



Weekly Digest

Week ending **25 September 2016**

What 8 years post Lehmans looks like

This month marks the eighth anniversary of the spectacular collapse of Lehman Brothers. At that time the global financial crisis was underway – we had already seen runs on high street banks such as the UK's Northern Rock by then – but the fall of a Wall Street titan sent shockwaves around the globe and served to highlight the scale of the liquidity and confidence drought that was upon us. The fact that Lehman went out of business taught market participants that even institutions that had been believed to be 'too big to fail' may well go under. Following the Lehman collapse, market liquidity all but dried up as lenders looked to both ensure their own balance sheet was sufficiently stable and to avoid lending to others because this was beginning to look like taking an unnecessary risk. As a result, yields of safe haven assets shot lower whereas the yield spread payable on corporate and personal debt spiked upwards reflecting the increased risk perception.

In the subsequent eight years there have been a number of interesting dynamics in markets which would have appeared extraordinary in 2008 but many of which are rapidly becoming the norm today. For example, if you had said to someone the day prior to Lehman going under that eight years later over one third of high quality government bonds would be yielding less than zero it is unlikely they would have believed you. Furthermore, if you had told them that global growth would still be languishing around 2.5% per year the best part of a decade on, they would have envisioned an impoverished and downtrodden society that would be on the verge of giving up all hope of long term prosperity. Thankfully this is not the case today.

This fictional sounding board would also no doubt be surprised to learn that trillions of dollars have been committed to markets by central banks in an attempt to foster inflation, animal spirits and ultimately economic growth and yet despite these efforts, inflation in the US is still only 1.1% year on year. This person would likely

also be taken aback when it is explained that these extraordinary monetary policies are not just confined to the purchase of government debt. The US Federal Reserve buying securitised credit would surprise, and it is likely that disbelief would have been expressed at the idea of respected central banks such as the Bank of Japan buying equity ETFs and looking to fix prevailing yields for certain debt maturities. Furthermore the concept of 'helicopter money' where a central bank prints money to essentially distribute directly to its citizens is not treated as laughable any more.

Paradoxically, despite the unexciting levels of economic growth, profitability of corporations is high and the corporate sector is sitting on huge cash reserves. Indeed this level of corporate caution, while effective in terms of boosting stock prices, is blamed for the lack of economic growth as cash that should be put to use in beneficial capital investments remains languishing on balance sheets. Furthermore, the low interest rate also attracts a fair share of the blame because this exceptionally cheap funding keeps alive inefficient companies that would be wiped out by higher borrowing costs. Yet eight years on from Lehman we have experienced strong returns from stock markets, with the MSCI World gaining an annualised 14.4% in total return terms in USD since the start of 2009. Serving to underline the fact that a macro story is not the same as an investment case and that judicious purchasing of assets when they are cheap will be well rewarded even when the going seems incredibly tough.

Finally, if you had told people that eight years on from the Lehmans collapse that the UK had voted to leave the European Union, open ended property funds would once again be gated due to redemptions and that Donald Trump and Hilary Clinton were neck and neck in the race for the Whitehouse, they really would think you had lost your marbles.

The Marketplace

- Markets buoyed by central bank meetings
- Bond yields fall after US interest rates kept unchanged
- 'Hard Brexit' speculation pushes sterling lower
- Subdued PMI results for the euro area
- Choppy week for oil ahead of OPEC meeting

Market Focus

US

- The Federal Open Markets Committee (FOMC) left interest rates unchanged at 0.25-0.5% at their meeting on Wednesday. This decision was expected, but equity markets none-the-less rallied after the removal of the uncertainty that had preceded the meeting.
- Three out of the twelve FOMC members voted for a rate rise, and an update on member rate forecasts showed that the median prediction is for two rate hikes during 2017.
- Global equities rose 2.0% over the week, whilst US equities rose 1.2%. US Treasury bond prices also rose by 0.6%, with inflation protected bonds rising 1.3%.

Japan

- The Bank of Japan (BoJ) slightly disappointed equity investors by leaving their deposit rate unchanged at -0.1%. Instead the Bank altered the structure of its bond purchases, committing to increased purchases of 10-year Japanese Government Bonds (JGBs) and buying fewer shorter term JGBs.
- The yen has risen 0.7% versus the US dollar since the BoJ meeting - likely to the dismay of Japanese policymakers, although its equities reacted positively, gaining 2.9% for the week.

Europe

- Brexit weighed on the sterling currency last week, culminating in a 0.2% weekly fall against the dollar, including a 0.9% fall on Friday following reports that Britain may become an independent member of the World Trade Organisation, meaning it would negotiate its own trade deals outside of the European Union.
- August's Purchasing Manager's Index readings, which provide an effective barometer for economic activity, were released on Friday for the euro area. The composite index, comprising readings from both the services and manufacturing sectors, dropped to 52.6 from 52.9 (a reading above 50 represents an expansion). The lower reading was attributable to a slowdown in the services sector.
- The relief rally after the FOMC meeting benefitted European financial assets: UK and Continental European equities gained 3.0% and 2.7% respectively over the week, with UK gilts gaining 1.4% and Euro government bonds gaining 0.8%.

Commodities

- Oil prices ended the week up 0.3% at USD 45.89 per barrel, despite volatile movements including a 3.7% fall on Friday. More volatility is expected ahead of OPEC's long anticipated meeting at the International Energy Forum in Algeria yesterday. The price of a barrel of Brent crude oil is up 1.5% at time of writing after Algeria's oil minister suggested that OPEC members are ready to agree to a production freeze during the meeting.

James Klempster (CFA) & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 23 September 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.2%	-0.2%	7.1%	13.4%
United Kingdom	GBP	3.0%	2.0%	14.5%	19.2%
Continental Europe	EUR	2.7%	0.7%	-2.9%	3.5%
Japan	JPY	2.9%	1.5%	-11.7%	-5.8%
Asia Pacific (ex Japan)	USD	3.3%	2.8%	13.5%	19.1%
Australia	AUD	2.6%	0.4%	6.2%	13.6%
Global	USD	2.0%	0.7%	5.7%	10.6%
Emerging Market Equities					
Emerging Europe	USD	4.5%	3.7%	17.3%	10.6%
Emerging Asia	USD	3.4%	3.0%	14.8%	18.8%
Emerging Latin America	USD	4.3%	0.0%	33.3%	31.3%
BRICs	USD	3.0%	3.7%	18.9%	20.6%
MENA countries	USD	-1.6%	-1.2%	-1.4%	-8.3%
South Africa	USD	5.1%	7.3%	24.7%	10.4%
India	USD	1.2%	1.0%	11.7%	13.3%
Global Emerging Markets	USD	3.6%	2.8%	17.8%	18.6%
Bonds					
US Treasuries	USD	0.6%	-0.2%	5.3%	4.8%
US Treasuries (inflation protected)	USD	1.3%	0.5%	7.6%	6.8%
US Corporate (investment grade)	USD	0.9%	-0.3%	9.1%	8.4%
US High Yield	USD	0.8%	0.3%	14.7%	10.1%
UK Gilts	GBP	1.4%	-1.8%	15.5%	14.4%
UK Corporate (investment grade)	GBP	1.1%	-1.1%	13.9%	14.0%
Euro Government Bonds	EUR	0.8%	0.0%	6.2%	6.8%
Euro Corporate (investment grade)	EUR	0.3%	-0.1%	6.0%	6.7%
Euro High Yield	EUR	0.4%	-0.4%	7.2%	7.3%
Japanese Government	JPY	0.5%	-0.2%	5.2%	6.3%
Australian Government	AUD	0.6%	-1.0%	6.3%	6.2%
Global Government Bonds	USD	1.1%	0.4%	10.6%	9.7%
Global Bonds	USD	0.9%	0.3%	9.1%	8.1%
Global Convertible Bonds	USD	1.2%	0.7%	3.0%	4.6%
Emerging Market Bonds	USD	2.1%	0.5%	15.8%	16.9%

Asset Class/Region	Currency	Currency returns			
		Week ending 23 September 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	4.1%	0.0%	13.0%	20.2%
Australian Property Securities	AUD	2.1%	-5.0%	9.8%	18.2%
Asia Property Securities	USD	2.9%	3.5%	10.7%	15.1%
Global Property Securities	USD	3.4%	0.6%	12.2%	18.2%
Currencies					
Euro	USD	0.6%	0.6%	3.4%	0.4%
UK Pound Sterling	USD	-0.2%	-1.2%	-12.0%	-14.9%
Japanese Yen	USD	1.2%	2.4%	19.1%	19.1%
Australian Dollar	USD	1.8%	1.4%	4.6%	8.9%
South African Rand	USD	3.4%	7.4%	12.8%	1.1%
Swiss Franc	USD	1.1%	1.4%	3.3%	1.0%
Chinese Yuan	USD	0.1%	0.2%	-2.6%	-4.2%
Commodities & Alternatives					
Commodities	USD	1.6%	1.7%	6.8%	-4.5%
Agricultural Commodities	USD	1.3%	3.8%	0.8%	0.2%
Oil	USD	0.3%	-2.4%	23.1%	-3.9%
Gold	USD	2.1%	2.2%	26.0%	18.3%
Hedge funds	USD	0.4%	0.4%	1.0%	-0.5%

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