FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **13 September 2015**

This week's news will be dominated by the Federal Reserve's (Fed's) decision on whether or not to increase interest rates. According to Deutsche Bank the market is pricing a 28% chance of a rate rise this week, whereas a Bloomberg survey of economists shows that 50% expect a 25bps hike to take place. The recent market volatility has undoubtedly made the Fed's decision more challenging because while the past couple of months have been volatile from an asset class perspective, the US economy seems to be on a reasonable footing. Interest rates are unusually low, especially given how far from the recessionary trough the US now finds itself, but the life support provided by central banks to the global economy in the prolonged aftermath of the global financial crisis is gradually being withdrawn. It seems inevitable that the Fed will put up rates in the coming months and so, for us, the more pertinent questions relate to the rate and rapidity of hikes rather than when the first one takes place.

The Fed needs to balance the desire to not upset the status quo with the need to start to normalise interest rates at some point. While the markets will likely fixate on the yes / no decision this week (and the minutiae of the accompanying statement) our view is that this is only part of the story. It is what happens after the first move that could be of far greater import. For example, the Fed could 'do a Trichet'; having raised rates start second guessing itself and cut interest rates again. This would destroy confidence in their hard earned reputation as a 'steady hand' and as a result it is highly unlikely that interest rates will be put up until the Fed is near certain that the first move is part of a series.

Once the hiking starts, the potential source of risk them stems from how high and how hard the Fed tightens. The Fed won't want to leave too long between a first and second hike as the market may become anxious that the Fed is regretting the first hike. Nevertheless, the Fed must remain data driven and making a second hike too soon for the purpose of window dressing is also dangerous as it could lead to too great a level of monetary tightening.

We remain of the opinion that official interest rates will peak at a level lower than normal. This is because the Fed is aware of the amount of outstanding debt and the dangers posed to borrowers of higher interest rates. This, coupled with still muted economic activity, should allow for (or even require) only modest rate rises in this cycle. There are two risks to this approach: the first is that inflation takes off, but the response to this is relatively simple – more hikes. There is a chance that inflation runs away making it more difficult to reign in with modest rate hikes, however. The second risk is a little more difficult to manage: if the next recession begins while interest rates are still low, then the ability to cut rates will be modest and the Fed would likely find themselves dipping into their bag of extraordinary policy responses quickly.

Finally, it is also worth bearing in mind that monetary policy works best when there is an element of surprise. It is difficult to see how the Fed can truly surprise the market any time soon, given the level of scrutiny that they operate under today. Perhaps if we collectively paid the Federal Open Market Committee (FOMC) a little less attention, they would feel freer to focus on their domestic mandate and the likely impact of any of their decisions would also increase. While inflation is muted, 'lower for longer' will surely remain the mantra even once interest rate rises have begun. Higher, quicker, would undoubtedly be a surprise.

The **Marketplace**

- Equity market volatility falls back
- China promises further fiscal stimulus
- Japan sees biggest one-day gain since 2008
- US data prints disappoint
- Brazil debt downgraded to junk status

Market **Focus**

Global

- Global equities rose last week as volatility in markets continued to fall. The VIX index of implied volatility, also known as the 'Wall Street Fear Gauge', declined by 16.6% last week.
- The ratings agency Standard and Poor's downgraded Brazil's sovereign debt to 'junk' status last week, as its economy comes under increasing pressure from the fall in commodity prices and allegations of corruption surrounding the current administration and the state-owned oil giant Petrobras continue to emerge.
- In Japan, the Nikkei 225 fell into negative territory year-to-date at the beginning of the week as fears over a China slowdown heightened, but the Japanese equity market rebounded spectacularly on Wednesday, posting gains of 7.7% in yen terms. This was the biggest one-day gain for the Japanese market since October 2008.
- The move comes on the back of Japanese Prime Minister Shinzo Abe's promise to cut corporate taxes by at least 3.3% next year, plus growing beliefs that the US Federal Reserve will delay its first interest rate hike.

US

- In the US, September's University of Michigan consumer sentiment survey estimate fell to 85.7 versus expectations of 91.1. The decline from August of 6.2 points represents the largest month-on-month fall since 2012.

Europe

- In Europe, inflation data printed as expected, with Germany's month-on-month Consumer Price Index flat, and printing a modest 0.2% increase year-on-year.
- Euro area GDP estimates for the second quarter of this year were revised upwards, from 0.3% to 0.4% growth, indicating no change from the Q1 quarter-on-quarter growth rate.

China

- Although concerns surrounding growth in China remain, investors took some solace from a report released by the Chinese Finance Ministry which stated that the authorities will continue to apply "stronger proactive fiscal policy" to help stimulate the economy.

James Klempster, CFA & Scott Gordon

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

Asset Class/Region	Currency	Currency returns			
		Week ending 11 Sep. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	2.1%	-1.3%	-3.8%	-0.4%
United Kingdom	GBP	1.3%	-2.1%	-4.7%	-7.5%
Continental Europe	EUR	0.5%	-2.2%	7.1%	6.5%
Japan	JPY	2.5%	-4.5%	6.2%	15.0%
Asia Pacific (ex Japan)	USD	2.9%	-1.5%	-12.6%	-18.3%
Australia	AUD	1.0%	-3.1%	-2.8%	-4.3%
Global	USD	2.0%	-1.8%	-3.5%	-4.6%
Emerging Market Equities					
Emerging Europe	USD	0.1%	-3.3%	-8.7%	-32.2%
Emerging Asia	USD	2.9%	-0.7%	-12.0%	-16.5%
Emerging Latin America	USD	-1.0%	-5.7%	-26.7%	-42.4%
BRICs	USD	2.2%	-3.3%	-13.6%	-23.8%
MENA countries	USD	2.4%	0.9%	-6.2%	-23.5%
South Africa	USD	0.0%	-6.4%	-16.4%	-19.9%
India	USD	2.4%	-2.8%	-9.5%	-10.8%
Global emerging markets	USD	1.9%	-2.0%	-14.4%	-23.1%
Bonds					
US Treasuries	USD	-0.2%	0.1%	1.1%	3.6%
US Treasuries (inflation protected)	USD	0.1%	-0.3%	-0.6%	-1.6%
US Corporate (investment grade)	USD	-0.1%	0.5%	-0.4%	1.2%
US High Yield	USD	0.5%	0.7%	0.8%	-1.3%
UK Gilts	GBP	-0.1%	1.0%	2.2%	9.4%
UK Corporate (investment grade)	GBP	0.1%	0.8%	0.8%	5.6%
Euro Government Bonds	EUR	0.0%	0.4%	0.5%	4.0%
Euro Corporate (investment grade)	EUR	0.0%	0.1%	-0.9%	0.8%
Euro High Yield	EUR	0.2%	0.1%	1.8%	2.0%
Japanese Government	JPY	0.0%	0.3%	0.0%	2.9%
Australian Government	AUD	-0.7%	0.0%	2.2%	8.1%
Global Government Bonds	USD	0.2%	0.5%	-1.7%	-3.5%
Global Bonds	USD	0.3%	0.4%	-2.2%	-3.8%
Global Convertible Bonds	USD	1.2%	0.3%	-0.3%	-3.6%
Emerging Market Bonds	USD	0.2%	0.0%	1.1%	-1.4%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 11 Sep. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	2.5%	-2.4%	-7.8%	-0.1%
Australian Property Securities	AUD	0.4%	-2.5%	2.5%	8.8%
Asia Property Securities	USD	3.5%	-1.6%	-1.6%	-5.4%
Global Property Securities	USD	2.4%	-1.9%	-5.9%	-4.6%
Currencies					
Euro	USD	1.8%	1.4%	-6.2%	-12.2%
UK Pound Sterling	USD	1.7%	0.2%	-1.0%	-5.1%
Japanese Yen	USD	-1.3%	0.9%	-0.7%	-10.8%
Australian Dollar	USD	2.6%	-1.1%	-13.2%	-22.1%
South African Rand	USD	2.4%	-1.8%	-14.6%	-19.0%
Swiss Franc	USD	0.3%	-0.7%	2.6%	-3.5%
Chinese Yuan	USD	-0.1%	0.2%	-2.6%	-3.8%
Commodities & Alternatives					
Commodities	USD	0.0%	-0.7%	-15.8%	-31.4%
Agricultural Commodities	USD	2.3%	0.4%	-13.0%	-11.5%
Oil	USD	-3.0%	-3.8%	-16.0%	-50.9%
Gold	USD	-1.4%	-2.3%	-6.5%	-10.7%
Hedge funds	USD	-0.1%	-0.3%	-1.3%	-3.9%

Source: Bloomberg

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