Friday, September 19th 2014

A new high on the S&P 500, a new high on the Dow Jones… and the world keeps on spinning. Well we had lots to see and hear this week, ranging from Yellen's comments on the statement of "considerable time" before they see the next rate hike; to the now infamous Scottish referendum (which now looks like a storm in a tea cup – the UK is still the same as the UK we have known for 307 years!); to the Chinese joining the QE party (of course with a Chinese twist)... Well if everyone else is doing it, why not?!

On Monday, stocks were mixed, with technology shares slammed ahead of Alibaba's planned debut later in the week, as investors unloaded high-fliers a day before the Federal Reserve started a two-day policy session. Stocks rebounded on Tuesday as the Dow flew to a new intraday record high on the report that China's central bank would likely increase their stimulus package – adding 500Bn Yuan of liquidity to the five largest banks (that's about $81Bn USD) but with a limited term of three months. "It's like quantitative easing with Chinese characteristics," said Louis Kuijs, Royal Bank of Scotland Group Plc's chief Greater China economist in Hong Kong - he formerly worked at the World Bank. "The threat is that growth is slowing down below the comfort level of policy makers and that will then also warrant further easing steps." China's credit expansion builds on targeted measures to shore up growth while stopping short of broad-based stimulus as we have seen in the U.S. and still being pushed in Europe and Japan. By attaching a three-month term to its injection, China is taking a step down that path while maintaining control of a process designed to fuel demand for credit in an already debt-laden economy. "With growth slowing and regulators cracking down on shadow banking, it seems like the PBOC is trying to cut costs for preferred borrowers and sectors without reflating the property sector," said David Loevinger, an analyst at TCW. This being said, there are a few pundits who have said that this is not a stimulus package and it is only the central bank pre-empting a liquidity squeeze coming in the foreseeable future. Perhaps with the Central Bank not passing any comment on this they are trying to downplay their intervention and to leave the door open to further policy shifts?

We have mentioned before about Sino-Russian relations when it comes to co-ordinating their economic actions in order to strengthen their trading ties. On Wednesday the Central Bank of Russia announced the provision of large amounts of FX liquidity for a new overnight facility. It looks like a sensible response from the central bank to stave off any looming liquidity crisis prior to it unravelling. Coordinated with the Chinese…? We highly doubt it, but nevertheless the liquidity machine ru(m)bles on!

As if this was not enough information, the FOMC stormed in with another "low rates for longer commentary". With no discernible indication or level to work towards the committee left the pathway totally clear for them to manage the rates at a pace that they see fit and maintaining the rates at a low level for a "considerable time". "It is highly conditional, and it is linked to the committee's assessment of the economy," Yellen said. "There is no fixed mechanical interpretation of a time period." The debate now will be between who is behind the rate rise curve? Using the Fed Fund Futures as an indicator for where rates will be at the end of 2015, the futures are pricing 0.79% yet the Fed officials have estimated the rate to be at 1.375%. So the Fed believes the market is behind the curve and the market believes the Fed is incorrectly pricing the data…

Well let's look at some of the figures out this week. What matters to the man on the ground are his wage and his cost of living. A report from Tuesday showed the cost of living in the U.S. unexpectedly dropped in August for the first time in more than a year, showing inflation still is falling short of the Fed's goal. The median income for people in the United States remained about flat at $51,900 in 2013 compared to the previous year, according to released U.S. government data that offered a key indicator of the country's economic well-being. The nation's poverty rate was slightly lower at 14.5% last year compared to 15% in 2012. "Annual increases in median household income were last experienced in 2007 for family households and in 2009 for non-family households,''. The cost of living may be slightly decreasing but there is no real wage growth and with heavy underutilisation we do not see any wage pressure in near future until that slack is taken up.

This morning we awoke to the news that Scotland wants to remain part of the United Kingdom, with Mr Salmond admitting defeat and urging the Scottish Yes voters to support the outcome of the vote. The collective sigh of relief heard around the globe will allow both Europe and other unions that have fractious states within their borders to rest easy a little while longer. After PM Rajoy of Spain voiced (rather vociferously) his country's concern over the Scottish parliamentary split we are sure that he will be one of the first to congratulate the UK on remaining "Better Together".

We leave you this week with a quick thought by the great industrialist Mr Henry Ford, "Coming together is a beginning; keeping together is progress; working together is success".

Market outlook

Core View: 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. And now, the Bank of China is said to join the "party" supporting the rising Japanese support…
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 despite the non-respected cease-fire and talks towards a definitive settlement.**
3. **Economic slowdown in Europe, noted above, combined with dangerously low 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 don't produce 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 to attenuate volatility and risks and not as an enhancement of returns! With the good news being that the last 30 trading days have improved for the Macro and CTA funds, having a much better trading environment after a tough first half of the year.

- **Currencies/Commodities -** The markets' low volatility relative to the past 5 years may be changing as we write with EUR "at the money" volatility now having pared its losses for the year. The USD is gaining versus almost all its major trading counterparts, now trading at about $1.2900 against the EUR and 0.9370 against the Swiss Franc. We maintain our belief in the fundamental strength of the US$ and would not bet against it at this time. The Japanese Yen has fallen heavily trading through to 109.40 vs. the US$ (another two full points in the past week!). Gold has been drifting down as the US$ rises, now around $1,225, we do note that Oil trading has been anaemic whilst risks to its supply are rising. WTI has drifted lower to $92.60 or so.

This Week's Highlights:

- In the FX markets the EUR tumbled on the FOMC wording as the USD rallied further, sending the pair as low as 1.2840 only to see it retrace a little to almost be back at 1.2900 this morning. With the "enormity" of the Scottish vote looming over the markets, the fact that we are unchanged between yesterday and today seems to sum up the markets take on the Pound. GBP is now at 1.64, having moved up from 1.6250 on Monday. The big moves this week have been in USDJPY with Yellen sending the pair soaring for the skies from 107.00 to 109.46 at the highs this morning.
- US Government bonds weakened and sent the yields higher again on Yellen's commentary. The US 10Yr yields moved from 2.56% to peak at 2.66% this morning. The UK Gilt is trading at 2.58% (unchanged on the day!!), having moved off the lows of 2.51%. With the referendum in the past there may be a short term settling down of the yields. The Bund yields are unchanged on the week at 1.09%. The yields on the French OAT 10 year bonds are now trading at 1.44% having dropped to 1.40% ahead of the FOMC meeting. Overall, the bond markets globally have fallen off their highs, bringing yields to slightly higher levels than their recent, all-time lows.
- With all of the speeches and worries out of the way, volatility has dropped and the markets have resumed their uptrends. Both the S&P500 and the Dow hit new all-time highs and European markets have taken a boost from the ECB's Draghi's comments on continued support and the hope for a weaker EUR. Global equities are up about 2.5% on the week with the S&P hitting 2012.34 and the Dow touching 17,275.37.

Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE

18/09/2014

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	1Y	YTD	
			PRICE CHANGE IN % (unless indicated)								
EQUITY MARKET INDICES - BY REGION											P/E
MSCI WORLD	USD	1,742.74	0.43	0.77	-0.34	0.45	-0.32	5.11	10.78	4.92	16.10
MSCI WORLD LOCAL	-	1,262.80	0.53	0.42	0.67	2.31	2.14	6.80	13.30	6.61	-
MSCI AC WORLD	USD	428.84	0.32	0.63	-0.63	0.11	-0.22	5.72	9.94	4.97	15.49
MSCI EM	USD	1,056.37	-0.56	-0.49	-2.90	-2.59	0.61	11.13	3.31	5.35	11.84
S&P 500 INDEX	USD	2,011.36	0.50	0.70	0.40	1.50	2.65	8.09	16.78	8.82	16.78
DOW JONES INDUS. AVG	USD	17,265.99	0.64	1.27	0.98	2.05	2.04	6.43	10.42	4.16	15.28
NASDAQ COMPOSITE INDEX	USD	4,593.43	0.69	0.04	0.29	1.46	5.37	6.64	21.22	9.98	19.60
RUSSELL 2000 INDEX	USD	1,159.27	0.47	-1.11	-1.28	-0.27	-2.09	-3.04	7.81	-0.37	19.16
EURO STOXX 50	EUR	3,271.37	1.05	1.69	3.70	6.43	-0.75	6.94	12.04	5.82	14.97
CAC 40 INDEX	EUR	4,464.70	0.75	0.94	2.34	5.38	-1.75	4.07	6.59	4.36	15.35
DAX INDEX	EUR	9,798.13	1.41	2.14	4.09	5.61	-1.46	6.26	13.38	3.20	14.00
FTSE 100 INDEX	GBP	6,819.29	0.57	0.79	0.60	1.20	0.78	4.38	3.55	1.66	-
SWISS MARKET INDEX	CHF	8,830.49	0.06	0.77	2.36	3.96	2.18	7.74	9.53	8.05	17.20
NIKKEI 225	JPY	16,067.57	1.13	2.59	5.81	5.64	6.25	12.85	10.53	0.18	18.05
HANG SENG INDEX	HKD	24,168.72	-0.85	-1.02	-1.61	-3.10	5.08	12.87	3.58	4.46	11.19
SHANGHAI SE COMPOSITE	CNY	2,315.93	0.35	-0.11	5.06	3.75	15.11	15.22	6.28	10.09	9.07
S&P BSE SENSEX INDEX	INR	27,112.21	1.81	0.30	1.89	2.73	7.70	24.32	31.46	28.21	17.34
RUSSIAN RTS INDEX $	USD	1,187.24	-0.24	-2.75	-0.87	-5.74	-13.98	2.08	-20.21	-18.22	5.04
BRAZIL IBOVESPA INDEX	BRL	58,374.48	-1.24	0.06	-4.75	-0.13	5.75	25.36	5.95	13.33	12.56
EQUITY MARKET INDICES - BY SECTOR											P/E
MSCI ENERGY	USD	289.88	-0.18	0.78	-4.03	-2.62	-6.48	6.98	9.76	5.19	14.16
MSCI MATERIALS	USD	244.24	0.17	0.53	-2.38	-3.13	-3.26	2.23	2.95	1.77	16.37
MSCI INDUSTRIALS	USD	202.47	0.30	0.66	-0.05	-0.11	-2.67	2.28	6.99	0.25	16.54
MSCI CONS DISCRETIONARY	USD	180.55	0.41	0.19	-0.44	-0.31	-0.44	1.25	6.12	-0.67	17.02
MSCI CONS STAPLES	USD	197.05	0.16	0.75	-0.18	-0.10	-2.06	5.72	6.26	3.45	18.79
MSCI HEALTH CARE	USD	197.22	0.78	1.73	1.75	3.51	5.40	8.14	23.05	14.76	18.32
MSCI FINANCIALS	USD	105.03	0.73	0.74	0.05	1.48	-0.10	4.35	7.65	3.08	13.77
MSCI INFO TECH	USD	138.15	0.69	0.70	0.75	1.47	5.56	10.69	23.46	12.17	17.38
MSCI TELECOMS	USD	71.55	0.53	1.10	-0.06	1.49	-2.09	2.29	8.39	-0.61	16.06
MSCI UTILITY	USD	119.67	-0.28	0.16	-1.43	-0.34	-4.18	2.88	8.77	8.91	15.99
MSCI WORLD REAL ESTATE	USD	187.30	-0.37	-1.01	-4.27	-4.43	-1.50	7.19	2.33	7.04	22.95
HEDGE FUND INDICES											
HFRX GLOBAL HEDGE FUND	USD	1,246.77	0.00	-0.20	-0.22	0.83	0.37	0.87	4.03	1.74	
HFRX EQUAL WEIGHTED	USD	1,218.90	0.00	-0.16	-0.18	0.50	0.25	0.76	3.62	1.82	
HFRX GLOBAL EUR	EUR	1,152.83	0.00	-0.21	-0.26	0.80	0.27	0.71	3.72	1.51	

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FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)										
US 3 MONTH	USD	0.01	0.00	-0.01	-0.02	-0.02	-0.01	-0.05	0.01	-0.06
US 2 YEAR	USD	0.58	3.66	0.02	0.09	0.15	0.13	0.16	0.25	0.20
US 10 YEAR	USD	2.64	0.81	0.03	0.29	0.24	0.01	-0.14	-0.12	-0.39
FIXED INCOME INDICES - BY TYPE OF ISSUER										
GLOBAL AGG TR HEDGED	USD	462.70	-0.12	-0.25	-0.85	-0.33	1.09	2.61	5.61	4.68
US GOVERNMENT TR	USD	2,027.82	-0.09	-0.36	-1.07	-0.87	0.28	0.91	2.08	2.43
US CORPORATE TR	USD	2,532.72	-0.05	-0.56	-1.82	-1.18	0.21	2.58	6.86	5.19
US HIGH YIELD TR	USD	1,656.58	0.17	0.07	-0.95	-0.55	-0.51	2.03	8.52	4.70
EU GOVERNMENT TR	EUR	231.07	-0.19	-0.17	-0.76	0.23	2.64	5.22	10.70	8.65
EU CORPORATE TR	EUR	240.94	-0.14	-0.18	-0.14	0.50	1.83	3.97	8.22	6.35
EU HIGH YIELD TR	EUR	268.02	0.05	-0.03	-0.05	0.73	-0.03	2.66	10.06	5.53
JACI GLOBAL	USD	255.59	0.15	-0.35	-1.28	-0.84	-3.09	-3.04	5.05	0.88
GLOBAL EM TR (HEDGED)	USD	325.71	-0.09	-0.64	-1.10	-0.55	0.50	5.17	8.58	6.76
S&P/LSTA U.S. LEV LOAN	USD	97.75	-0.02	-0.05	-0.53	-0.14	-1.11	-0.68	-0.20	-0.50
COMMODITY INDICES - BY TYPE OF ISSUER										
GSCI INDEX TOTAL RETURN	USD	4,543.37	-1.20	-0.84	-4.47	-2.78	-11.66	-7.66	-8.19	-5.92
GSCI ENERGY TR	USD	1,050.10	-1.26	-0.47	-4.51	-2.50	-12.76	-5.90	-8.59	-6.75
GSCI INDUSTRIAL METALS TR	USD	1,373.38	-0.99	-1.22	-4.10	-1.91	2.24	7.97	2.16	0.48
GSCI PRECIOUS METALS TR	USD	1,538.18	-0.78	-0.91	-4.73	-5.62	-4.08	-10.08	-7.51	0.98
GSCI AGRICULTURE TR	USD	510.38	-1.45	-2.55	-8.62	-8.73	-19.86	-26.24	-21.30	-15.86
GENERIC 1ST 'CL' FUTURE	USD	93.07	-0.12	0.75	-3.13	1.20	-8.28	-1.39	-8.39	0.90
GOLD SPOT $/OZ	USD	1,225.19	-0.17	-0.53	-5.02	-5.60	-7.37	-8.01	-10.48	1.45
CURRENCIES										
DOLLAR INDEX SPOT	USD	84.32	0.06	0.16	1.97	3.04	5.05	5.48	4.98	5.42
Euro Spot	EUR	1.29	-0.25	-0.56	-1.84	-3.22	-5.27	-6.81	-4.72	-6.20
Japanese Yen Spot	JPY	108.69	-0.36	-1.60	-4.57	-5.65	-6.55	-6.20	-8.83	-3.46
British Pound Spot	GBP	1.64	0.40	1.19	-0.82	-0.93	-3.39	-0.48	2.68	-0.57
Brazilian Real Spot	BRL	2.36	-0.30	-2.84	-5.45	-4.55	-5.81	-1.31	-7.56	-0.12
China Renminbi Spot	CNY	6.14	0.06	-0.04	0.09	0.06	1.49	0.92	-0.27	-1.36
Singapore Dollar Spot	SGD	1.27	0.00	-0.31	-1.44	-1.54	-1.35	0.54	-1.59	-0.31
Norwegian Krone Spot	NOK	6.32	-0.19	0.42	-2.19	-2.70	-3.41	-4.74	-7.99	-4.18
VOLATILITY / LIQUIDITY INDICES										
CBOE SPX VOLATILITY INDX	USD	12.03	-4.90	-6.02	0.42	-1.47	13.28	-20.44	-8.59	-12.32
USD SWAP SPREAD SEMI 2YR		24.31	-1.52	0.80	6.97	6.97	54.65	85.01	49.63	128.00
TED SPREAD		-	-	2.23	7.36	9.52	3.85	22.30	-7.42	-84.38

All data is compiled from Bloomberg

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