momentum

Viewpoint

Monthly market update

June 2015

global investment management

Contents

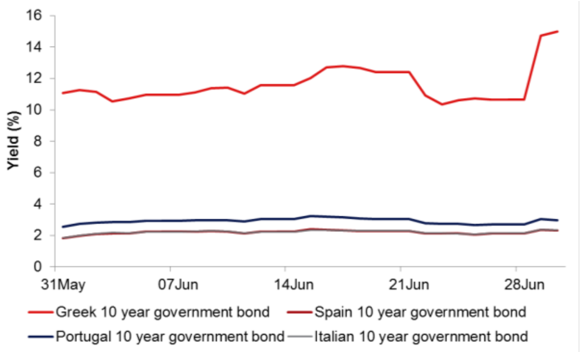
1. Market commentary

Market volatility has increased in recent weeks as a result of fears over a 'Grexit' from the Eurozone, sharp declines in Chinese equities and uncertainty around the first rise in interest rates in the US. Equity markets, especially in Europe and the UK, have weakened, and bond markets (with the exception of 'safe-haven' assets such as German bunds which rallied towards the end of the month) have also sold-off.

We view these moves as a healthy correction rather than something more sinister. The supportive monetary environment will ensure continuing high levels of liquidity in global markets, and while there are clear risks, none of these appear to be potentially damaging enough to result in a renewed global bear market.

Greece grabbed the headlines in June, as the governing Syriza party continues to surprise markets with its extraordinary negotiating tactics, announcing a referendum on the latest terms being offered by the country's creditors. Greek voters returned a 'No' vote, strengthening Syriza's position domestically but also prompting a hardening of the position of Greece's European partners.

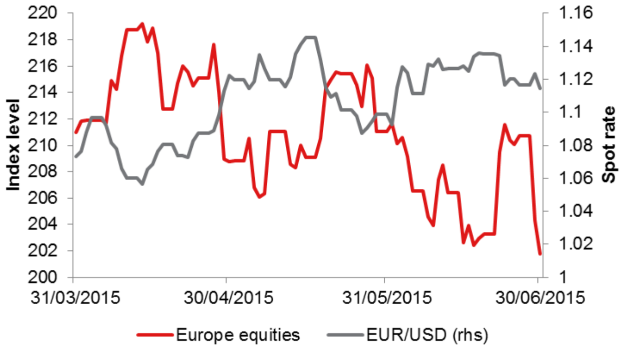
Figure 1: Peripheral bond yields vs Greek bond yields



Although the impact on the rest of the continent is a real risk, Europe is in a much better position today that it was in during the heights of the euro crisis three years ago. Most banks outside Greece have reduced their exposure to Greek debt to minimal levels, and there is now less risk of contagion if Greece were to default. Moreover, it looks increasingly likely that a deal will be reached between the indebted nation and its creditors.

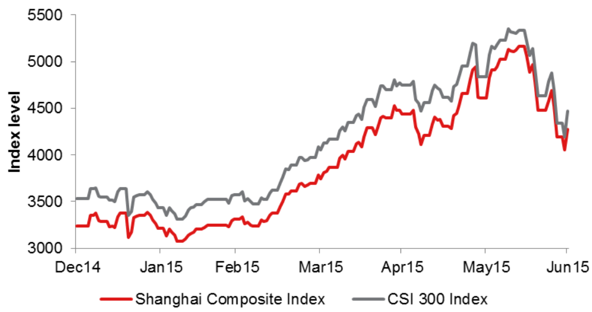
Notably, the euro has remained remarkably stable, and government bond yields across the euro area have only been affected moderately. Peripheral European markets have sold off, but not substantially. The relative calmness of these markets has no doubt encouraged other euro member state partners to maintain a robust line in their negotiations.

Figure 2: European equities and the euro



The other big news story this month was the sharp falls in Chinese equity markets. Since the market peak in mid-June, shares listed on the Shanghai Composite index have fallen by circa 17% to the end of June, prompting fresh intervention by China's authorities. Having been driven higher by an extraordinary surge in retail buying, much of it on margin and leveraged, there has now been a panic sell-off. A sharp correction was bound to happen sooner or later, given that over the previous twelve months the market had risen by circa 150% and seen returns of circa 60% so far this year. Valuations in China were reaching truly unsustainable levels and were reminiscent of the US technology boom of 2000.

Figure 3: Chinese equity returns year-to-date



As with Greece, the key question for investors will be whether there are wider ramifications following these moves in Chinese stock prices. Since the bubble was created predominantly by domestic investors and most international investors have little or no exposure directly to China, we do not foresee a significant immediate impact.

Arguably, despite the Greek crisis and China's equity market collapse, the most important factor for investors remains the Federal Reserve's upcoming decision on interest rates and the evolution of its monetary policy. Data from the US suggests that growth has picked up from the first quarter weather-related drop: the labour market has continued to improve, the housing market remains in good shape and most forward indicators point to sustainable growth of 2-2.5%. Against this backdrop the Fed has painted a more upbeat assessment of the economy, but has reaffirmed that any tightening will be gradual and data dependent, with no mechanical formula.

The markets are focussed on the timing of the first interest rate rise but whether this takes place in September, December or even early next year is less relevant than the extent to which the Fed ultimately tightens policy. The key risk for markets will be if the economy picks up more sharply and inflation becomes a threat, but at this stage, against an uncertain global economic backdrop and debt levels at historically very high levels, we believe that interest rates in the US will remain well below previous cyclical peaks for many years ahead.

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

2. Market performance

Asset class/region	Index	Currency	Month	Year to date
		To 30 June 2015		
Developed markets equities				
United States	S&P 500 NR	USD	-2.0%	0.9%
United Kingdom	MSCI UK NR	GBP	-6.4%	1.1%
Continental Europe	MSCI Europe ex UK NR	EUR	-4.4%	13.7%
Japan	Topix TR	JPY	-2.4%	17.0%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-3.9%	3.4%
Global	MSCI World NR	USD	-2.3%	2.6%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-2.5%	6.3%
Emerging Asia	MSCI EM Asia NR	USD	-4.0%	5.1%
Emerging Latin America	MSCI EM Latin America NR	USD	1.0%	-6.4%
BRICs	MSCI BRIC NR	USD	-2.9%	8.3%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-2.6%	2.9%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-1.0%	-0.1%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-1.1%	0.1%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-1.8%	-0.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-1.5%	2.5%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-1.9%	-0.8%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-2.5%	-0.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-2.6%	-1.3%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-2.0%	-1.6%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	-1.9%	1.3%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.0%	-0.8%
Australian Government	JP Morgan Australia GBI TR	AUD	-1.3%	0.3%
Global Government Bonds	JP Morgan Global GBI	USD	-0.3%	-3.4%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-0.5%	-3.4%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-1.6%	1.5%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-1.9%	1.0%

Source: Bloomberg. e denotes estimate

		To 30 June 2015		
Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	-4.7%	-6.7%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-5.6%	4.2%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.6%	10.3%
Global Property Securities	S&P Global Property USD TR	USD	-3.9%	-0.8%
Currencies				
Euro		USD	1.5%	-7.9%
UK Pound Sterling		USD	2.8%	0.9%
Japanese Yen		USD	1.3%	-2.3%
Australian Dollar		USD	0.8%	-5.7%
South African Rand		USD	-0.1%	-4.9%
Commodities & Alternatives				
Commodities	RICI TR	USD	1.7%	-0.9%
Agricultural Commodities	RICI Agriculture TR	USD	10.5%	-0.9%
Oil	Brent Crude	USD	-3.0%	10.9%
Gold	Gold Spot	USD	-1.5%	-1.0%
Hedge funds	HFRX Global Hedge Fund	USD	-1.2%	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		5.75%		

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	🟡

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