FINANCIAL PARTNERS

# Rhyme without reason?

Weekly Digest

10 September 2018

– *Alex Harvey, CFA*

Twenty years ago almost to the day I stepped into JP Morgan's St James's office to start the job that spawned my investment career. In a poetic turn September 1998 also happens to be the month that Momentum incepted its London business where I find myself today. When I started back then Asia was still reeling from a regional crisis and in August 1998 Russia defaulted on its debt, having devalued the ruble and hiked rates to 150%. An exciting time to be starting an investment career. There will be a glut of anniversary commentary over the coming week reminding us of the collapse of Lehman Brothers, but as the old adage goes, history doesn't repeat itself but rhymes. The psychology underlying the investment rhythm usually bears the hallmarks of excess, leverage and a catalyst to trigger crises.

Today, five years on from the 'Taper Tantrum', emerging market (EM) currencies are again under pressure with JP Morgan's EM currency index down 16% from the February 2018 'high' but still some 40% below pre-tantrum levels. History may appear to be rhyming but the catalyst has morphed from fears of a liquidity withdrawal to one of Fed tightening and a stronger Dollar; arguably fallout of the same policy, just with an extended timeline. More specifically the spotlight has recently fallen on Argentina and Turkey which have both seen their currencies plunge in recent months, and Indonesia whose currency is at its weakest level for 20 years. All three of these countries are running negative and deteriorating current account balances but, Argentina aside, have shrunk their deficits since 2013's tantrum as have the other three countries that made up the 'Fragile Five'[1]. Dollar strength has certainly acted as a catalyst in part but the current trade war rhetoric, idiosyncratic crises of confidence and waning credibility of select EM central banks have conspired to make this something of a rout. And let us not forget Venezuela whose currency was devalued by 95% in August.

I recently read 'When Genius Failed', Roger Lowenstein's account of the history of Long-Term Capital Management (LTCM), a hedge fund which collapsed spectacularly in September 1998. When reflecting on what at the time were seismic market events, the common threads of credit and leverage jump out at you. At its height, LTCM leveraged its capital 30:1 and was itself invested in derivatives with implicit leverage that amplified this leverage factor by several multiples. As Lowenstein notes, "*One can be big (and therefore illiquid); one can (within prudent limits) be leveraged. But the investor who is highly leveraged and illiquid is playing Russian roulette, for he must be right about the market not merely at the end, but every single day*". It was the leverage that killed LTCM, but a crisis which triggered it.

The Asian crisis of the late 90s was, in a nutshell, borne out of exchange rate policies that encouraged excessive foreign borrowing. Whilst a handful of pegs and managed currencies remain, most emerging market currencies today float freely. And while debt levels globally remain high, leverage is not thought to be excessive. The recent weakness is not without pain but the exchange rate mechanisms are in place to allow these economies to adjust and ultimately rebound. It may be too early to tell, but let's hope this episode turns out to be a 'tapered' tantrum.

[1] The 'Fragile Five' included India, Brazil, Turkey, South Africa and Indonesia

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## The **Marketplace**

- U.S. equity indices set new records
- Emerging market currencies tumble
- Brent Crude increased 2.1% to $77.42
- Gold fell by 0.5% to $1200 per ounce

## Market **Focus**

### US

- The US employment report announced a pickup in average hourly earnings. They increased 0.4% month-on-month, beating expectations of 0.2% and taking the year-over- year value to 2.9%, the highest since 2009. Additionally, the US added 201,000 jobs in August, beating expectations of 190,000
- The positive jobs data contributed to a jump in longer term interest rates, with the yield on the benchmark 10-year Treasury note briefly touching 2.95%
- US Purchasing Managers Index's (PMI) confirm robust growth continues; the ISM manufacturing print of 61.3 for August beat expectations for 57.6, and represented a jump of 3.2pts from July. This is the highest reading since 2004 and the biggest one month jump since 2010
- The NYSE FANG Index fell 5.94% in the week following the Congressional hearing on misinformation and election interference which included the appearances of Facebook, Twitter and Alphabet
- The S&P 500 fell 1.03% ending the week at 2871.7
- The NASDAQ fell 2.55% following the declines in the technology sector

### UK

- Optimism that the UK and European Union (EU) would reach an amicable separation agreement rose after the EU chief negotiator said that he was willing to discuss alternative backstops to the Brexit withdrawal agreement
- The FTSE 100 Index fell 2.08% to end the week at 7277

### Europe

- The Swedish general election has resulted in the governing centre-left coalition marginally ahead of centre-right Alliance rivals, both on roughly 40%; however have fallen short of a majority. The Swedish Democrats won 18% of the vote versus 12.9% in prior election
- The Stoxx 600 Index fell 2.22%, with most countries indexes lower except Italy. The FTSE MIB outperformed this week, advancing 0.89%, in light of the populist government providing reassurance they would respect the European Union fiscal restrictions

### Emerging Markets / Asia

- Emerging markets remain under pressure; the MSCI Emerging Market Index fell 3.12% in the week and the Emerging Market currency index down 1.18%
- South Africa posted a second negative quarterly GDP print of -0.7% pushing the country into its first recession since 2009, the South African rand weakened 3.7% against the US dollar
- In Turkey, the August CPI print reached a new 15-year high at 17.9%, it was above market expectations of 17.6% but more significantly jumped two percentage points from July
- The Japanese equity market declined 2.9% this week, weighed down by the effects of a severe typhoon and an earthquake on the northern island of Hokkaido

***Past performance is not indicative of future returns.***

*Source: Bloomberg. Returns in local currency unless otherwise stated.*

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| Asset Class/Region | Currency | Currency returns | | | |
|---|---|---|---|---|---|
| | | Week ending 07 Sept. 2018 | Month to date | YTD 2018 | 12 months |
| **Developed Market Equities** | | | | | |
| United States | USD | -1.0% | -1.0% | 8.4% | 18.1% |
| United Kingdom | GBP | -1.9% | -3.0% | -2.4% | 1.9% |
| Continental Europe | EUR | -2.2% | -3.0% | -1.3% | 1.5% |
| Japan | JPY | -2.9% | -3.2% | -6.2% | 7.6% |
| Asia Pacific (ex Japan) | USD | -3.4% | -3.9% | -7.4% | -0.5% |
| Australia | AUD | -2.5% | -3.0% | 4.6% | 12.6% |
| Global | USD | -1.7% | -2.0% | 3.1% | 10.9% |
| **Emerging markets equities** | | | | | |
| Emerging Europe | USD | -3.4% | -2.5% | -15.2% | -12.6% |
| Emerging Asia | USD | -3.2% | -3.7% | -8.2% | -0.5% |
| Emerging Latin America | USD | -0.4% | 0.6% | -11.4% | -14.5% |
| BRICs | USD | -3.1% | -3.4% | -10.4% | -4.3% |
| MENA countries | USD | -2.2% | -2.2% | 5.9% | 3.9% |
| South Africa | USD | -6.3% | -6.0% | -25.1% | -14.5% |
| India | USD | -2.3% | -2.1% | -1.2% | 5.1% |
| Global emerging markets | USD | -3.1% | -3.2% | -10.0% | -4.0% |
| **Bonds** | | | | | |
| US Treasuries | USD | -0.5% | -0.4% | -1.3% | -2.4% |
| US Treasuries (inflation protected) | USD | -0.6% | -0.6% | -0.4% | -0.3% |
| US Corporate (investment grade) | USD | -0.5% | -0.5% | -2.5% | -1.8% |
| US High Yield | USD | -0.1% | -0.2% | 1.9% | 3.0% |
| UK Gilts | GBP | -0.4% | -0.2% | -0.2% | -1.7% |
| UK Corporate (investment grade) | GBP | -0.3% | -0.2% | -1.5% | -1.8% |
| Euro Government Bonds | EUR | 0.3% | 0.3% | -0.1% | -0.4% |
| Euro Corporate (investment grade) | EUR | -0.3% | -0.3% | -0.7% | -0.4% |
| Euro High Yield | EUR | -0.1% | -0.3% | -0.6% | 0.6% |
| Japanese Government | JPY | 0.1% | 0.1% | -0.1% | -0.1% |
| Australian Government | AUD | -0.1% | 0.2% | 2.9% | 3.7% |
| Global Government Bonds | USD | -0.3% | -0.3% | -1.9% | -3.1% |
| Global Bonds | USD | -0.4% | -0.4% | -2.0% | -2.7% |
| Global Convertible Bonds | USD | -1.2% | -1.2% | -0.7% | -0.6% |
| Emerging Market Bonds | USD | -0.2% | -0.2% | -7.2% | -8.2% |

*Source: Bloomberg. Past performance is not indicative of future returns*

| Asset Class/Region | Currency | Currency returns | | | |
|---|---|---|---|---|---|
| | | Week ending 07 Sept. 2018 | Month to date | YTD 2018 | 12 months |
| **Property** | | | | | |
| US Property Securities | USD | -1.3% | -0.9% | 2.9% | 2.7% |
| Australian Property Securities | AUD | 0.1% | -0.5% | 3.5% | 9.2% |
| Asia Property Securities | USD | -3.7% | -3.7% | -8.1% | -4.0% |
| Global Property Securities | USD | -2.1% | -2.0% | -1.7% | 1.4% |
| **Currencies** | | | | | |
| Euro | USD | -0.3% | -0.8% | -3.8% | -3.6% |
| UK Pound Sterling | USD | -0.2% | -0.6% | -4.4% | -1.1% |
| Japanese Yen | USD | 0.1% | 0.2% | 1.4% | -2.2% |
| Australian Dollar | USD | -1.1% | -2.1% | -9.0% | -11.4% |
| South African Rand | USD | -3.5% | -3.1% | -18.6% | -15.7% |
| Swiss Franc | USD | 0.1% | 0.2% | 0.4% | -1.7% |
| Chinese Yuan | USD | -0.1% | -0.2% | -5.1% | -5.4% |
| **Commodities & Alternatives** | | | | | |
| Commodities | USD | -1.7% | -1.5% | 1.0% | 7.5% |
| Agricultural Commodities | USD | -1.1% | -0.1% | -3.7% | -5.1% |
| Oil | USD | -0.8% | -1.2% | 14.9% | 41.0% |
| Gold | USD | -0.3% | -0.3% | -8.4% | -10.9% |
| Hedge funds | USD | -1.0% | -1.0% | -1.5% | 0.4% |

*Source: Bloomberg. Past performance is not indicative of future returns*

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

**Financial Partners Ltd.**
泛柏資產管理有限公司
Unit 01 - 03
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