FINANCIAL PARTNERS

Weekly Digest

Week ending **18 October 2015**

Did the taper tantrum teach us anything?

Thus far October has been a decent month for equity markets. This is likely due to three factors. Firstly, markets fell precipitously in the past two and a half months and as a result they were probably overdue a bounce of sorts. Secondly, the Federal Reserve (Fed) postponed its interest rate decision last month and thirdly, and relatedly, recent data out of the US and other developed markets has been weak and if anything deflationary, giving the markets hope that interest rate policy will remain unusually accommodative and that central bank liquidity, in all its various guises, will be around for the foreseeable future.

We occupy a strange world at the moment where bad news for the economy is interpreted as good for markets. From a purely qualitative perspective there seems to be a pretty strong relationship between these factors: market participants believe loose monetary conditions to be beneficial to equity markets. It is easy to see where they are coming from; despite the extraordinary levels of monetary stimulus put to work in the past decade, the recovery from the financial crisis has been uninspiring. But it has been reasonably solid and perhaps we all need to start becoming accustomed to that being good enough. In a 'normal' environment good economic news should, in the round, provide a positive environment for businesses and consumers to operate, but we know that each positive data print is unlikely to positively influence the markets as directly as good news is negatively impacting the markets today. A positive economic environment is helpful but it is not the same as an investment case and valuations and corporate prospects should override a macro story.

Today, however, market participants continue to conflate bad economic news with continued liquidity and as a consequence a better outlook for markets. The Fed has tried managing expectations through their regular communications, but the unexpected delay in hiking rates still caused some confusion. Perhaps it would be better if they simply grasped the nettle and made the first interest rate hike a fait accompli and therefore moving the debate forward from when interest rates will rise. Putting aside economic pros and cons of such a move for a moment, recent history remind us that markets reacted far more maturely to the advent of QE tapering than they did in anticipation to it. There is reason to believe that the same will happen with respect to interest rate policy. The first hike will be small and further hikes will be data dependent and so the anticipated riskiness of such a move is arguably overblown now. As I have noted before, the Fed will be reluctant to 'do a Trichet' (see Fed up? of 14 September 2015 for further details) and if anything the recent slew of weak data does increase the risk of that, but still, it is surely only a matter of time until the market is jolted into a more 'normal' mind-set where good economic news is good for markets and we can once more focus on rewarding companies purely on their prospects rather than whether they will be buoyed, regardless of merit, by more liquidity.

We have allowed ourselves to believe in the efficacy of central bankers while they acquiesced with what we collectively wanted; namely flooding markets with liquidity. Perhaps now we must show the same faith in them as they embark on rate rises. Whether we think it is exactly the right time or not, the fact is that when the Federal Reserve raises rates the committee will, on average, believe that the time is right and we should cut them some slack in the immediate aftermath.

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

The **Marketplace**

- Market volatility falls
- China reports 6.9% GDP growth
- People's Bank of China expands easing policy
- CPI drops in the Europe, US and UK
- US Initial Jobless Claims hits 42-year low

Market **Focus**

Global

- Global equities rose by 0.6% last week with emerging equities adding 0.7%. A subdued week in markets was characterised by volatility continuing to fall, as investors await third quarter earnings reports.
- The Vix index of implied volatility (known as the 'Wall Street Fear Gauge') fell by 11.9% last week..

United States

- US Treasuries added 0.4% last week, while US investment grade debt also added 0.4%. US high yield bonds rose by 0.1%. UK Gilts added 0.5% in sterling terms.
- The US Initial Jobless Claims number fell by 7,000 to reach a multi-decade low of 255,000.

China

- China's much anticipated third quarter GDP number printed 6.9% annualised, slightly higher than expectations of 6.8% and marginally down from the 7.0% reported for Q2.
- The latest year-on-year trade data revealed a 3.7% decline in exports in USD terms (versus consensus of -6.0%), and a sharp drop in imports, which fell by 20.4% versus forecasts of -16.0% in USD terms.
- At the start of the week, the People's Bank of China announced that it will allow more lenders to borrow at cheap rates using loans as collateral, in an attempt to boost lending to smaller and medium sized businesses across the country.

UK

- In the UK, the Consumer Price Index (CPI) fell to -0.1% in September, taking the inflation number into negative territory once again, while in the US, CPI data read -0.2% month-on-month taking the year-on-year number to 0.0%. In Europe, the year-on-year CPI number is now also negative at -0.1%.

Commodities

- Gold rose by 1.7% as oil and other commodities continued to fall. Brent crude fell by 4.2% last week.

Russell Andrews & Scott Gordon

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Asset Class/Region	Currency	Currency returns			
		Week ending 16 Oct. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	0.9%	6.0%	-0.1%	10.7%
United Kingdom	GBP	-0.7%	5.4%	-0.4%	5.9%
Continental Europe	EUR	0.1%	4.5%	8.9%	21.0%
Japan	JPY	-0.6%	6.7%	8.9%	28.4%
Asia Pacific (ex Japan)	USD	1.4%	9.4%	-5.7%	-4.4%
Australia	AUD	-0.2%	4.9%	1.1%	5.0%
Global	USD	0.6%	6.5%	0.0%	7.7%
Emerging Market Equities					
Emerging Europe	USD	-0.9%	9.7%	-1.3%	-16.7%
Emerging Asia	USD	1.8%	9.4%	-4.6%	-1.6%
Emerging Latin America	USD	-3.7%	8.2%	-23.3%	-31.9%
BRICs	USD	0.0%	9.3%	-6.7%	-8.8%
MENA countries	USD	0.1%	2.3%	-5.9%	-15.1%
South Africa	USD	0.6%	12.4%	-6.3%	-1.7%
India	USD	0.6%	4.9%	-1.9%	2.2%
Global emerging markets	USD	0.7%	9.3%	-7.6%	-8.7%
Bonds					
US Treasuries	USD	0.4%	0.3%	2.1%	2.4%
US Treasuries (inflation protected)	USD	0.1%	0.8%	-0.3%	-2.1%
US Corporate (investment grade)	USD	0.4%	0.7%	0.6%	0.6%
US High Yield	USD	0.1%	2.2%	-0.3%	-0.3%
UK Gilts	GBP	0.5%	-0.5%	2.0%	5.2%
UK Corporate (investment grade)	GBP	0.5%	0.3%	0.5%	2.9%
Euro Government Bonds	EUR	0.4%	0.5%	1.7%	4.6%
Euro Corporate (investment grade)	EUR	0.3%	0.9%	-1.0%	0.5%
Euro High Yield	EUR	0.3%	1.8%	1.4%	3.8%
Japanese Government	JPY	0.0%	0.3%	0.4%	2.7%
Australian Government	AUD	0.7%	0.2%	3.2%	6.5%
Global Government Bonds	USD	0.7%	1.2%	-0.3%	-3.2%
Global Bonds	USD	0.6%	1.3%	-1.0%	-3.3%
Global Convertible Bonds	USD	0.6%	3.3%	1.1%	3.4%
Emerging Market Bonds	USD	0.7%	3.8%	3.8%	2.4%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 16 Oct. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	1.2%	5.9%	0.5%	10.4%
Australian Property Securities	AUD	1.0%	2.1%	6.6%	15.7%
Asia Property Securities	USD	1.7%	7.8%	5.9%	9.7%
Global Property Securities	USD	1.0%	5.9%	1.1%	7.9%
Currencies					
Euro	USD	-0.1%	1.5%	-6.2%	-11.4%
UK Pound Sterling	USD	0.7%	2.0%	-0.9%	-4.1%
Japanese Yen	USD	0.6%	0.3%	0.2%	-11.0%
Australian Dollar	USD	-1.0%	3.5%	-11.1%	-17.0%
South African Rand	USD	2.0%	5.9%	-11.5%	-15.0%
Swiss Franc	USD	0.9%	2.1%	4.3%	-1.1%
Chinese Yuan	USD	-0.1%	0.1%	-2.3%	-3.6%
Commodities & Alternatives					
Commodities	USD	-1.7%	3.0%	-14.3%	-26.3%
Agricultural Commodities	USD	0.2%	1.9%	-11.3%	-10.1%
Oil	USD	-4.2%	4.3%	-12.0%	-40.3%
Gold	USD	1.7%	5.6%	-0.6%	-5.0%
Hedge funds	USD	-0.1%	0.9%	-2.2%	-0.7%

* Estimate

Source: Bloomberg

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