Weekly Digest

Week ending **29 November 2015**

Over the past month there has been a reasonable amount of commentary on the price action in High Yield (HY) markets. This has centered on the dislocation in performance between the US HY market and that of its equities. HY bonds are issued by the lowest rated businesses in an economy. These companies are generally a relatively high credit risk and the debt is sensitive to the short term performance of the individual company, whilst also being buffeted by the prevailing economic conditions. For HY bonds a difficult trading period, whether due to company specific factors or due to broader economic malaise, could impact the ability of the issuer to repay the debt.

When comparing the US equity and HY markets' performance year-to-date the daily returns of the two were similar, but with the US HY total return index demonstrating far less volatility than the stock market. In November, however, high yield sold off whereas the equity market has gained. It is this recent performance differential which has led to the scratching of heads.

There are a number of theories behind why this is the case. The first is a re-pricing of risk in fixed income markets which has led investors to demand a higher risk premium from the asset class. There may be something to this: as US HY spreads have moved out from their 2015 lows of 422bps in June to c.600bps today. European HY spreads have widened less and now sit at 420bps.

Turning to the interest rate cycle, it is widely acknowledged that the US is on the brink of raising rates and Europe seems likely to loosen policy further. This should influence the reference bond yields used to price these assets and could impact the spread if it is anticipated that diverging interest rate policies could impact business prospects. This alone does not suggest there should be a dislocation between the US HY market and the stock market, however. Moreover, the EU HY market has a higher proportion of banking names and they may benefit from lower short term interest rates, especially if the levels they are able to loan out funds at are relatively insensitive to official rate drops.

It is more likely, therefore, that the compositional differences between the US HY market and the US stock market are to blame. The US HY market has a much larger exposure to the energy sector than the broad equity market; so while the price of oil remains low, this is likely to endure. Indeed the energy sector has underperformed the US equity market substantially and this has weighed on the high yield market too. Interestingly, the proportion of the US equity market exposed to energy names is approximately the same as the weight in the EU HY market.

This demonstrates the importance of doing research into an asset class and understanding its foibles. HY is not just a low volatility equity proxy, but actually a separate asset class which needs to be understood in its own right. In fact there are sufficient differences between EU and US HY that they must be viewed as heterogeneous exposures. US yield spread is attractive today and we believe that investors are well compensated for an increase in defaults and normal recovery rates, but if the oil price stays under pressure the question becomes 'will there be a higher than normal level of defaults and a lower than normal level of recovery?' We think that the returns available still justify the risk, but there are more risks to this view the longer oil stays weak.

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

FINANCIAL PARTNERS

Weekly Digest — Week ending **29 November 2015**

The **Marketplace**

- Euro falls as dollar strengthens
- Turkey downs Russian jet
- European PMIs surprise on the upside
- Chinese equities tumble
- Japan sees mixed inflation prints

Market **Focus**

Global

- Global developed markets were close to flat last week and emerging markets and gold fell as a result.
- Emerging European equities suffered in particular, down by 5.0%. Tensions rose in the region as Turkey shot down a Russian military plane after alleging it had breached Turkish airspace. European assets shrugged off the event and ended the week +0.6% in euro terms.
- High yield debt fell by 0.1% in the US and by 0.2% in euro terms in Europe. Global government bonds were flat.
- In Japan, inflation has risen to +0.3% year-on-year (versus expectations of +0.2%) in October, but core inflation (ex food and energy) disappointed, printing +0.7% year-on-year versus +0.8% expected and down from 0.9% in September.

United States

- The US dollar continues to strengthen ahead of the latest jobs report and the December Federal Reserve Open Market Committee meeting.
- In the US, the October Personal Consumption Expenditure (PCE) core and deflator numbers remained unchanged year-on-year, printing +0.2% and +1.3%, respectively. The expected numbers were +0.3% and +1.4%.

Europe

- The euro continues to fall against the dollar as markets await Thursday's European Central Bank (ECB) policy meeting, where further easing is expected.
- European flash Purchasing Manager Index (PMI) numbers surprised on the upside, with the headline number reading 54.4 versus expectations of 54.0. The number was underpinned by rises of 0.5 points for both the underlying manufacturing and service numbers.

China

- Chinese equity markets tumbled at the end of last week, as the regulator announced investigations into some of the country's more significant brokerages. The Shanghai composite fell by 5.5% in RMB terms, its biggest one day drop for circa three months.
- Chinese industrial profits fell by 4.6% year-on-year in October, down from -0.1% year-on-year in September.

James Klempster, CFA & Scott Gordon

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

FP FINANCIAL PARTNERS

Weekly Digest

Week ending **29 November 2015**

Asset Class/Region	Currency	Currency returns			
		Week ending 27 Nov. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	0.1%	0.7%	2.9%	2.3%
United Kingdom	GBP	0.6%	0.5%	-0.1%	-2.4%
Continental Europe	EUR	0.6%	2.3%	15.5%	13.0%
Japan	JPY	-0.5%	2.3%	15.3%	16.7%
Asia Pacific (ex Japan)	USD	-1.4%	-1.8%	-9.0%	-11.4%
Australia	AUD	-1.0%	0.0%	0.5%	0.9%
Global	USD	-0.1%	-0.2%	1.3%	-0.7%
Emerging Market Equities					
Emerging Europe	USD	-5.0%	-2.8%	-7.7%	-23.0%
Emerging Asia	USD	-1.1%	-2.2%	-8.1%	-10.0%
Emerging Latin America	USD	-3.9%	-0.5%	-25.2%	-33.7%
BRICs	USD	-3.1%	-2.1%	-10.8%	-16.1%
MENA countries	USD	0.4%	-2.4%	-12.4%	-19.1%
South Africa	USD	-4.5%	-6.0%	-16.0%	-21.0%
India	USD	-0.1%	-3.6%	-8.3%	-12.6%
Global emerging markets	USD	-2.0%	-2.5%	-11.7%	-16.4%
Bonds					
US Treasuries	USD	0.2%	-0.4%	1.0%	1.5%
US Treasuries (inflation protected)	USD	0.3%	0.0%	-0.8%	-1.8%
US Corporate (investment grade)	USD	0.2%	-0.3%	0.0%	0.3%
US High Yield	USD	-0.1%	-2.4%	-2.1%	-3.7%
UK Gilts	GBP	0.7%	1.3%	2.4%	3.8%
UK Corporate (investment grade)	GBP	0.5%	1.5%	1.6%	2.8%
Euro Government Bonds	EUR	0.3%	0.6%	2.9%	4.1%
Euro Corporate (investment grade)	EUR	0.2%	0.8%	0.3%	0.9%
Euro High Yield	EUR	-0.2%	0.6%	2.9%	2.8%
Japanese Government	JPY	0.1%	0.0%	0.5%	1.8%
Australian Government	AUD	0.4%	-1.2%	2.1%	4.5%
Global Government Bonds	USD	0.0%	-1.6%	-3.2%	-3.7%
Global Bonds	USD	-0.1%	-1.6%	-3.6%	-4.4%
Global Convertible Bonds	USD	-0.6%	-0.9%	0.4%	-1.4%
Emerging Market Bonds	USD	-0.3%	0.0%	3.6%	1.0%

* Estimate

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 27 Nov. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	1.0%	0.1%	0.5%	2.5%
Australian Property Securities	AUD	-1.0%	-2.2%	7.1%	10.1%
Asia Property Securities	USD	-1.8%	-2.7%	1.3%	-0.4%
Global Property Securities	USD	-0.4%	-1.5%	-0.4%	-0.6%
Currencies					
Euro	USD	-0.5%	-3.8%	-12.4%	-15.0%
UK Pound Sterling	USD	-1.0%	-2.6%	-3.5%	-4.5%
Japanese Yen	USD	0.0%	-1.7%	-2.5%	-3.0%
Australian Dollar	USD	-0.4%	0.8%	-12.0%	-15.8%
South African Rand	USD	-3.1%	-4.1%	-19.7%	-23.7%
Swiss Franc	USD	-1.1%	-4.1%	-3.4%	-6.4%
Chinese Yuan	USD	-0.1%	-1.3%	-3.0%	-4.0%
Commodities & Alternatives					
Commodities	USD	-0.3%	-7.5%	-22.4%	-32.2%
Agricultural Commodities	USD	-0.3%	-3.4%	-14.2%	-15.1%
Oil	USD	0.4%	-9.5%	-21.8%	-38.2%
Gold	USD	-1.9%	-7.4%	-10.8%	-11.2%
Hedge funds	USD	0.0%	-0.7%	-2.3%	-3.1%

* Estimate

Source: Bloomberg

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

Financial Partners Ltd.
泛柏資產管理有限公司
24/F, Kinwick Centre
32 Hollywood Road
Central, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
client.services@f-p.hk
www.f-p.hk

Important notes