FINANCIAL PARTNERS

Weekly Digest

Week ending **14 February 2016**

Banks feeling unloved on Valentine's

While focus has been on the precipitous fall in energy and commodity related stocks in recent months, outside of the spotlight, bank stocks have also been under a lot of pressure. Despite the gloom, Friday brought with it a solid rally for the banks as a batch of good news proved enough to reduce the pressure on the embattled sector. This came thanks to much better than expected results from Commerzbank, combined with news that JP Morgan's Jamie Dimon purchased $26m of his own bank's stock. The most material show of faith, however, came from arguably the most embattled bank, as Deutsche Bank's co-CEO John Cryan publicly confirmed that the firm was "absolutely rock solid" as the bank embarked on a $5.4bn debt buyback plan.

Banking and finance are reliant on the confidence of the industry's participants to function properly. It was the evaporation of this faith that ultimately triggered the global financial crisis (GFC). The geared nature of fractional-reserve banking meant that the rapid withdrawal of credit quickly became self-fulfilling and that is an outcome that everyone involved in the financial system is at pains to avoid. But banks are in much better shape today: substantial measures were taken post financial crisis to reduce the systemic risk posed by liquidity of any single bank and the potential for an isolated liquidity crisis to spiral into an industry wide solvency crisis is much reduced. As a result, banks are better capitalised today and much more conservative in terms of their willingness to extend their balance sheet. Up until recently, this conservatism has been blamed on a number of different modern gripes including a failure to return to the extraordinary level of profitability pre-GFC and, as a result of their withered treasury departments, banks are also regularly held culprit for the thinner volume and pernicious volatility that characterise today's markets.

While we seem a long way from a financial crisis, the price action of Financials suggests that the market is worried. It is difficult to tell exactly where we are but this does seem overdone and as a result this recent pause is welcome. Today's main epicentres of concerns are: overcapacity in China, combined with weakening activity generally in global emerging markets which is making their outstanding debt more difficult to service; the falls in the oil price; lacklustre developed market (DM) growth rates and corresponding interest rate cuts; and the potential of the end of the credit cycle in DM. Of all these issues the most pertinent for banks, given the apparent relative financial prudence of today, seems to be the negative interest rates and the inability for banks to operate profitably in such an environment. This may also be why a lot of the selling pressure has been in European Financials. If that is correct and it proves to be contrary to the good functioning of the financial system, then perhaps the era of negative interest rates (NIRP) will be a short lived one. If banks find the going tough thanks to NIRP it is difficult to see how confidence in the financial sector would improve and would likely prove to be a drag on growth which we can ill afford.

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

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The **Marketplace**

- Global equities fall, driven by financial stocks
- Oil tumbles Monday to Thursday, rallies Friday
- Gold trading above $1,200/oz
- Dollar lowest since October 2015
- Japanese 10-year yield turns negative

Market **Focus**

Global

- All major global equity indices were down during the week, with the developed world falling 2.4% while emerging markets dropped further, losing 3.8%. The most notable loss occurred in Japanese markets, down 12.6% in yen terms.
- Financial stocks led the downturn in equities, with European banks suffering in particular. Deutsche Bank saw the most extreme falls, as investors grew increasingly concerned about the bank's outstanding contingent convertible bonds. Reassuring messages from Bank executives resulted in brief respite, but not enough to offset the substantial losses in what was a volatile week of trading. JP Morgan CEO Jamie Dimon's announcement that he had purchased 500,000 shares in JP Morgan boosted sentiment in the sector towards the end of the week, however.
- The Japanese yen continued its post-rate-cut rally, ending the week up 3.2% against the dollar. Meanwhile, the yield on 10-year Japanese government bonds turned negative on Tuesday for the first time in their history.

US

- The US Dollar fell 1.1% against a basket of global currencies, as Chair of the Federal Reserve, Janet Yellen, conceded that US inflation is likely to rise slower than they had previously anticipated. The probability, using Fed Funds Futures, of a rate hike during 2016 ended the week just under 30%, down from 53% a week earlier.
- In the US, retail sales in January grew at a better than expected rate of 0.2% month-on-month. This is the third consecutive month of growth, signaling continued improvements in consumer confidence.

Commodities

- Brent crude oil fell 11.7% from Monday to Thursday, but a significant rally on Friday left the commodity down a mere 2.1% for the week. A substantial rally on Thursday left gold trading above $1,200 per ounce for the first time since June 2015, after the price of the precious metal rose by 4.1% on the day. Gold ended the week +5.5%.

James Klempster, CFA & Scott Gordon

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Asset Class/Region	Currency	Currency returns			
		Week ending 12 Feb. 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	-0.7%	-3.8%	-8.6%	-9.4%
United Kingdom	GBP	-2.3%	-5.9%	-8.2%	-13.7%
Continental Europe	EUR	-4.4%	-8.9%	-14.8%	-14.1%
Japan	JPY	-12.6%	-16.5%	-22.7%	-15.9%
Asia Pacific (ex Japan)	USD	-3.8%	-4.4%	-11.9%	-21.6%
Australia	AUD	-4.2%	-4.7%	-9.9%	-13.0%
Global	USD	-2.4%	-4.8%	-10.5%	-13.0%
Emerging Market Equities					
Emerging Europe	USD	-4.9%	-5.9%	-8.6%	-25.6%
Emerging Asia	USD	-4.0%	-4.5%	-11.5%	-22.1%
Emerging Latin America	USD	-3.6%	-3.1%	-7.6%	-33.3%
BRICs	USD	-5.4%	-6.9%	-16.2%	-29.3%
MENA countries	USD	-3.2%	0.0%	-11.3%	-28.1%
South Africa	USD	-1.9%	-2.6%	-6.3%	-33.2%
India	USD	-7.3%	-8.1%	-14.6%	-26.2%
Global emerging markets	USD	-3.8%	-4.2%	-10.4%	-25.0%
Bonds					
US Treasuries	USD	0.6%	1.1%	3.4%	3.1%
US Treasuries (inflation protected)	USD	0.1%	0.1%	1.7%	-1.0%
US Corporate (investment grade)	USD	-0.3%	-0.2%	0.1%	-2.1%
US High Yield	USD	-2.0%	-3.1%	-4.6%	-10.4%
UK Gilts	GBP	1.4%	1.3%	5.2%	4.6%
UK Corporate (investment grade)	GBP	-0.1%	-0.7%	0.5%	-1.2%
Euro Government Bonds	EUR	-0.2%	-0.4%	1.6%	1.0%
Euro Corporate (investment grade)	EUR	-0.5%	-0.7%	-0.1%	-1.8%
Euro High Yield	EUR	-2.1%	-2.8%	-4.0%	-4.6%
Japanese Government	JPY	-0.5%	0.1%	1.5%	3.8%
Australian Government	AUD	0.7%	1.2%	2.7%	3.3%
Global Government Bonds	USD	1.3%	3.3%	4.9%	2.9%
Global Bonds	USD	0.8%	2.4%	3.5%	1.2%
Global Convertible Bonds	USD	-1.5%	-1.7%	-6.1%	-7.1%
Emerging Market Bonds	USD	-0.8%	-0.6%	0.0%	1.2%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 12 Feb. 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	-4.2%	-6.2%	-9.4%	-13.1%
Australian Property Securities	AUD	-2.0%	-0.9%	0.1%	-2.0%
Asia Property Securities	USD	-5.0%	-5.8%	-13.7%	-14.4%
Global Property Securities	USD	-4.0%	-4.6%	-9.5%	-13.4%
Currencies					
Euro	USD	0.9%	3.9%	3.7%	-1.3%
UK Pound Sterling	USD	0.0%	1.8%	-1.6%	-5.7%
Japanese Yen	USD	3.2%	7.0%	6.2%	5.2%
Australian Dollar	USD	0.6%	0.4%	-2.4%	-8.0%
South African Rand	USD	0.8%	0.0%	-2.6%	-26.2%
Swiss Franc	USD	1.4%	4.6%	2.5%	-4.8%
Chinese Yuan	USD	0.0%	0.0%	-1.2%	-5.0%
Commodities & Alternatives					
Commodities	USD	-0.5%	-3.0%	-6.7%	-29.6%
Agricultural Commodities	USD	-1.3%	-2.1%	-3.7%	-13.7%
Oil	USD	-2.1%	-4.0%	-10.5%	-41.5%
Gold	USD	5.5%	10.7%	16.6%	1.3%
Hedge funds	USD	-1.3%	-2.1%	-5.0%	-8.9%

* Estimate

Source: Bloomberg

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