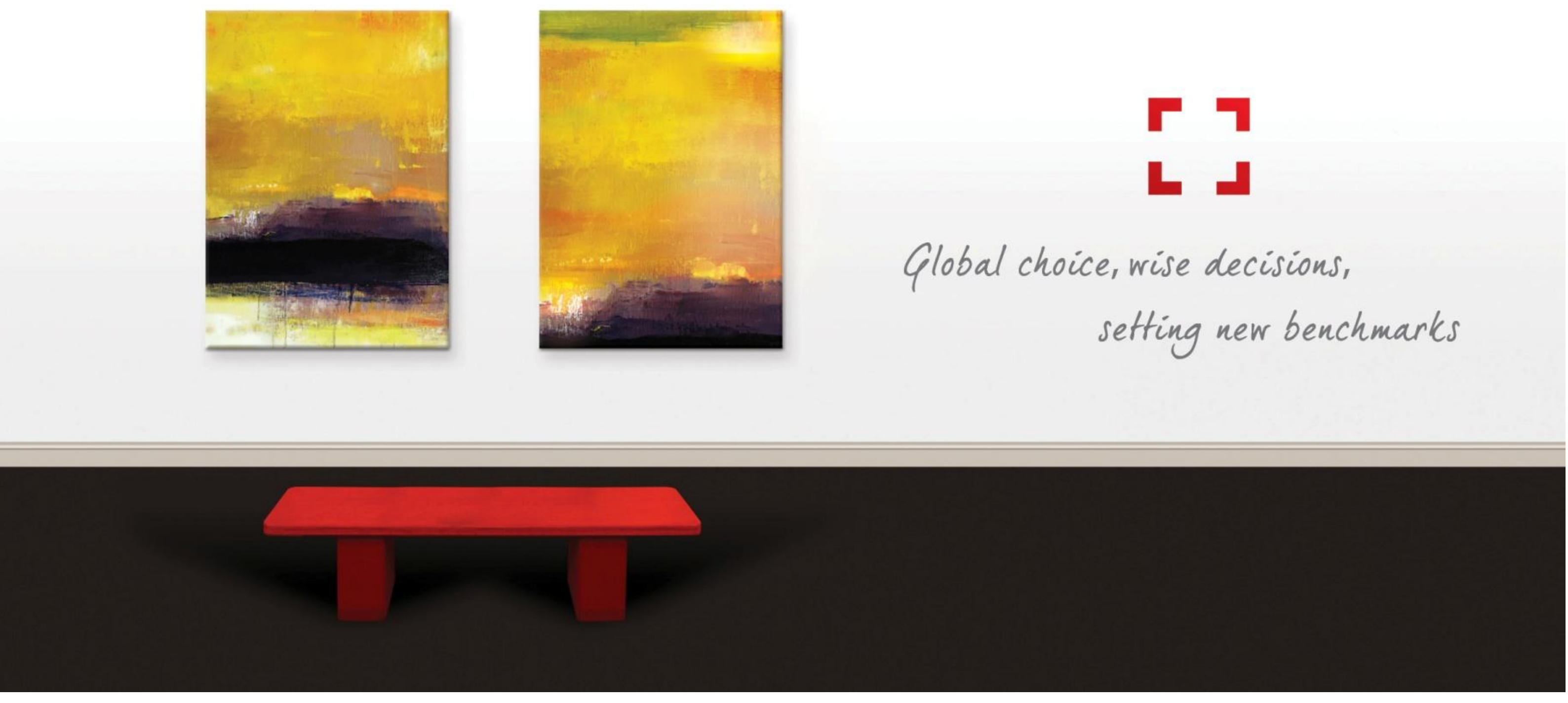
momentum

Viewpoint

Monthly market update

January 2014



global investment management

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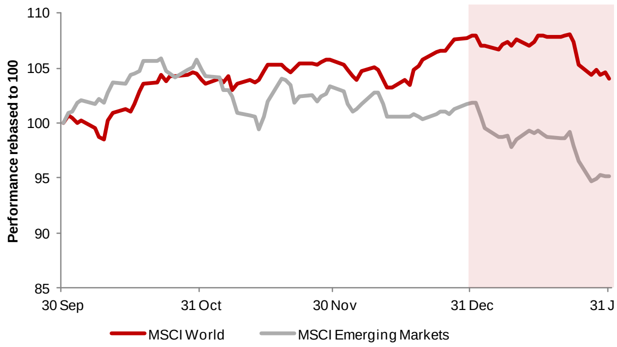
1. Market commentary

Emerging market woes, which came to the fore after the Federal Reserve's first tapering comments in May 2013, finally spread to developed markets in January. The problems of the fragile five (Turkey, Brazil, India, Indonesia and South Africa) spread much more widely in January, as concerns about reduced dollar liquidity, the withdrawal of funds from developing countries, slowing growth across much of the developing world and country specific issues combined to produce sharp falls in EM currencies and stock markets. This, together with some slightly disappointing growth data from the US, led to a risk off period globally, with developed market equities also falling sharply as the month progressed.

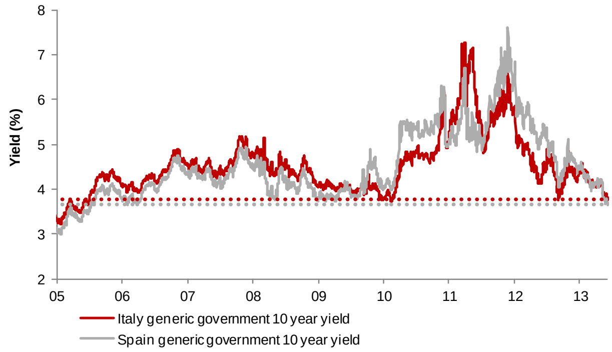
Figure 1: Global equity markets fall back at the start of 2014



Equity markets suffered their worst start to a calendar year in five years, with the MSCI World index declining by 3.7% and the MSCI Global Emerging Markets index down by 6.5% (with Latin America falling by almost 10%). All markets suffered in the sell-off, although Japan was the weakest of the majors (-6.3% in yen terms) while Europe and in particular peripheral Europe held up relatively well (-1.6% in euro terms). Meanwhile the US and the UK both fell by 3.6% in local currency terms.

As equities suffered, traditional safe haven government bonds instead rallied. 10 year treasuries, which ended 2013 with yields of over 3%, saw yields fall back to 2.7%, despite the decision by the US Federal Reserve to continue tapering its asset purchase programme by a further USD 10 billion. The JPMorgan Global Government Bond index returned 1.6% in January, with all major markets producing similar returns other than peripheral Europe, which performed particularly well as yields on Spanish and Italian bonds fell to levels not seen for eight years.

Figure 2: Investor appetite for Spanish and Italian government bonds



The positive performance of government bonds (which provide a reference rate for all other fixed income securities) prompted gains in credit markets, with investment grade bonds in the US returning 1.8%. High Yield, on the other hand, did less well amidst rising risk aversion, returning 0.7%, while emerging market debt fell by 1.6% to continue its poor performance from 2013.

Gold saw renewed interest from investors, with a return of 3.2% during the month, and the price appears to have found support at around USD 1,200. In contrast, other commodity markets fell as fears grew about growth in the developing world (oil -3.1%; copper -5.9%; aluminium -5.3%).

Currency markets were dominated by sharp falls for EM currencies. The South African rand depreciated by 5.6% versus the US dollar (Turkish lira -4.8%; Russian rouble -6.5%), while in Argentina the central bank took the decision to devalue the currency by the biggest amount in 12 years, as its foreign exchange reserves continued to decline. The yen, in contrast, was seen as a safe haven and rallied by 3.2% versus the dollar, a move which appears to have caught out many hedge fund managers who had been short the yen and long the Japanese stock market.

There was a series of bad news for developing countries – some specific such as the ongoing slowdown and weak data in China, mining strikes in South Africa, the devaluation of the Argentinean peso, political crises in Ukraine, Turkey and Thailand – but the big underlying issue remained (and remains) the challenge posed by the withdrawal of excess dollar liquidity. This has brought into sharp relief the critical need for structural reforms and rebalancing in many countries. Several countries, notably India, Brazil and Indonesia, had already raised interest rates in the course of 2013 but many more elected to hike rates in January, including Turkey (from 4.5% to 10%), South Africa and India. Inevitably this will lead to tougher economic conditions in 2014 across much of the developing world.

Data from the US has also slightly disappointed, although the picture is mixed and recent activity levels have undoubtedly been affected by severe winter weather conditions. PMIs have slipped slightly and December payrolls disappointed at only 75,000, while housing was weak but perhaps affected more than most industries by the weather.

There were more positive signs for Europe (although debt levels and unemployment both remain extremely high), as Ireland exited its bailout programme and several weaker members of the eurozone successfully raised debt funding in the markets.

The UK stands out as the best economic performer in Europe, with growth accelerating and spreading more widely. Job creation has been a notable feature of the economy, with the strongest jobs growth since 1999, bringing unemployment down close to the central bank's 7% target.

The fall in markets in January will no doubt blunt investors' optimism at the start of 2014. Many pundits had entered the new year forecasting a continuation of the strong performance from developed market equities and poor performance from bonds. The reverse has happened. Equity markets rose strongly in 2013 and price moves have at times outperformed underlying earnings. There are undoubtedly severe problems to overcome in the emerging world but we see opportunities being created by this setback and are looking to add to positions in hard currency EM debt as well as into equity markets on further weakness. The least risky opportunities remain in the developed world but as the year progresses there will be opportunities in emerging markets where valuations have fallen to increasingly attractive levels on a longer term horizon.

Source: Bloomberg. Returns in US dollars unless otherwise stated. January 2014.

2. Market performance

		To 31 January 2014		
Asset class/region	Index	Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	-3.5%	-3.5%
United Kingdom	MSCI UK NR	GBP	-3.6%	-3.6%
Continental Europe	MSCI Europe ex UK NR	EUR	-1.6%	-1.6%
Japan	Topix TR	JPY	-6.3%[e]	-6.3%[e]
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-5.1%	-5.1%
Global	MSCI World NR	USD	-3.7%	-3.7%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-9.1%	-9.1%
Emerging Asia	MSCI EM Asia NR	USD	-4.8%	-4.8%
Emerging Latin America	MSCI EM Latin America NR	USD	-9.5%	-9.5%
BRICs	MSCI BRIC NR	USD	-7.7%	-7.7%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-6.5%	-6.5%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.6%	1.6%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	2.2%	2.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.8%	1.8%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.7%	0.7%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	2.2%	2.2%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.3%	2.3%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.2%	2.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.4%	1.4%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-1.5%	-1.5%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.8%	0.8%
Australian Government	JP Morgan Australia GBI TR	AUD	1.2%	1.2%
Global Government Bonds	JP Morgan Global GBI	USD	1.6%	1.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.1%	1.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-0.2%	-0.2%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-1.6%	-1.6%

Source: Bloomberg

		To 31 January 2014		
Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	4.2%	4.2%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	0.4%	0.4%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-6.5%	-6.5%
Global Property Securities	S&P Global Property USD TR	USD	-0.9%	-0.9%
Currencies				
Euro		USD	-1.9%	-1.9%
UK Pound Sterling		USD	-0.7%	-0.7%
Japanese Yen		USD	3.2%	3.2%
Australian Dollar		USD	-1.8%	-1.8%
South African Rand		USD	-5.6%	-5.6%
Commodities & Alternatives				
Commodities	RICI TR	USD	-1.3%	-1.3%
Agricultural Commodities	RICI Agriculture TR	USD	-0.8%	-0.8%
Oil	ICE Crude Oil CR	USD	-3.1%	-3.1%
Gold	Gold Spot	USD	3.2%	3.2%
Hedge funds	HFRX Global Hedge Fund	USD	-0.1% e	-0.1% e
Interest rates			**Current rate**	**Change at meeting**
United States	29 January 2014	USD	0.25%	-
United Kingdom	9 January 2014	GBP	0.50%	-
Eurozone	9 January 2014	EUR	0.25%	-
Japan	4 April 2013	JPY	0.10%	-
Australia	3 December 2013	AUD	2.50%	-
South Africa	29 January 2014	ZAR	5.50%	-

e Estimate

3. Asset allocation dashboard

🟢 Positive	🟡 Neutral	🔴 Negative

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

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