Weekly Digest

Week ending **17 May 2015**

Most economic surprise indices are painting a pretty depressing picture at the moment, with economic data prints coming out below analyst expectations. This can mean one of two things. Firstly, it may suggest that analyst expectations were simply too hubristic; getting ahead of themselves and the reality is struggling to live up to the lofty expectations. Alternatively, it may imply that while analysts are relatively circumspect about the state of an economy, the reality is even worse. Either way, while negative economic surprises are relatively common they can lead to periods of soft market returns as asset prices move to reflect the latest piece of news. This in part underlines why the US dollar has weakened recently and also why the US stock market has been a bit slack of late. In a world where the US's economic performance is underwhelming there is less need for the Federal Reserve to put up interest rates and this has weighed on the greenback over the past couple of months. Furthermore, the US stock market has also become close to being fully valued and recent data disappointments have given the market cause to re-appraise that market's relative attractiveness compared to others.

If negative economic surprises tend to presage market underperformance the converse is also true for positive surprises. Europe is producing positive economic surprises at the moment and its equity market is the stand out developed equity market year to date, while bond yields have moved out markedly over the past month. For example, yields on the German 10-year bond have moved from 0.08% in April to 0.66% today. Japan's data is also, in aggregate, ahead of expectations and again its equity market is performing well. Given Japan and Europe are the most active market in terms of liquidity provision presently, this is unlikely to be a coincidence.

The good news for long term investors is that while there is no direct link between economic surprises and the performance of markets, there is a relationship. The most exciting times for us as an active manager is when markets are disappointing compared to expectations because just as analysts become too hubristic on the way up, they also tend to be too pessimistic on the way down meaning that assets may be overly penalised in the short term, providing us with enticing valuation discounts.

The Marketplace

- Developed markets added 0.8% and emerging equities rose by 0.8% too.
- US Treasuries were flat over the week, but UK gilts fell by 0.5% in sterling terms and European government bonds dropped even further (-0.7% in euro terms).
- The broad RICI commodity index rose by 1.2% with gold adding 3.0% and Brent crude rising by 2.2%.

Market Focus & Data overleaf

Market Focus

UK

- The Bank of England downgraded its growth forecasts from 2.9% in 2015 and 2016, to 2.5% and 2.7% respectively. These numbers align closer with broader expectations for growth. The Bank cited poor productivity growth as a key reason for lowering expectations.

US

- US data prints continue to disappoint, and expectations of a delay in interest rate hikes have heightened. The S&P 500 closed at a record high of 2,121on Wednesday, and the US dollar hit a four-month low.
- The University of Michigan Index of Consumer Sentiment fell to 88.6 in May (from 95.9 in April), it was the biggest drop since the end of 2012 and a seven month low.
- Second quarter growth in the US is now forecast to be a mere +0.7% by the Atlanta Federal Reserve.

Europe

- First quarter euro area GDP numbers were as expected (+0.4% quarter-on-quarter) – a level of growth not seen since the beginning of 2011.
- Germany's GDP number disappointed, printing +0.3% versus forecasts of +0.5%.
- France exceeded expectations printing +0.6% versus expectations of +0.4%.

China

- The latest reports on Chinese government spending indicated a shift towards expansionary policies. April saw year-on-year spending jump by 33.2%, compared to a 4.4% year-on-year increase for March.

Oil

- The continued rally in the price of oil got a further boost from the latest OPEC and Energy Information Administration (EIA) reports, with both organisations revising up their figure for global demand in 2015. OPEC increased its expected level of growth from 1.17 million barrels a day to 1.18 million barrels, and the EIA is now expecting growth of 1.2 million barrels a day.

James Klempster, CFA & Scott Gordon

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

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Asset Class/Region	Currency	Currency returns			
		Week ending 15 May 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	0.4%	1.9%	3.7%	15.1%
United Kingdom	GBP	-1.1%	0.1%	7.6%	4.9%
Continental Europe	EUR	-0.9%	0.2%	17.8%	19.7%
Japan	JPY	1.2%	0.9%	15.1%	38.9%
Asia Pacific (ex Japan)	USD	1.5%	-0.6%	9.9%	7.8%
Australia	AUD	2.2%	-0.4%	8.0%	8.7%
Global	USD	0.8%	1.8%	6.6%	9.5%
Emerging Market Equities					
Emerging Europe	USD	2.5%	4.3%	19.2%	-11.6%
Emerging Asia	USD	0.6%	-1.4%	10.9%	12.8%
Emerging Latin America	USD	0.8%	2.9%	2.6%	-15.6%
BRICs	USD	1.0%	-0.1%	16.5%	12.6%
MENA countries	USD	0.1%	-0.8%	8.3%	-5.2%
South Africa	USD	1.5%	-1.3%	7.3%	3.7%
India	USD	1.4%	1.4%	-0.2%	10.3%
Global emerging markets	USD	0.8%	-0.4%	9.7%	3.8%
Bonds					
US Treasuries	USD	0.0%	-0.5%	0.6%	3.4%
US Treasuries (inflation protected)	USD	-0.1%	-1.2%	0.9%	0.0%
US Corporate (investment grade)	USD	0.1%	-0.7%	0.9%	3.0%
US High Yield	USD	0.0%	0.1%	3.9%	2.2%
UK Gilts	GBP	-0.5%	-0.3%	0.3%	9.7%
UK Corporate (investment grade)	GBP	-0.3%	-0.3%	1.1%	8.2%
Euro Government Bonds	EUR	-0.7%	-2.0%	0.7%	8.0%
Euro Corporate (investment grade)	EUR	-0.3%	-0.7%	0.1%	4.2%
Euro High Yield	EUR	0.1%	-0.3%	3.1%	4.3%
Japanese Government	JPY	0.2%	-0.5%	-0.7%	2.9%
Australian Government	AUD	-0.2%	-1.1%	0.5%	8.2%
Global Government Bonds	USD	0.7%	-0.1%	-1.1%	-4.6%
Global Bonds	USD	0.7%	0.1%	-1.1%	-4.2%
Global Convertible Bonds	USD	1.0%	1.0%	5.0%	-0.1%
Emerging Market Bonds	USD	-0.3%	-0.1%	3.3%	2.3%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 15 May 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	0.7%	2.1%	0.4%	12.8%
Australian Property Securities	AUD	1.6%	1.1%	8.5%	21.1%
Asia Property Securities	USD	0.7%	-1.3%	11.9%	11.4%
Global Property Securities	USD	1.3%	1.3%	6.4%	11.3%
Currencies					
Euro	USD	2.3%	2.0%	-5.3%	-16.5%
UK Pound Sterling	USD	1.8%	2.5%	1.0%	-6.3%
Japanese Yen	USD	0.4%	0.0%	0.3%	-14.5%
Australian Dollar	USD	1.5%	1.8%	-1.5%	-14.0%
South African Rand	USD	1.0%	0.8%	-2.1%	-12.0%
Swiss Franc	USD	1.7%	1.8%	8.5%	-2.7%
Chinese Yuan	USD	0.0%	0.0%	0.0%	0.4%
Commodities & Alternatives					
Commodities	USD	1.2%	1.0%	0.8%	-25.7%
Agricultural Commodities	USD	1.0%	1.1%	-7.6%	-22.4%
Oil	USD	2.2%	0.0%	16.5%	-39.5%
Gold	USD	3.0%	3.4%	3.3%	-5.6%
Hedge funds	USD	-0.1%	-0.1%	2.2%	1.7%

* Estimate

Source: Bloomberg

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Important notes