Friday, September 12th 2014

Last Friday we saw a disappointing US Non-Farm-Payroll publication- The US economy added 142,000 jobs, versus a Bloomberg survey forecast of 230,000, an advance weaker than the lowest estimate in a Bloomberg survey and followed a revised 212,000 gain in July. The unemployment rate fell to 6.1% from 6.2% in July, reflecting a drop in joblessness among teenagers. But what is really going on with the US employment? A number of economists look past the "main" unemployment rate to a different figure the Bureau of Labour Statistics calls "U-6," which it defines as "total unemployed, plus all marginally attached workers plus total employed part time for economic reasons, as a percent of all civilian labour force plus all marginally attached workers." The U-6 rate fell in August to 12%. While it is down 160 basis points over the last year, the trend has been somewhat more volatile than in the main unemployment rate, which steadily declined. If we were to believe the “U-6”, clearly there still is a huge reserve of un-utilized labour in the States, so wage-drive inflation remains far in the future.

On Monday we saw that China’s trade surplus climbed to a record in August as exports rose on the back of increased shipments to the U.S. and Europe, while imports fell for a second month as a property slump hurt domestic demand. Exports increased 9.4% from a year earlier, the Beijing-based customs administration said, compared with the 9% median estimate in a Bloomberg survey. Imports unexpectedly dropped 2.4%, leaving a trade surplus of $49.8 billion. The trade surpluses will add to pressure for the yuan to appreciate “in order to avoid international tension,” Louis Kuijs, chief Greater China economist at Royal Bank of Scotland Group Plc in Hong Kong, said in a note. Well, the Yuan is now at 6.135 vs. the US$, a 2% rally since its 6.26 level on May 1st, but weak on a YTD base, having started the year at 6.05 The “other currency story” is the Pound Sterling… Jitters on the back of the possible (if not probable) break-up of the UK have taken their toll- The GBP vs. the US$ has declined from $1.72 in July to 1.605 after a poll last Sunday showed that the cessation vote is ahead, only to rebound a little this week to $1.625 as fresher polls show the “No” vote taking the lead. We don’t know the real importance of this referendum, but clearly, if the vote will favour a split, the UK will experience some serious upheavals- risks and uncertainty will take a bite out of the GBP and possibly the Footsie. We will know soon enough- then, if a “Yes” were to pass, who will be the next? Catalonians, Basques, Venetians?

Well, the “real” economic story of the past few weeks is clearly the strength of the US Dollar. It can be argued that the rise of the currency is tantamount to a tightening in interest rates- If the Fed were to raise rates, it could be expected to cause the currency to rise. As it did already, is this the tightening the markets have been expecting? Arguably, as the Dollar has risen quite dramatically, the Fed need not raise rates… “It’s very supportive for the dollar that Treasury yields are now heading higher,” said Michael Sneyd, a foreign-exchange strategist at BNP “When we had good data before, geopolitical risks kept yields down. Now that they are rising, the stars are aligning for the dollar.”

Then, with oil prices falling, it is like a tax cut for the American economy. Arguably, another booster for the stock market. Or are oil prices falling from slowing demand? Brent crude fell through $100 for the first time in 16 months Monday, and was trading at $97.65 on Thursday morning. West Texas Intermediate is also under pressure, falling to $91.45 per barrel on Monday, trading near levels not seen since May 2013. Demand growth in the oil markets will be more subdued than previously expected, according to the International Energy Agency, which has once again downgraded its projections for the rest of the year. "The recent slowdown in demand growth is nothing short of remarkable," the IEA said in a new monthly report on Thursday morning. "While festering conflicts in Iraq and Libya show no sign of abating, their effect on global oil market balances and prices remains muted amid weakening oil demand growth and plentiful supply," "U.S. production continues to surge, and OPEC output remains above the group's official 30 million b/d supply target."

If you are worried as to the support for the high equity prices, a quiet titbit of information may comfort you- The Federal Reserve Survey of Consumer Finance found that only 48.8 percent of Americans held stock either directly or indirectly in 2012, the latest period measured. That's the lowest level since 1995, when 40.5 percent of Americans held some form of stock.- so there truly is a potential buying in the wings… This data may support what technical strategists at Piper Jaffray said this week- the firm held to its ambitious year-end target of 2,100—a nearly 6 percent gain from here—but also predicted the stock market index would hit 2,350 by the end of 2015, a 17 percent increase from the current level. They added “with $2.3 trillion still in money market funds, we believe there is ample dry powder still on the side-lines,"

We did notice a little dark cloud on the horizon- It is the NY Fashion Week and we see Hemlines getting longer for spring. Aesthetics aside, hemlines do correlate well as a leading indicator for the direction of the stock markets…

Market outlook

<u>Core View</u>: We hold our long-standing base-view that the world's economies are mending from the fallout of the "Great Recession" if at a slower pace than hoped for. The economics are settling back into a reasonable growth pattern and with stability that creates a positive bias that is expected to continue. We maintain this "bullish" view although European economies remain weak. We expect the ECB to add fuel to these economies and act as a back-stop against declines, just as the Fed has done over the past several years.

As a group, most Central Banks are targeting an elusive 2% inflation rate. As the industrialized economies are running with excess labour and industrial capacity, the return of inflation appears to be in the distance and as such, short term interest rates are unlikely to rise anytime soon. This in itself lightens the risk of significant changes to the yield-curves. Whilst this suggests that there is little "duration-risk" in the fixed-income sector, *there is little upside to holding bonds. Total-returns from fixed-income will not replicate the stellar returns of the past decade and are likely to remain in the very low single digit.*

1. **Geopolitics in connection with the Islamic radicalisation in Iraq and Syria, accentuated by the risk of spill-over into Saudi Arabia, the Israel-Hamas war (now calmed to a stand-still), in-fighting in Libya, and the ongoing quarrels in the Sea of China.**
2. **Russia-Ukraine conflict - the risk of escalation remains severe inspite of announced (and non-respected) cease-fire and talks towards a definitive settlement.**
3. **Economic slowdown in Europe as noted above combined with dangerously <u>low</u> inflation.**
4. **The health-scare of Ebola spreading beyond West Africa - with risks of quarantines, reduced air-travel and eventual repercussions on economies.**

These risks engender hardly predictable outcomes and effects in our markets.

- **Fixed Income -** As all Central Banks are seeking somewhat higher inflation than they have, it is hardly reasonable that they raise rates! Vigilance is important. Short maturities/low duration are, and remain, appropriate - virtually no upside exists in the sector and expected returns at the 3% level (coupons with eventual capital gains/losses) are insufficient to offset the underlying risks. We find that the reward for assuming credit-risk has become too small and we have been observing ongoing exits from the "High Yield" sub-sector.

- **Equities -** We feel secure in owning equities. We remain positive and recommend exposures to be maintained or even increased- we say this even with indices at or near all-time highs! We suggest using global-diversified equity funds, or allocating some fixed income holdings into convertible bonds for bond-oriented investors.

- **Alternatives -** With relative economic stability and a clearing horizon, fundamentals are returning to text-book norms of relative values. We expect this active management allocation to maintain, if not exceed, its relatively low recent results and possibly returning to past highs - with low correlation to any particular sector and significantly lower volatility than equities. We hold our view that a well-diversified Fund-of-Funds is the best way to express this allocation. We reiterate the role of hedge funds in a portfolio is <u>to attenuate</u> volatility and risks <u>and not</u> as an enhancement of returns!

- **Currencies/Commodities -** The markets' low volatility relative to the past 5 years may be changing as we write. The USD is gaining versus almost all its major trading counterparts, now trading at about $1.293 against the EUR and up to 0.935 against the Swiss Franc. We maintain our belief in the fundamental strength of the US$ and would not bet against it at this time. The Japanese Yen has fallen further trading through 107.00 vs. the US$ (another two full points in the past week!). Gold has been drifting down as the US$ rises, now around $1,235, we do note that Oil trading has been anaemic whilst risks to its supply are rising. WTI has ticked-up somewhat to $93.50 or so).

This Week's Highlights:

- In the FX markets, EUR/USD seems to have settled (for now) at 1.2920 and USD/CHF trades at 0.9350 and then, the USD/JPY raced up through 107.20 by this morning! The US Dollar is definitively the place to be. We see no significant clouds over the Greenback and sense there may yet be another leg-up against the World.
- US Government bonds weakened and sent the yields higher. The US 10Yr yields moved from their slumber of Labour Day levels at 2.34% to peak at 2.51% this morning. The UK Gilt is trading at 2.52%, having moved off the lows on Monday of 2.41% (some Scottish tremors here?). The Bund yields have finally reversed their course from 0.80% of two weeks ago and are now trading at 1.06%. The yields on the French OAT 10 year bonds are now trading at 1.42% having dropped to 1.23% after Draghi's "show". Overall, the bond markets globally have fallen off their highs, bringing yields to slightly higher levels than their recent, all-time lows. <u>For perspective purposes, the US 10 year Treasury Note had started the year at 3.00%!</u>
- Global equities had basically flat week so far. The US markets all drifted in lockstep and have oscillated around the level we closed at last week. Europe also drifted down slightly whilst emerging markets' equities were down quite harshly, with the MSCI Emerging index falling 2.50% and within it the Brazilian BOVESPA moving down another 4.0% and Russia down another 3.30%. The VIX closed Thursday at 12.80, marginally lower than last week's close at 13.0

Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE

11/09/2014

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	1Y	YTD
			PRICE CHANGE IN % (unless indicated)							
FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)										
US 3 MONTH	USD	0.01	**0.00**	-0.02	-0.01	-0.02	-0.03	-0.03	-0.01	-0.06
US 2 YEAR	USD	0.56	**0.77**	0.06	0.08	0.13	0.13	0.20	0.12	0.18
US 10 YEAR	USD	2.56	**0.33**	0.10	0.21	0.11	-0.04	-0.17	-0.35	-0.47
FIXED INCOME INDICES - BY TYPE OF ISSUER										
GLOBAL AGG TR HEDGED	USD	463.87	**-0.02**	-0.28	-0.60	0.22	1.41	3.16	6.57	4.94
US GOVERNMENT TR	USD	2,035.22	**0.04**	-0.26	-0.71	-0.28	0.71	1.63	3.41	2.81
US CORPORATE TR	USD	2,546.98	**0.05**	-0.53	-1.27	-0.36	1.01	3.58	8.81	5.78
US HIGH YIELD TR	USD	1,655.34	**-0.14**	-0.79	-1.02	0.29	-0.41	2.04	9.22	4.62
EU GOVERNMENT TR	EUR	231.46	**-0.08**	-0.40	-0.59	0.87	2.69	5.79	11.39	8.84
EU CORPORATE TR	USD	241.38	**0.04**	-0.03	0.04	1.01	2.05	4.34	8.70	6.54
EU HIGH YIELD TR	EUR	268.10	**0.08**	0.01	-0.02	1.52	0.03	2.59	10.42	5.56
JACI GLOBAL	USD	256.48	**-0.15**	-1.03	-0.94	0.00	-3.16	-3.12	6.36	1.23
GLOBAL EM TR (HEDGED)	USD	327.81	**0.08**	-0.35	-0.46	0.86	0.79	5.76	11.08	7.45
S&P/LSTA U.S. LEV LOAN	USD	97.80	**-0.15**	-0.45	-0.48	-0.09	-1.05	-0.63	-0.02	-0.45
COMMODITY INDICES - BY TYPE OF ISSUER										
GSCI INDEX TOTAL RETURN	USD	4,581.74	**-0.09**	-2.44	-3.66	-4.76	-8.61	-7.33	-7.51	-5.13
GSCI ENERGY TR	USD	1,055.04	**0.26**	-2.67	-4.06	-5.44	-9.30	-6.55	-7.91	-6.31
GSCI INDUSTRIAL METALS TR	USD	1,390.37	**-0.82**	-3.04	-2.91	-1.80	3.99	9.44	3.02	1.73
GSCI PRECIOUS METALS TR	USD	1,552.35	**-0.65**	-2.25	-3.86	-5.73	-2.05	-8.50	-10.85	1.91
GSCI AGRICULTURE TR	USD	523.72	**-0.94**	-2.77	-6.23	-7.17	-17.78	-23.73	-20.29	-13.66
GENERIC 1ST 'CL' FUTURE	USD	92.83	**0.56**	0.06	-2.72	-1.48	-7.98	1.59	-9.96	1.32
GOLD SPOT $/OZ	USD	1,240.93	**-0.13**	-2.33	-3.76	-5.35	-2.68	-9.33	-6.23	2.80
CURRENCIES										
DOLLAR INDEX SPOT	USD	84.30	**0.00**	0.66	1.87	3.43	4.61	5.89	3.44	5.32
Euro Spot	EUR	1.29	**-0.05**	-0.25	-1.62	-3.37	-4.67	-7.08	-2.86	-6.00
Japanese Yen Spot	JPY	107.11	**-0.07**	-1.96	-2.89	-4.60	-5.12	-4.13	-7.14	-1.75
British Pound Spot	GBP	1.63	**-0.12**	-0.56	-2.18	-3.43	-4.09	-2.30	2.73	-1.94
Brazilian Real Spot	BRL	2.30	**-0.40**	-2.39	-2.69	-0.97	-2.79	2.87	-0.97	2.80
China Renminbi Spot	CNY	6.13	**-0.04**	0.14	0.18	0.42	1.41	0.21	-0.24	-1.28
Singapore Dollar Spot	SGD	1.26	**-0.02**	-0.78	-1.20	-1.05	-1.23	0.21	0.28	-0.07
Norwegian Krone Spot	NOK	6.38	**-0.13**	-1.66	-2.97	-3.23	-6.17	-6.84	-7.89	-4.94
VOLATILITY / LIQUIDITY INDICES										
CBOE SPX VOLATILITY INDX	USD	12.80	**-0.62**	1.27	6.84	-9.41	1.91	-11.54	-10.43	-6.71
USD SWAP SPREAD SEMI 2YR		23.31	**2.15**	13.38	6.39	4.06	58.95	74.69	60.01	126.76
TED SPREAD		-	-	5.50	5.25	8.04	11.30	18.63	-6.15	-84.68

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11/09/2014

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			PRICE CHANGE IN % (unless indicated)								
EQUITY MARKET INDICES - BY REGION											P/E
MSCI WORLD	USD	1,736.99	**0.09**	-0.78	-0.67	2.21	0.67	4.29	13.31	4.57	16.02
MSCI WORLD LOCAL	-	1,257.55	**0.04**	-0.22	0.25	3.47	2.01	5.69	14.39	6.17	-
MSCI AC WORLD	USD	428.16	**0.02**	-0.97	-0.78	2.02	0.75	5.19	12.72	4.80	15.43
MSCI EM	USD	1,069.43	**-0.51**	-2.50	-1.70	0.47	1.39	13.21	7.98	6.66	11.88
S&P 500 INDEX	USD	1,997.45	**0.12**	-0.01	-0.30	3.29	3.49	6.92	18.65	8.07	16.67
DOW JONES INDUS. AVG	USD	17,049.00	**-0.09**	-0.12	-0.29	2.95	1.88	4.34	11.43	2.85	15.10
NASDAQ COMPOSITE INDEX	USD	4,591.81	**0.12**	0.65	0.25	4.61	6.84	6.21	23.57	9.94	19.58
RUSSELL 2000 INDEX	USD	1,172.34	**0.65**	0.44	-0.17	3.47	1.12	-1.60	11.81	0.75	19.34
EURO STOXX 50	EUR	3,237.76	**-0.20**	-1.14	2.05	7.08	-1.42	5.62	13.13	4.14	14.69
CAC 40 INDEX	EUR	4,440.90	**-0.22**	-1.02	1.37	6.70	-2.49	3.13	8.14	3.37	15.18
DAX INDEX	EUR	9,691.28	**-0.09**	-0.57	2.33	6.86	-2.49	5.47	14.10	1.46	13.75
FTSE 100 INDEX	GBP	6,799.62	**-0.45**	-0.81	-0.30	2.52	-0.64	2.70	3.20	0.75	-
SWISS MARKET INDEX	CHF	8,829.01	**0.15**	0.46	1.96	5.99	1.82	6.24	9.90	7.63	17.11
NIKKEI 225	JPY	15,909.20	**0.76**	1.78	3.40	5.19	6.51	7.54	10.85	-2.11	17.63
HANG SENG INDEX	HKD	24,662.64	**-0.03**	-2.61	-0.43	-0.21	6.31	12.49	7.33	5.71	11.32
SHANGHAI SE COMPOSITE	CNY	2,311.68	**-0.29**	0.97	5.05	4.84	13.53	16.60	3.26	10.08	9.10
S&P BSE SENSEX INDEX	INR	26,995.87	**-0.22**	-0.04	1.42	4.39	5.63	23.61	36.57	27.61	17.27
RUSSIAN RTS INDEX $	USD	1,217.88	**-1.71**	-3.30	2.14	1.42	-11.58	10.51	-13.25	-15.73	5.11
BRAZIL IBOVESPA INDEX	BRL	58,337.29	**0.24**	-4.05	-4.81	3.36	5.87	27.20	9.44	13.26	12.56
EQUITY MARKET INDICES - BY SECTOR											P/E
MSCI ENERGY	USD	291.04	**-0.02**	-2.26	-3.65	-0.87	-3.72	7.38	11.89	5.61	14.21
MSCI MATERIALS	USD	243.97	**-0.08**	-1.68	-2.49	-2.38	-1.48	1.32	6.25	1.66	16.31
MSCI INDUSTRIALS	USD	201.79	**-0.01**	-0.73	-0.39	1.87	-2.08	1.28	10.17	-0.08	16.46
MSCI CONS DISCRETIONARY	USD	180.53	**0.16**	-1.03	-0.45	1.79	0.62	0.36	9.27	-0.68	16.99
MSCI CONS STAPLES	USD	196.51	**0.02**	-0.86	-0.46	1.45	-0.90	4.73	9.53	3.17	18.73
MSCI HEALTH CARE	USD	194.66	**0.02**	0.30	0.43	5.64	5.27	6.62	23.57	13.27	18.08
MSCI FINANCIALS	USD	104.47	**0.09**	-0.95	-0.49	2.62	0.03	3.18	10.12	2.53	13.68
MSCI INFO TECH	USD	137.76	**0.13**	0.36	0.47	4.13	6.73	9.99	25.68	11.85	17.31
MSCI TELECOMS	USD	71.10	**0.46**	-0.43	-0.68	1.63	-1.82	1.95	9.28	-1.24	15.91
MSCI UTILITY	USD	120.83	**0.61**	-1.46	-0.47	3.00	-0.16	4.12	13.51	9.97	16.11
MSCI WORLD REAL ESTATE	USD	192.45	**-0.04**	-2.25	-1.64	0.45	2.01	8.79	9.86	9.98	23.59
HEDGE FUND INDICES											
HFRX GLOBAL HEDGE FUND	USD	1,249.30	**-0.11**	-0.15	-0.02	1.80	0.30	0.54	4.41	1.94	
HFRX EQUAL WEIGHTED	USD	1,220.91	**-0.12**	-0.08	-0.02	1.12	0.21	0.50	3.93	1.99	
HFRX GLOBAL EUR	EUR	1,155.29	**-0.11**	-0.15	-0.05	1.78	0.20	0.40	4.11	1.72	

Disclaimer

All data is compiled from Bloomberg