momentum

# Viewpoint

## Monthly market update

*September 2013*


global investment management

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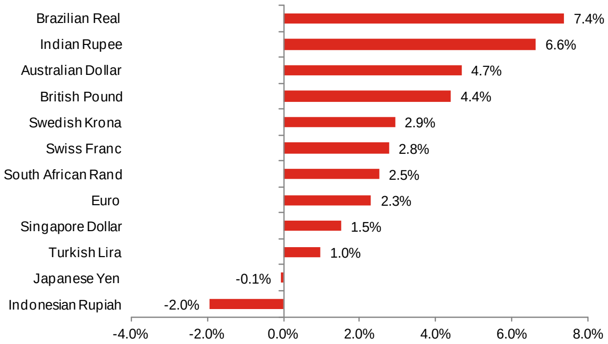
# 1. Market commentary

Two key decisions by US policymakers dominated markets in September as politicians addressed how to react to the Syrian regime's use of chemical weapons and whether to begin the tapering of its monthly $85 billion asset purchasing program. In the event, markets were positively surprised by both decisions, resulting in a strong month across nearly all asset classes except for commodities, particularly oil and precious metals.

Developed markets performed strongly in September, returning 5.0% to bring their year to date returns to 17.3% in US dollar terms. The performance of individual countries was also good, with Japan leading the way, returning 8.7% in yen terms, followed by Germany and France, up by 6.1% and 5.5% in euro terms respectively. These returns were further improved in US dollar terms by the weakness of the greenback against most other currencies, with the euro (+2.3%), British pound (+4.4%), and Australian dollar (+4.7) all strengthening in September.

After a sharp fall in August and steep underperformance over the past year, emerging markets returned 6.5% in September in US dollar terms. The markets which had seen the greatest sell off in August rallied most, with India and Russia returning 4.9% and 5.5% in local currency terms respectively. Emerging market currencies also returned to strength against the US dollar, with the Indian rupee and the Brazilian real up by 6.6% and 7.4% respectively.

*Figure 1: Performance of major currencies against the US dollar*

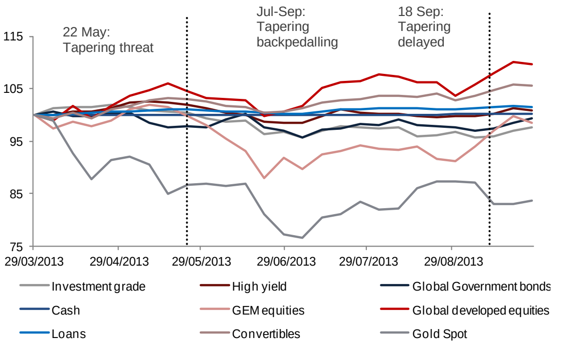



At the start of the month, the Syrian crisis carried a very serious risk of escalating into a much more damaging regional conflict, drawing in the key western allied forces. In the event, unexpected intervention from Russia resulted in Syria committing to a Russia-US deal to eradicate chemical weapons by mid 2014. This move has dramatically eased tensions and substantially reduced the risk of the conflict escalating. Less widely reported but arguably of greater strategic importance has been the early signs of a thawing of relations between the US and Iran, with the latter, under new president Hassan Rouhani, having moved to rebuild relations with the West and put the nuclear issue firmly on the agenda for an early resolution. These events contributed to oil and gold prices falling sharply over the month, down by 5.9% and 4.7% in US dollar terms, respectively.

Markets, otherwise, were dominated by news from the US Federal Reserve (Fed). First, Larry Summers, the more hawkish candidate to succeed Bernanke as Governor in 2014, pulled out of the race, leaving Janet Yellen as the leading candidate, which investors interpreted as increasing the likelihood of prolonged ultra-loose monetary policy (since Summers was expected to rein this in much sooner). However, the bigger surprise came with the Federal Open Market Commitee's (FOMC) decision not to 'taper' at its meeting on the 17th-18th September. Whilst the market consensus had been for a USD 15 billion taper, Fed Chairman Ben Bernanke noted that the downside risks to cutting the rate of asset purchases from the current USD 85 billion per month posed too great a threat for the economy.

Markets reacted very positively to the announcement, especially those most dependent on the continuing flow of liquidity from the Fed. However by the end of the month, when the initial euphoria had dissipated and after investors had absorbed the fact that the Fed's decision was a delay not a cancellation of tapering, nearly all equity markets and gold were back to levels seen prior to the announcement. Bond markets, however, sustained a significant rise, with US 10 year yields back down to 2.61% by the end of the month, down from their 2.99% high seen on the 5th September. Other bond markets followed a similar pattern, perhaps helped by the revised forecasts for growth given by the Fed, which saw GDP growth forecasts for 2013 cut from 2.3-2.6% to 2.0-2.3% and 2014's forecasts cut from 3.0-3.5% to 2.9-3.1%.

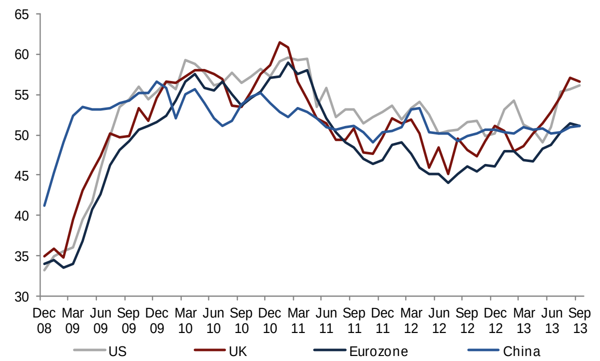
*Figure 2: Taper reprieve has induced tactical rallies*




Figures from the US on the state of the economy remained mixed because payrolls, mortgage applications, consumer confidence and retail sales data were below expectations but both manufacturing and non-manufacturing ISM Purchasing Managers Indices (PMIs) reported numbers in growth territory, at 56.2 and 54.4 respectively.

The overall picture of a gradually recovering US economy was mirrored in Europe, with the UK housing market strengthening outside of London and the Euroarea composite PMI, which covers both manufacturing and services sectors, improving to 52.2 from 51.5 in August. Notably European Central Bank (ECB) President, Mario Draghi, also reaffirmed his commitment to very loose monetary policy, pledging to "use any instrument, including another [Long Term Refinancing Option] LTRO if needed, to maintain short term money market rates" which was interpreted by the market as a commitment to keep rates low for a protracted period. There was also further evidence of stabilisation in China, with an improvement in trade figures and HSBC's manufacturing PMI for the country recording a reading of 51.2 in September.

*Figure 3: Strength in Manufacturing PMI indices*




Another notable event during September was the widely expected re-election of Angela Merkel as German Chancellor. After gaining a larger share of the vote than anticipated, Merkel confirmed her position as one of the most powerful politicians in Europe and her commitment to preserving the euro makes another bailout of distressed peripheral EU countries likely in the future. Meanwhile in Japan news on the economy remains encouraging, with second quarter GDP revised up to 3.8% and industrial production growing at 3.2% in September.

As the month drew to a close the market's attention switched back to the US government and budget negotiations as the new fiscal year on the 1st October approached. Since then, having failed to pass the Senate's "clean" funding bill, without any provisions to delay Obamacare, the Republican controlled House of Representatives forced a shutdown of non-essential operations until a new budget deal between them and the opposing Democratic Party could be forged. Having failed to reach a compromise, officials have warned the first shutdown in 17 years could last longer than expected; drawing concern its impact could be magnified if not resolved before the looming debt ceiling deadline later in October.

At the time of writing, a last minute deal to prevent the US defaulting on its obligations has been struck. Against this backdrop, with developed world economies gradually picking up, the environment for equities remains supportive.

## 2. Market performance

| | | To 30 September 2013 | | |
|---|---|---|---|---|
| Asset class/region | Index | Currency | Month | Year to date |
| **Developed markets equities** | | | | |
| United States | S&P 500 NR | USD | 3.1% | 19.2% |
| United Kingdom | MSCI UK NR | GBP | 0.8% | 12.8% |
| Continental Europe | MSCI Europe ex UK NR | EUR | 5.2% | 15.0% |
| Japan | Topix TR | JPY | 8.7% | 41.4% |
| Asia Pacific (ex Japan) | MSCI Pacific ex Japan TR | USD | 6.9% | 5.3% |
| Global | MSCI World NR | USD | 5.0% | 17.3% |
| **Emerging markets equities** | | | | |
| Emerging Europe | MSCI EM Europe NR | USD | 9.6% | -3.0% |
| Emerging Asia | MSCI EM Asia NR | USD | 5.2% | -1.6% |
| Emerging Latin America | MSCI EM Latin America NR | USD | 8.6% | -11.3% |
| BRICs | MSCI BRIC NR | USD | 8.4% | -5.1% |
| Global emerging markets | MSCI EM (Emerging Markets) NR | USD | 6.5% | -4.4% |
| **Bonds** | | | | |
| US Treasuries | JP Morgan United States Government Bond Index TR | USD | 0.8% | -2.5% |
| US Treasuries (inflation protected) | Barclays Capital U.S. Government Inflation Linked TR | USD | 1.5% | -7.3% |
| US Corporate (investment grade) | Barclays Capital U.S. Corporate Investment Grade TR | USD | 0.7% | -2.6% |
| US High Yield | Barclays Capital U.S. High Yield 2% Issuer Cap TR | USD | 1.0% | 3.7% |
| UK Gilts | JP Morgan United Kingdom Government Bond Index TR | GBP | 0.9% | -2.7% |
| UK Corporate (investment grade) | BofA Merrill Lynch Sterling Non Gilts TR | GBP | 0.9% | 0.8% |
| Euro Government Bonds | Citigroup EMU GBI TR | EUR | 0.8% | 1.1% |
| Euro Corporate (investment grade) | Barclays Capital Euro Aggregate Corporate TR | EUR | 0.7% | 1.4% |
| Euro High Yield | BofA Merrill Lynch Euro High Yield Constrained TR | EUR | 3.9% | 8.7% |
| Japanese Government | JP Morgan Japan Government Bond Index TR | JPY | 0.6% | 2.0% |
| Australian Government | JP Morgan Australia GBI TR | AUD | 0.5% | 0.3% |
| Global Government Bonds | JP Morgan Global GBI | USD | 1.8% | -3.3% |
| Global Bonds | Citigroup World Broad Investment Grade (WBIG) TR | USD | 2.0% | -1.8% |
| Global Convertible Bonds | UBS Global Convertible Bond | USD | 4.1% | 12.8% |
| Emerging Market Bonds | JP Morgan EMBI+ | USD | 2.9% | -8.9% |

*Source: Bloomberg. September 2013*

| | | To 30 September 2013 | | |
|---|---|---|---|---|
| Asset class/region | Index | Currency | Month | Year to date |
| **Property** | | | | |
| US Property Securities | MSCI US REIT NR | USD | 3.1% | 2.3% |
| Australian Property Securities | S&P/ASX 200 A-REIT Index TR | AUD | 1.0% | 4.6% |
| Asia Property Securities | S&P Asia Property 40 Index NR | USD | 7.1% | 8.5% |
| Global Property Securities | S&P Global Property USD TR | USD | 5.7% | 4.6% |
| **Currencies** | | | | |
| Euro | | USD | 2.3% | 2.5% |
| UK Pound Sterling | | USD | 4.4% | -0.4% |
| Japanese Yen | | USD | -0.1% | -11.7% |
| Australian Dollar | | USD | 4.7% | -10.4% |
| South African Rand | | USD | 2.6% | -15.5% |
| **Commodities & Alternatives** | | | | |
| Commodities | RICI TR | USD | -2.4% | -3.2% |
| Agricultural Commodities | RICI Agriculture TR | USD | -0.8% | -8.1% |
| Oil | ICE Crude Oil CR | USD | -5.9% | -1.5% |
| Gold | Gold Spot | USD | -4.7% | -20.7% |
| Hedge funds | HFRX Global Hedge Fund | USD | 1.0% | 4.3% |
| **Interest rates** | | | **Current rate** | **Change at meeting** |
| United States | 18 September 2013 | USD | 0.25% | - |
| United Kingdom | 5 September 2013 | GBP | 0.50% | - |
| Eurozone | 5 September 2013 | EUR | 0.50% | - |
| Japan | 5 September 2013 | JPY | 0.10% | - |
| Australia | 3 September 2013 | AUD | 2.50% | - |
| South Africa | 19 September 2013 | ZAR | 5.00% | - |

[e] Estimate

# 3. Asset allocation dashboard

| | | |
|---|---|---|
| Positive | Neutral | Negative |

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

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