23.1%
Bonds					
US Treasuries	USD	0.8%	0.9%	1.8%	3.9%
US Treasuries (inflation protected)	USD	0.2%	-0.4%	0.1%	-2.8%
US Corporate (investment grade)	USD	0.6%	0.4%	0.1%	1.0%
US High Yield	USD	-0.8%	-2.2%	-0.3%	-3.2%
UK Gilts	GBP	1.3%	1.6%	2.5%	9.5%
UK Corporate (investment grade)	GBP	0.6%	0.4%	1.2%	6.4%
Euro Government Bonds	EUR	0.1%	-0.1%	0.9%	4.5%
Euro Corporate (investment grade)	EUR	-0.1%	-0.1%	-0.5%	1.7%
Euro High Yield	EUR	-0.5%	-0.9%	1.7%	2.3%
Japanese Government	JPY	0.3%	0.4%	-0.1%	2.8%
Australian Government	AUD	1.1%	1.0%	2.9%	8.3%
Global Government Bonds	USD	1.4%	1.5%	-1.3%	-4.9%
Global Bonds	USD	1.1%	1.2%	-1.8%	-4.9%
Global Convertible Bonds	USD	-1.9%	-2.3%	-1.2%	-5.5%
Emerging Market Bonds	USD	-1.0%	-1.7%	-0.1%	-3.3%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 21 August 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	-2.1%	-1.1%	-2.5%	3.9%
Australian Property Securities	AUD	-2.6%	-5.3%	4.2%	7.0%
Asia Property Securities	USD	-3.4%	-5.5%	2.0%	-4.3%
Global Property Securities	USD	-2.9%	-2.8%	-1.6%	-2.2%
Currencies					
Euro	USD	2.5%	3.7%	-5.9%	-14.3%
UK Pound Sterling	USD	0.4%	0.5%	0.8%	-5.3%
Japanese Yen	USD	1.9%	1.5%	-2.0%	-14.7%
Australian Dollar	USD	-0.9%	0.1%	-10.5%	-21.3%
South African Rand	USD	-1.1%	-2.2%	-10.8%	-17.4%
Swiss Franc	USD	3.2%	2.1%	5.1%	-3.7%
Chinese Yuan	USD	0.1%	-2.8%	-2.8%	-3.6%
Commodities & Alternatives					
Commodities	USD	-3.2%	-5.6%	-17.3%	-34.7%
Agricultural Commodities	USD	-1.8%	-2.0%	-12.1%	-13.6%
Oil	USD	-7.3%	-12.9%	-20.7%	-55.7%
Gold	USD	4.1%	5.9%	-2.0%	-9.1%
Hedge funds	USD	-0.7%	-1.6%	-0.3%	-2.4%

* Estimate

Source: Bloomberg

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