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Weekly Digest

Week ending **13 March 2016**

Opportunities in fixed income

While equity markets were at the epicentre of the broad market sell off last year, all 'risk' assets were influenced to a degree by the nervousness. As a result some interesting valuation opportunities have emerged. Naturally one's interest is drawn to those markets which have suffered the most, such as certain equity regions or sectors, but away from the spotlight some interesting opportunities in fixed income have emerged.

For us the best opportunities in fixed income remain in US credit, especially in the mid-quality part of the credit spectrum. Despite US high yield rallying well over the past couple of weeks, spreads are still well above what we consider to be fair value. Although there are valid concerns over the energy sector, which accounts for roughly 10% of issuance in this market, last year's sell off of these securities represented concerns of so much more to us: at its nadir it looked as though the market was starting to price in either a systemic issue in high yield or concerns over the credit cycle being long in the tooth. While we have come a long way post Global Financial Crisis we do not see the excesses that one would associate with either risk. With the level of defaults that we expect from this asset class, today's spread of nearly 6.5% represents an attractive level of reward for investors, thus we believe there is merit in a high yield allocation.

There are other opportunities in credit markets. Emerging market debt, especially that issued by governments or corporations in hard currency (USD), is where we focus today. The spread of over 4% for emerging market sovereign issuers is, we believe, compelling compensation for the amount of risk inherent in the asset class. In recent years the higher quality end of the credit spectrum, so called 'investment grade' credit, has been relatively expensive. The yield spreads available in this sector were relatively slight on top of the lowly benchmark government bond yields in the US, UK, Japan and Europe. While the reference sovereign bonds remain expensive, the spread in UK investment grade debt pushed out last year (from a low off 1.2% to 1.9%) and as a result we have added to these positions too.

Finally, convertible debt, a security that has both equity and bond like characteristics, sold off last year such that they were trading at prices in the market cheaper than their component parts (in essence a corporate bond and an equity option). This allowed investors to effectively buy the equity market optionality for nothing. With that opportunity having unwound somewhat today, the valuation case for convertibles is less strong that it was. However we like this asset class as it's sensitivity to the movement in the equity market varies as markets run up or down, which helps risk management in our portfolios.

On the subject of risk, even though these credit securities are attractively priced for long term investors in the short term, it is worth reminding ourselves that during periods of market stress they will not preserve capital as well as so called 'safe haven' government bonds. We believe these bonds to be fundamentally expensive, but they still have some (modest) room to rally should interest rates fall.

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

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The **Marketplace**

- ECB lowers base interest rates
- ECB extends its quantitative easing programme
- Price of oil rises above USD 40 per barrel
- Iron ore posts record daily gain
- China's trade surplus falls almost 50%

Market **Focus**

Europe

- The European Central Bank's March meeting dominated markets last week with the news that the refinancing interest rate has been lowered from 0.05% to zero, while the deposit rate moved 0.1 percentage points further into negative territory to -0.4%.
- The bank will also increase its asset purchase (quantitative easing) programme from €60 billion to €80 billion per month, starting in April. These purchases will now include investment grade bonds issued by non-financial corporates, alongside the usual government debt purchases.

China

- China's exports declined by 25.4% year-on-year in February, which was much greater than the expected fall of 14.5% in US dollar terms. Imports also experienced a large fall, declining 13.8% year-on-year against an expected -12.0%.
- These two falls culminated in February's trade surplus declining to USD 32.6 billion from January 2015's 63.3 billion, a drop of 48.5%.

Commodities

- Brent crude closed above $40 per barrel at the start of the week, the first time it has done so since 9 December. Despite declines on Tuesday (8 March), news on Wednesday (9 March) that US gasoline inventories declined more than expected resulted in crude finishing the week up 4.3%, at $40.39 per barrel.
- Iron ore started the week with the largest daily gain, 18.6%, since data began in 2009. With the commodity closing out the week at $57.09 per tonne, a level previously seen in September of last year, it has increased 31.0% year-to-date.

James Klempster & Jonathan Adamson

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

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Asset Class/Region	Currency	Currency returns			
		Week ending 11 Mar. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.2%	4.7%	-0.7%	0.6%
United Kingdom	GBP	-1.0%	0.9%	-0.6%	-5.6%
Continental Europe	EUR	0.7%	3.2%	-6.0%	-11.0%
Japan	JPY	-1.2%	4.7%	-12.1%	-9.2%
Asia Pacific (ex Japan)	USD	1.4%	8.1%	-1.3%	-11.5%
Australia	AUD	1.7%	6.4%	-1.2%	-6.5%
Global	USD	1.2%	5.2%	-1.8%	-3.1%
Emerging Market Equities					
Emerging Europe	USD	3.5%	9.7%	8.0%	-5.7%
Emerging Asia	USD	1.0%	6.9%	-2.2%	-13.2%
Emerging Latin America	USD	2.0%	15.4%	14.2%	-11.1%
BRICs	USD	1.2%	10.4%	-2.6%	-15.1%
MENA countries	USD	2.2%	3.9%	-2.7%	-21.7%
South Africa	USD	0.1%	8.8%	5.1%	-20.2%
India	USD	0.3%	9.5%	-6.4%	-18.2%
Global emerging markets	USD	1.3%	8.2%	1.1%	-13.0%
Bonds					
US Treasuries	USD	-0.4%	-1.1%	2.1%	2.3%
US Treasuries (inflation protected)	USD	-0.5%	-0.7%	2.1%	0.2%
US Corporate (investment grade)	USD	0.5%	0.4%	1.6%	-0.4%
US High Yield	USD	1.2%	3.8%	2.7%	-4.0%
UK Gilts	GBP	-0.4%	-1.4%	4.0%	5.3%
UK Corporate (investment grade)	GBP	0.5%	0.4%	1.3%	0.5%
Euro Government Bonds	EUR	0.3%	-0.5%	2.4%	-0.4%
Euro Corporate (investment grade)	EUR	0.7%	0.7%	1.8%	-0.5%
Euro High Yield	EUR	2.2%	3.5%	1.7%	-0.5%
Japanese Government	JPY	-0.5%	0.0%	3.5%	6.0%
Australian Government	AUD	-0.7%	-1.6%	1.2%	1.9%
Global Government Bonds	USD	0.3%	0.2%	4.6%	5.3%
Global Bonds	USD	0.5%	0.6%	3.7%	4.0%
Global Convertible Bonds	USD	1.0%	2.9%	-1.8%	-1.0%
Emerging Market Bonds	USD	0.6%	1.7%	4.4%	6.5%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 11 Mar. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	1.7%	5.7%	1.6%	3.1%
Australian Property Securities	AUD	2.4%	1.5%	4.6%	3.6%
Asia Property Securities	USD	-0.4%	5.3%	-1.9%	-1.2%
Global Property Securities	USD	1.5%	5.7%	1.3%	1.1%
Currencies					
Euro	USD	1.3%	2.6%	2.7%	5.7%
UK Pound Sterling	USD	1.1%	3.4%	-2.4%	-3.6%
Japanese Yen	USD	-0.1%	-1.0%	5.6%	6.7%
Australian Dollar	USD	1.7%	5.9%	3.8%	-0.4%
South African Rand	USD	0.8%	4.3%	1.7%	-19.3%
Swiss Franc	USD	1.0%	1.6%	2.0%	2.7%
Chinese Yuan	USD	0.1%	0.9%	0.0%	-3.6%
Commodities & Alternatives					
Commodities	USD	2.7%	6.4%	0.4%	-21.1%
Agricultural Commodities	USD	2.0%	3.5%	-1.2%	-8.6%
Oil	USD	4.3%	12.3%	8.3%	-29.8%
Gold	USD	-0.7%	1.0%	17.8%	8.3%
Hedge funds	USD	-0.2%	0.4%	-2.8%	-7.6%

* Estimate

Source: Bloomberg

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Important notes