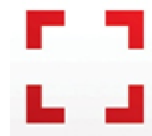
momentum

Viewpoint

Monthly market update

January 2016



global investment management

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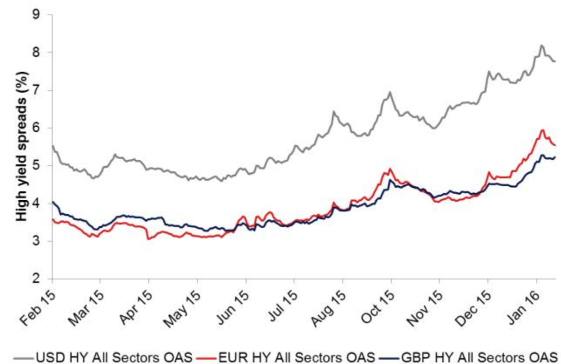
1. Market commentary

In the worst start to a year since the financial crisis, and one of the worst on record, equity markets plunged in January. Despite a sizeable rally in the final days of the month, global equities fell by 6.0% and emerging equity markets were down by 6.5%. Falls were led by China, down over 20%, and a number of European markets.

Figure 1: Global equities over 6 months.

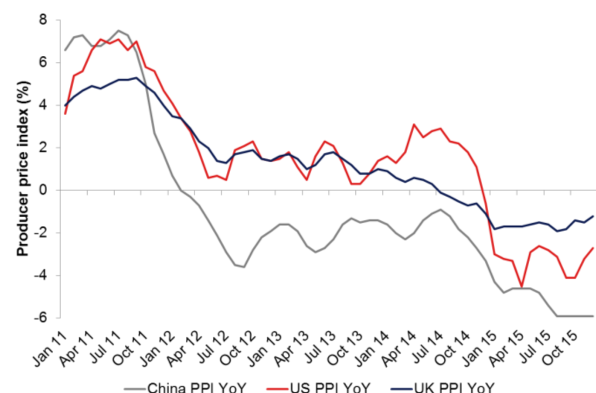
The second half of 2015 saw various factors driving uncertainty across markets, including weakness in China, the collapse in the oil price, the sharp emerging market downturn and the negative impact of the strong dollar. While these continued to reverberate in January, the market's attention shifted to the potential impact of these negative influences on global growth and inflation. There is clear and growing evidence of a slowdown across the developed world, especially in manufacturing and in the US, alongside deflationary forces and increasingly tough competitive conditions. This spilled over into the credit markets, where spreads have widened materially over the month, and into concerns about rising defaults: not just in the beleaguered oil sector but more widely across the corporate sector. In turn this affected financial stocks globally; banks are under pressure, especially in Europe, from profitability concerns in a zero interest rate world with deteriorating credit conditions. Despite the headline focus on oil and commodities, the weakest equity sector so far this year has been Financials, down over 16% at time of writing.

Figure 2: High yield spreads over past 12 months.



In China, news continued to point to a slowing economy. Growth in Q4 2015 came in at 6.8%, while the annual growth in 2015 of 6.9% was the lowest for 25 years. Moreover, deflationary forces prevailed, with the Producer Price Index -5.9%, falling for the 48th consecutive month. The economic competence of the Chinese authorities continues to be called into question, with the markets fearing a competitive devaluation of the renminbi should the unsustainable level of support the Chinese administration is throwing at the currency be withdrawn. In the developed world, the spill-over of slower growth from China and negative growth in emerging markets has been exacerbated by the collapse in spending by oil and commodity companies. Although data outside the industrials sector has been more mixed, the trend appears to be for a weakening of growth; US GDP growth slipped to 0.7% in Q4 2015.

Figure 3: Producer Price Indices over 5 years.



Central banks have become increasingly dovish against this macro-economic backdrop. The Bank of

Japan surprised investors with a cut in its deposit rate to take it to -0.10%: the first time in the Bank's 150 year history that it has taken the rate into negative territory. The Bank of England, while not formally easing policy, indicated that its earlier plans to replicate the US rate increase at the turn of the year has been pushed into 2017. This leaves the US Federal Reserve in a dilemma. Having raised rates in December, it has seen increasing evidence of a slowdown and tighter financial conditions across the developed world, and therefore despite originally flagging four rate rises in 2016, it now seems likely that we won't see the next rate rise until 2017. Ten year bond yields have fallen by 0.55 percentage points in the US and UK, and some $7 trillion of the world's government debt is now offering negative yields, a wholly unprecedented situation.

As things stand, we believe that fears over global growth and concerns over the strength of the financial system are starting to look overdone. The global economy has softened but is still growing, central banks have become more accommodating and the fall in energy and other commodity prices, which to date has had a material negative impact on the global economy, will begin to show through in higher consumer incomes and spending as the year progresses. While the risks to the financial system are not to be dismissed, banks across the world are in a much stronger capital position than they were before the global financial crisis, and in the first weeks of 2016 bond and equity markets appear to have re-priced for these risks very quickly. Predicting when sentiment will turn is impossible, and given the prevailing nervousness of investors, risks of further falls in markets cannot be ruled out. Positive factors such as the boost to consumer spending to come from lower oil prices and the continuation of low interest rates are welcome and complement the now attractive valuations. We remain in a challenging environment where returns are likely to be subdued and markets volatile, but against a background of low yet steady growth in the developed world, the weakness over the past nine months has taken many markets back to levels last seen in 2013: this represents a good opportunity to add to equity positions.

Source: Bloomberg. Returns in US dollars unless otherwise stated. January 2016.

2. Market performance

Asset class/region	Index	To 29 January 2016	
		Currency	Year-to-date
Developed markets equities			
United States	S&P 500 NR	USD	-5.0%
United Kingdom	MSCI UK NR	GBP	-2.4%
Continental Europe	MSCI Europe ex UK NR	EUR	-6.5%
Japan	Topix TR	JPY	-7.4% [e]
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-7.8%
Global	MSCI World NR	USD	-6.0%
Emerging markets equities			
Emerging Europe	MSCI EM Europe NR	USD	-2.9%
Emerging Asia	MSCI EM Asia NR	USD	-7.3%
Emerging Latin America	MSCI EM Latin America NR	USD	-4.6%
BRICs	MSCI BRIC NR	USD	-10.0%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-6.5%
Bonds			
US Treasuries	JP Morgan United States Government Bond Index TR	USD	2.2%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.5%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.4%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-1.6%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	3.9%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.2%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.6%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-1.2%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	1.5%
Australian Government	JP Morgan Australia GBI TR	AUD	1.4%
Global Government Bonds	JP Morgan Global GBI	USD	1.5%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-4.5%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	0.6%

Source: Bloomberg. e denotes estimate

		To 29 January 2016	
Asset class/region	Index	Currency	Year-to-date
Property			
US Property Securities	MSCI US REIT NR	USD	-3.4%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	1.0%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-8.4%
Global Property Securities	S&P Global Property USD TR	USD	-5.1%
Currencies			
Euro		USD	-0.2%
UK Pound Sterling		USD	-3.3%
Japanese Yen		USD	-0.7%
Australian Dollar		USD	-2.8%
South African Rand		USD	-2.6%
Commodities & Alternatives			
Commodities	RICI TR	USD	-3.9%
Agricultural Commodities	RICI Agriculture TR	USD	-1.6%
Oil	Brent Crude Oil	USD	-6.8%
Gold	Gold Spot	USD	5.3%
Hedge funds	HFRX Global Hedge Fund	USD	-3.2% e
Interest rates			
United States		0.50%	
United Kingdom		0.50%	
Eurozone		0.05%	
Japan		0.10%	
Australia		2.00%	
South Africa		6.75%	

Source: Bloomberg. e denotes estimate

3. Asset allocation dashboard

Positive	Neutral	Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Positive
European equities (relative to developed)	Positive
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Positive
Emerging market equities	Neutral
Fixed Income	
Government	Neutral
Index-linked (relative to government)	Positive
Investment grade (relative to government)	Positive
High yield	Positive
Loans	Positive
Emerging market debt	Positive
Convertible bonds	Positive
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Positive
Yen	Neutral

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