

# Weekly Digest

Week ending **28 June 2015**

The bond conundrum.

Since the global financial crisis, Zero Interest Rate Policy (ZIRP) has been a key tenet of global markets, but we are likely to see the end of this extraordinary easing in the foreseeable future (at least in the US and UK). While we do not expect interest rates to fly up and cause mass casualties in bond markets, we do expect bond yields to rise. This anticipated path of yields (and the consequent reduction in capital values) leads many to believe bonds to be extremely 'risky' today.

Broadly speaking we agree with this view, but as discussed previously we take a more subtle view of risk than simple volatility. Risk for us is about failing to achieve the outcomes that our clients require, be it the generation of a real return or the desire for a particular performance attainment. We judge the opportunity provided to us by the price of a particular asset class in comparison to our assessment of its fundamental valuation. When viewed through this valuation lens, sovereign paper has been priced at a level that rendered it unattractive for the past few years because it was difficult to attain the necessary performance outcomes in anything but an extremely negative scenario. This has adjusted slightly of late as yields have crept up, but it is still too early for us to consider adding government bond exposure in a meaningful way. It is always worth bearing in mind, however, that sovereign debt remains the ultimate safe haven in terms of market distress. For some clients, therefore, government bonds can be thought of as 'portfolio insurance'. This 'safety' has come at a price, however.

Nevertheless, we continue to believe that fixed income has a pivotal role to play in multi asset portfolios, although we assess the asset class with a healthy dose of circumspection. This is largely thanks to the breadth of the potential opportunity set in fixed income which spans from ultra-high quality sovereign debt to assets such as high yield and convertible debt (often termed credit) which are not dissimilar to equity in terms of its potential risks. On balance, in terms of risk and return, credit has been far more attractively priced post financial crisis and therefore provided a reasonable probability of achieving the necessary performance outcomes for our clients.

Looking forward we expect the next decade to be different for prevailing bond yields than those before the financial crisis. This means that, in the absence of significant levels of inflation, we expect headline levels of yields to remain relatively muted. As a result, an 'attractive' entry yield back into the core sovereign markets, while still eluding us today, is likely to be substantially lower than what it has been in previous cycles.

## The Marketplace

- Markets tumble as fear of 'Grexit' heightens
- PM Tsipras calls a referendum on latest creditor proposals
- ECB did not increase emerging funding; Greek banks close
- Economic data out of the rest of Europe encouraging
- China eases policy, as technically its bull markets ends

## Market Focus

### Global

- Global equities were flat last week (+0.1%), but have tumbled this morning (29/06) as worries rise that Greece may default on its debt repayments and forced to leave the euro. This stands in contrast to last week, when optimism around the situation drove the European market up by 3.6% in euro terms. At time of writing, European equities are down circa 4%.
- Last week saw US treasuries fall by 1.0%, but yields are tightening this morning. Similarly UK gilts fell by 1.1% in sterling terms last week. European government bonds lost 0.2% in euro terms. Emerging market bonds fell by 0.1% as yields move up.

### US

- In the US, President of the Reserve Bank of New York, stated that September is still "very much in play" for the first rate hike, citing strong economic data coming out of the US.

### Europe

- Over the weekend, Greek Prime Minister, Alexis Tsipras, walked away from the negotiating table, and surprised many by announcing that the latest bailout conditions proposed by its creditors would be subject to a referendum.
- Some confusion remains, however, as euro area officials officially withdrew their latest (draft) bailout proposal after Mr Tsipras walked out on negotiations. It is currently unclear what the Greeks will in fact be voting for.
- Euro area officials have also declined a request by Greece to extend the current bailout programme until after the referendum is held on Sunday.
- The European Central Bank has kept its Emergency Liquidity Assistance (ELA) programme in place but has refused to raise its limit past the current EUR 89 billion level. Critically, this means that Greek banks are no longer able to cover the large amounts of money being withdrawn, and capital capitals have been put in place. Banks will not open for a week, and Greeks are limited to withdrawing a maximum of EUR 60 a day.
- Away from Greece, economic releases in the rest of Europe were encouraging. The June estimate Purchasing Manager's Index (PMI) read 54.1 (versus expectations of 53.5) rising from 53.6 in May. Breaking down the composite number, both manufacturing and services industries rose in June (+0.3 and +0.6, respectively).

### China

- The People's Bank of China cut its one-year lending rate for the fourth time since November, and cut its deposit rate too. The deposit rate now sits at 2.0%, while the 0.25% cut to its lending rate (now at 4.85%) was larger than expected. There were also cuts to Reserve Requirement Ratios for financing companies and banks that lend to rural inhabitants and small and medium sized businesses.
- The Shanghai Composite Index has fallen 22.0% since it peaked on June 12; technically this drop brings a spectacular year-long bull run to an end.

### Commodities

- Brent crude added 0.4% while Gold fell by 2.1%.

*James Klempster, CFA & Scott Gordon*

Asset Class/Region	Currency	Currency returns			
		Week ending 26 June 2015	Month to date	YTD 2015	12 months
<b>Developed Market Equities</b>					
United States	USD	-0.4%	-0.2%	2.8%	8.9%
United Kingdom	GBP	0.7%	-3.1%	4.7%	3.5%
Continental Europe	EUR	3.6%	-0.2%	18.7%	18.9%
Japan	JPY	2.3%	-0.2%	19.6%	34.4%
Asia Pacific (ex Japan)	USD	0.1%	-3.1%	4.3%	0.4%
Australia	AUD	-0.7%	-3.8%	4.7%	6.0%
Global	USD	0.1%	0.0%	5.0%	4.2%
<b>Emerging Market Equities</b>					
Emerging Europe	USD	0.1%	-1.9%	6.9%	-25.6%
Emerging Asia	USD	1.1%	-3.3%	5.9%	4.7%
Emerging Latin America	USD	-0.6%	2.1%	-5.4%	-22.6%
BRICs	USD	0.3%	-2.1%	9.2%	1.4%
MENA countries	USD	-0.7%	-1.3%	5.8%	-2.6%
South Africa	USD	2.0%	2.2%	1.9%	-1.9%
India	USD	1.7%	-0.1%	1.3%	7.2%
Global emerging markets	USD	0.8%	-1.9%	3.6%	-4.1%
<b>Bonds</b>					
US Treasuries	USD	-1.0%	-1.8%	-0.9%	1.9%
US Treasuries (inflation protected)	USD	-1.1%	-1.9%	-0.7%	-2.5%
US Corporate (investment grade)	USD	-1.2%	-2.5%	-1.6%	0.1%
US High Yield	USD	-0.2%	-1.1%	2.9%	0.0%
UK Gilts	GBP	-1.1%	-3.1%	-2.0%	7.7%
UK Corporate (investment grade)	GBP	-1.1%	-3.0%	-1.3%	5.8%
Euro Government Bonds	EUR	-0.2%	-2.7%	-1.4%	4.2%
Euro Corporate (investment grade)	EUR	-0.2%	-2.0%	-1.7%	1.6%
Euro High Yield	EUR	1.0%	-1.0%	2.2%	2.3%
Japanese Government	JPY	-0.3%	-0.2%	-1.0%	2.2%
Australian Government	AUD	-1.0%	-1.6%	0.0%	6.1%
Global Government Bonds	USD	-1.4%	-1.1%	-4.2%	-7.9%
Global Bonds	USD	-1.3%	-1.1%	-4.0%	-7.3%
Global Convertible Bonds	USD	-0.3%	-0.5%	2.6%	-3.4%
Emerging Market Bonds	USD	-0.1%	-1.7%	1.1%	-2.2%

\* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 26 June 2015	Month to date	YTD 2015	12 months
<b>Property</b>					
US Property Securities	USD	-2.7%	-3.3%	-5.3%	4.9%
Australian Property Securities	AUD	-1.1%	-4.3%	5.6%	15.9%
Asia Property Securities	USD	-0.1%	-1.8%	11.2%	8.5%
Global Property Securities	USD	-1.2%	-2.7%	0.5%	3.1%
<b>Currencies</b>					
Euro	USD	-1.6%	1.6%	-7.7%	-18.1%
UK Pound Sterling	USD	-0.9%	3.0%	1.1%	-7.3%
Japanese Yen	USD	-1.0%	0.2%	-3.4%	-17.6%
Australian Dollar	USD	-1.5%	0.2%	-6.3%	-18.6%
South African Rand	USD	-0.3%	-0.4%	-5.2%	-13.4%
Swiss Franc	USD	-1.6%	0.8%	6.6%	-4.2%
Chinese Yuan	USD	0.0%	-0.2%	0.0%	0.5%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	1.6%	0.5%	-2.0%	-28.5%
Agricultural Commodities	USD	5.5%	6.9%	-4.1%	-15.9%
Oil	USD	0.4%	-3.5%	10.3%	-44.1%
Gold	USD	-2.1%	-1.3%	-0.8%	-10.7%
Hedge funds	USD	0.2%	-0.2%	2.4%	0.1%

\* Estimate

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