

Viewpoint

Monthly market update

July 2015



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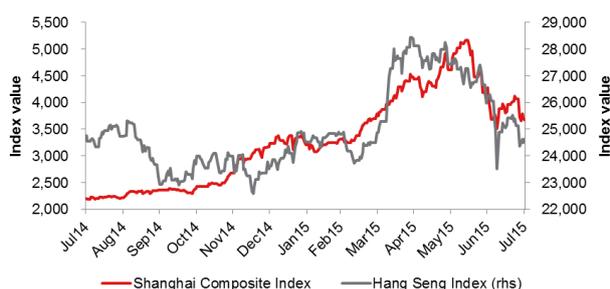
1. Market commentary

For the first time this year, the Greek crisis slipped out of the headlines in July, but not before the Syriza government had made major concessions to its European Union and International Monetary Fund creditors, and accepted extremely tough terms to allow negotiations on a third bailout to begin. The outcome removes an immediate risk of the euro project going into reverse, and provided a fillip to European equity and bond markets, but clear risks remain. The politics are still unpredictable, and the implementation of a bailout plan will likely be drawn-out and difficult.

With Greece out of the spotlight, investors focused on events in China, where the economy appears to be slowing more rapidly than the authorities would like. Although the official GDP numbers showed growth at the targeted 7% in the second quarter of this year, most indicators point to much slower growth, perhaps in the order of 4-5%. Beyond dispute is the fact that capital spending – for so long the great driver of the Chinese economy – is waning. The governing Communist Party is looking to move away from years of over-spending and inefficient investment and is turning to the consumer and service sectors to drive growth. In turn, the economy is becoming less dependent on commodities, with the effect of this abundantly clear in July, as virtually all commodity markets saw an acceleration of recent declines in price.

Exacerbating the situation has been the boom and bust in the Chinese stock market, which had doubled in 12 months, but has recently seen a sharp correction. After a brief rally in the first half of July, triggered by extraordinary intervention by the Chinese authorities, market forces took over again towards the end of the month and Chinese stocks continued their decline.

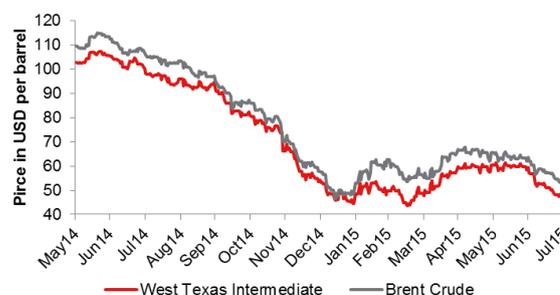
Figure 1: China and Hong Kong equities



While few foreign investors have direct exposure to China's domestic stock market, there have been knock-on effects in Hong Kong and in Chinese stocks listed in New York and elsewhere. Events in China are also at risk of hitting those companies in developed markets with significant exposure to the Chinese market. There have been a series of warnings from car producers, suppliers of capital goods, luxury goods and other consumer products that the Chinese boom has slowed, with potentially damaging consequences for revenues and profits.

Commodity prices have also been affected, with the most notable and important move being the renewed decline in price of oil. After a period of recovery following the collapse from \$115 per barrel last year, the oil price entered a renewed sell-off, with Brent crude once again falling below \$50 per barrel (as it had done in January). With the global and Chinese economy sluggish, as well as US shale oil production remaining at high levels and Saudi Arabia pumping well over 10 million barrels a day, the market remains in oversupply by circa 2 million barrels a day.

Figure 2: Oil price tumbles back to January levels



On top of this, there is now the prospect of Iran rapidly increasing its production as soon as sanctions end – now expected by late November – following the signing of a nuclear agreement with the West. There are indications that Iran will have no difficulty increasing output rapidly; the energy minister announced that the country will be able to ramp up production by 1 million barrels per day within one month of sanctions ending.

In light of all this, major oil companies are now planning for a long period of low oil prices and have slashed capital spending by a staggering \$200 billion as well as cutting a large number of jobs. These cuts

will ultimately curtail production and global growth will eventually absorb the excess supply, but the cycle still has some way to run. In the meantime, the further drop in the oil price is unambiguously good news for consumers and will help to support growth in the year ahead.

The other big issue for investors is the timing of the US Federal Reserve's (Fed's) first increase in interest rates since the global financial crisis. With GDP growth for the second quarter of 2015 printing 2.3% and wage inflation at 1.8%, there are no immediate

pressures. Moreover, the turn of events in the global economy, with growth evidently slowing, will give the Fed further reason for caution. Market expectations are for a first rise in December, but with a September rise still possible. The key issue, however, is not the timing of the first interest rate rise, but the extent to which the Fed ultimately tightens policy, and in this respect a dovish approach is to be expected: the mantra "lower for longer" remains.

Source: Bloomberg. Returns in US dollars unless otherwise stated. July 2015.

2. Market performance

Asset class/region	Index	To 31 July 2015		
		Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	2.1%	3.0%
United Kingdom	MSCI UK NR	GBP	2.5%	3.7%
Continental Europe	MSCI Europe ex UK NR	EUR	4.6%	18.9%
Japan	Topix TR	JPY	1.8%	19.1%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-5.0%	-1.8%
Global	MSCI World NR	USD	1.8%	4.5%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-4.4%	1.6%
Emerging Asia	MSCI EM Asia NR	USD	-7.2%	-2.5%
Emerging Latin America	MSCI EM Latin America NR	USD	-8.4%	-14.2%
BRICs	MSCI BRIC NR	USD	-8.4%	-0.8%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-6.9%	-4.2%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.0%	0.8%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.3%	0.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.7%	-0.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-0.6%	1.9%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	1.7%	0.9%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.5%	0.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.3%	1.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.2%	-0.4%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	1.3%	2.6%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.3%	-0.5%
Australian Government	JP Morgan Australia GBI TR	AUD	1.6%	1.8%
Global Government Bonds	JP Morgan Global GBI	USD	0.6%	-2.8%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.5%	-3.0%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-0.3%	1.2%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	0.6%	1.6%

Source: Bloomberg. e denotes estimate

		To 31 July 2015		
Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	5.6%	-1.5%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	5.7%	10.1%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.1%	7.9%
Global Property Securities	S&P Global Property USD TR	USD	2.0%	1.2%
Currencies				
Euro		USD	-1.5%	-9.2%
UK Pound Sterling		USD	-0.6%	0.3%
Japanese Yen		USD	-1.1%	-3.4%
Australian Dollar		USD	-5.2%	-10.6%
South African Rand		USD	-4.0%	-8.7%
Commodities & Alternatives				
Commodities	RICI TR	USD	-11.6%	-12.3%
Agricultural Commodities	RICI Agriculture TR	USD	-9.5%	-10.3%
Oil	Brent Crude	USD	-17.9%	-8.9%
Gold	Gold Spot	USD	-6.5%	-7.5%
Hedge funds	HFRX Global Hedge Fund	USD	0.0%	1.3%
Interest rate		Current rate		
United States			0.25%	
United Kingdom			0.50%	
Eurozone			0.05%	
Japan			0.10%	
Australia			2.00%	
South Africa			6.00%	

Source: Bloomberg. e denotes 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		



For more information, please contact:

Russell Andrews

Head of Distribution Services

E: Russell.andrews@momentum.co.uk

T: +44 (0)207 618 1803



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