momentum

Viewpoint

Monthly market update

October 2015

global investment management

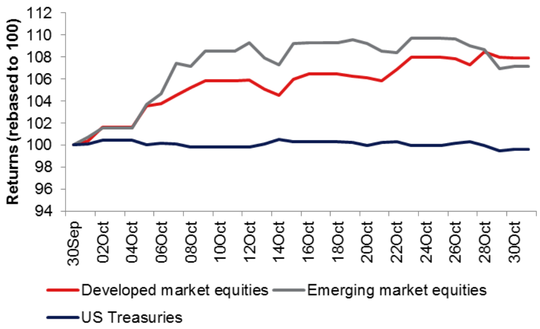
Contents

1. Market commentary

Following the steep falls in markets in August and September, there was a sharp recovery in October, with global equity markets up by 7.9% and the riskier parts of the fixed income markets including high yield bonds, emerging market debt and convertible bonds all up by 3-4%. In contrast, yields on safe-haven government bonds in the US and UK edged up, resulting in negative returns from this asset class over the month.

With investors taking advantage of better valuations, as well as the European Central Bank (ECB) clearly indicating that it is prepared to loosen policy even further at its December meeting, risk assets had their best month since October 2011. Even commodities which had been at the epicentre of recent declines managed a modest, albeit unconvincing, recovery in October.

Figure 1: Risk assets rally in October

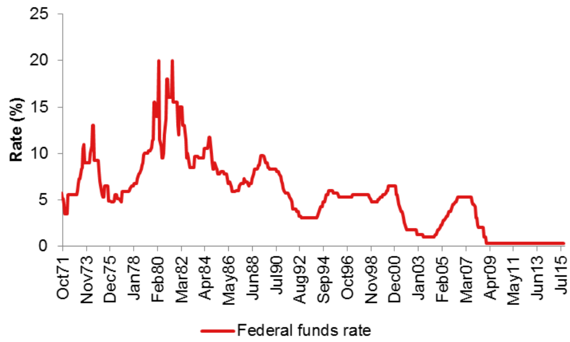


China's third quarter growth registered 6.9%, a touch below the administration's target of 7.0%, and within a few days of the announcement, the People's Bank of China used it as a signal to loosen policy further, with its sixth interest rate cut in the past year. At the same time it eased banks' reserve requirements, which in turn should inject additional liquidity into the economy.

In Europe the ECB, although it kept policy on hold at its October meeting, surprised investors with a dovish statement from President Mario Draghi. Mr Draghi gave a clear signal that if data on the economy and inflation remain subdued, further loosening at the December meeting is likely. This could include a further cut in the policy rate (which is already negative) and an extension of the central bank's Quantitative Easing programme, both in terms of duration and range of assets purchased. Asset prices across the euro area responded enthusiastically, pushing bond yields still lower. German government bonds now offer negative yields out to six years.

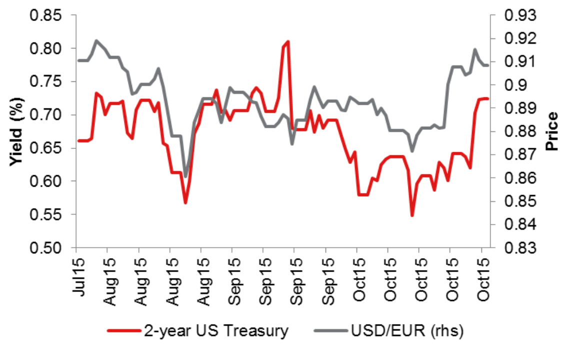
Despite Mr Draghi's statement, all eyes remain on the Federal Reserve (Fed) in the US. Against a backdrop of mixed signals from the economy and core inflation remaining well below the Fed's target of 2%, the Fed kept policy on hold in October, as widely expected. Expectations for a rate rise this year have diminished considerably over the course of the past 12 months, but Fed Chair Janet Yellen was unexpectedly hawkish in her post meeting statement, raising the probability a rate hike in December.

Figure 2: Federal funds rate remains at historic lows



If data releases remain broadly positive, the Fed is expected to continue preparing markets for the first rate rise in almost 10 years. So far markets have remained largely unmoved by the Fed's more hawkish tone and the impact of such a rise, expecting the process of normalisation to be very gradual. The only assets to have been notably impacted by the more immediate prospect of policy tightening have been gold, trading back down towards the $1,100 level; US Treasuries, where yields have risen, especially at the shorter end of the curve; and the dollar, which has continued to firm, notably against the euro.

Figure 3: Short-end Treasury yields and the dollar spike



While the timing of the Fed’s first rate rise is a concern for markets currently, we have always argued that it is the extent of the tightening in this cycle, and not the timing of the first move, that will be critical for markets over the next few years. On that score, we firmly believe that rates will move up only very gradually and will peak at levels well below those reached in previous cycles. As we know from the Fed’s statements, policy decisions will be data dependent, and given the fragility of the global economy, the continuing debt overhang, the sharp slowdown in growth in developing countries and the powerful deflationary forces across the world, there is no question that the US central bank will be extremely cautious.

Having bounced sharply from the big sell-off in August and September, markets might well pause for a time, with the prospect of some nervousness likely as the Fed’s December 16 decision approaches. Ahead of that, we will probably see the dollar remaining firm, bond yields edging higher and markets generally reacting to every piece of data that might give guidance to the Fed’s decision. But putting aside this short term ‘noise’ we believe that markets are set to make modest upward progress next year, following a period of sideways trading and bouts of heightened volatility since the middle of 2014.

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

2. Market performance

		To 30 October 2015		
Asset class/region	Index	Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	8.4%	2.2%
United Kingdom	MSCI UK NR	GBP	5.2%	-0.6%
Continental Europe	MSCI Europe ex UK NR	EUR	8.2%	12.9%
Japan	Topix TR	JPY	10.4%	12.7%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	7.5%	-7.3%
Global	MSCI World NR	USD	7.9%	1.4%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	5.6%	-5.0%
Emerging Asia	MSCI EM Asia NR	USD	7.8%	-6.0%
Emerging Latin America	MSCI EM Latin America NR	USD	6.1%	-24.8%
BRICs	MSCI BRIC NR	USD	6.7%	-8.9%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	7.1%	-9.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.4%	1.4%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.3%	-0.8%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.4%	0.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	2.7%	0.2%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-1.4%	1.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-0.2%	0.1%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.1%	2.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.4%	-0.4%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	2.8%	2.4%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.4%	0.5%
Australian Government	JP Morgan Australia GBI TR	AUD	0.2%	3.3%
Global Government Bonds	JP Morgan Global GBI	USD	-0.1%	-1.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.1%	-2.1%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	3.4%	1.2%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	3.5%	3.5%

Source: Bloomberg. e denotes estimate

		To 30 October 2015		
Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	5.7%	0.4%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	5.0%	9.5%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	6.0%	4.2%
Global Property Securities	S&P Global Property USD TR	USD	5.9%	1.1%
Currencies				
Euro		USD	-1.5%	-9.0%
UK Pound Sterling		USD	2.0%	-1.0%
Japanese Yen		USD	-0.6%	-0.8%
Australian Dollar		USD	1.7%	-12.6%
South African Rand		USD	0.3%	-16.2%
Commodities & Alternatives				
Commodities	RICI TR	USD	0.8%	-16.1%
Agricultural Commodities	RICI Agriculture TR	USD	2.1%	-11.1%
Oil	Brent Crude	USD	2.5%	-13.6%
Gold	Gold Spot	USD	2.4%	-3.6%
Hedge funds	HFRX Global Hedge Fund	USD	1.5%	-1.6%
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	Neutral
UK equities (relative to developed)	Positive
European equities (relative to developed)	Neutral
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Neutral
Emerging market equities	Neutral
Fixed Income	
Government	Neutral
Index-linked (relative to government)	Neutral
Investment grade (relative to government)	Neutral
High yield	Positive
Loans	Positive
Emerging market debt	Positive
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Neutral
Yen	Neutral

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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