momentum

Viewpoint

Monthly market update

September 2014

global investment management

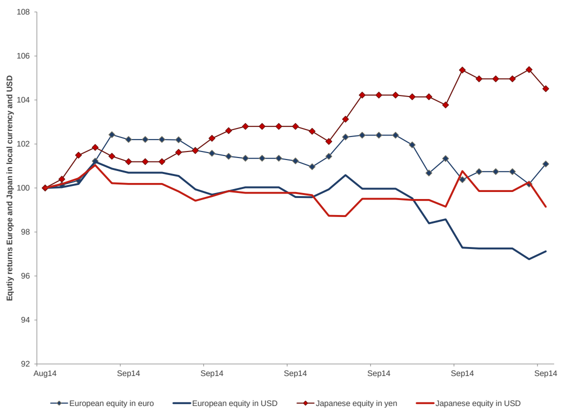
Contents

1. Market commentary

As we move into the final quarter of the year, several interrelated themes are playing out in markets. First, slowing global growth; second, divergent performance among economies, especially between the US and other developed markets; third, divergent expectations for central bank behaviour and fourth, sizeable shifts in relative pricing with a strong US dollar and weak commodity prices. All four of these themes have far reaching implications for asset prices, and are – in our opinion – of greater importance to asset allocation than current events in the Middle East and Ukraine.

Evidence of slowing growth and a continuing surge in the US dollar were key factors weighing on markets in September. Developed equity markets declined by 2.7% in US dollar terms and have returned 3.9% year to date, while emerging markets (EM) fell by 7.4% to take their year to date returns to 2.4%. Within EM, Brazilian equities slumped by circa 12% in local currency terms and by 20% in US dollar terms, as the general downdraft affecting markets was amplified by fears that this month's presidential elections will return the incumbent as opposed to a more market and investor-friendly opposition candidate. Continental Europe returned 1.1% in euro terms and Japan returned 4.5% in yen terms, but the strength of the greenback wiped out these returns when converted into US dollars. The euro depreciated by 3.8% against the US dollar while the yen fell by 5.0% over the month. US stocks were down by 1.4% and UK equities lost 2.9% in sterling terms (with the pound also falling by 2.3%).

Figure 1: Equity returns Europe and Japan in local currency and USD



The US economy remains on track for reasonable growth this year and next, and although there has been some recent evidence of a slowdown – for example, in construction and manufacturing spend – the data still points to a stable increase in output. This means that the Federal Reserve (Fed) can be expected to end its asset purchasing programme in October as planned. The Fed is also starting to be more aggressive on its guidance regarding the pace of interest rate increases once they start, increasing its forecast rates for 2015 and 2016 by 0.25% and introducing a new target of 3.75% by 2017. This led to falls in US Treasuries, which returned -0.6% over the month.

In contrast, the European Central Bank (ECB) moved to a more aggressive easing programme in the face of weakening growth and falling inflation across the continent. The ECB cut 0.10% off its main refinancing rate, taking it to -0.20%, and announced a EUR 1trillion target increase in the size of its balance sheet, which would take it back to early 2012 levels of EUR 3 trillion. It will start a 'private' quantitative easing (QE) programme in October, lasting at least 2 years and buying at least EUR 400 billion of asset backed securities (ABS) and covered bonds. Mario Draghi, President of the ECB, noted that the bank stands "ready to adjust the size and composition" of its asset purchases if necessary, hinting at the possibility of government bond purchases. Euro government bonds rose as a result and remain the outstanding asset class year to date in 2014.

Figure 2: Balance sheet change at developed market central banks

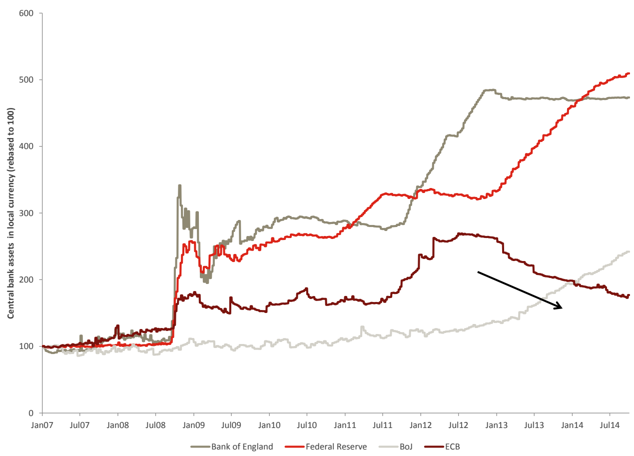
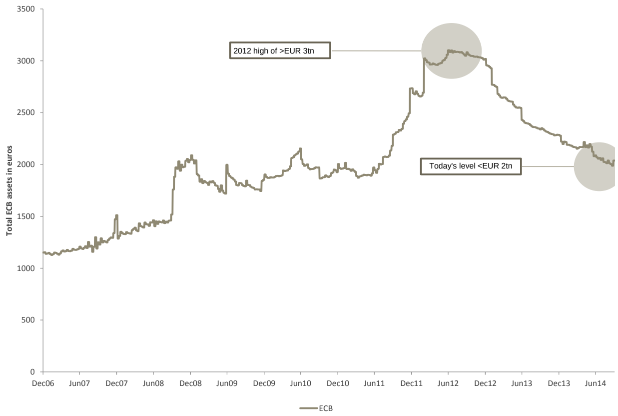


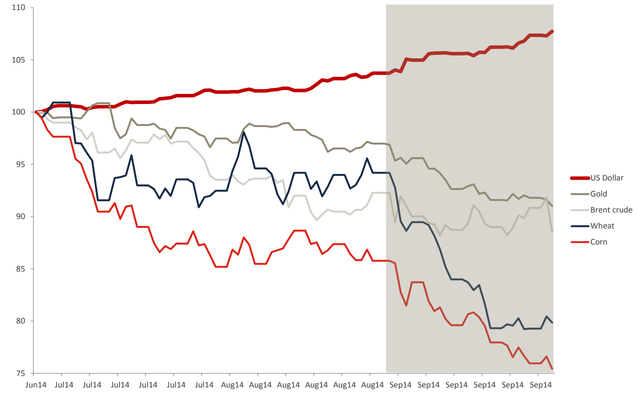
Figure 3: Total assets in euros at the European Central Bank



The prospect of rising short-term rates and weaker global growth is also having an impact on credit markets. Investment grade bonds returned -1.4%, and high yield bonds were down by 2.1% in the US and 5.0% in Europe. There have been substantial flows out of high yield bond funds over the past month, and investors appear to be re-pricing default risk back towards more normal levels.

As the dollar continued its strong run and global growth softened, most other commodity markets came under pressure too. Precious metals were weak, with gold falling by 6.1%, while soft commodity prices fell sharply as record harvests put pressure on prices. Perhaps most importantly the oil price continued to fall, down by 5.8%, to bring its cumulative decline over the past four months to approximately 13%. These falls will keep inflation, which is already falling, at very subdued levels, and importantly give central banks greater room for manoeuvre going forward.

Figure 4: US dollar strength vs. commodity weakness



Markets are correcting as they adjust to reduced growth expectations, an increasingly difficult environment for earnings growth and the challenge of the first increase in US interest rates since June 2006. This weakness is likely to continue in the short term. However, markets will be supported by investors' search for yield and the prospect of very loose monetary policy for a long time ahead. While valuations of some markets are a cause for some concern, equities in our view are still reasonably supported by the fundamentals.

Source: Bloomberg. Returns in US dollars unless otherwise stated. September 2014.

2. Market performance

		To 30 September 2014		
Asset class/region	Index	Currency	Month	Year to date
Equities				
UK - All Cap	MSCI UK NR	GBP	-2.9%	0.9%
UK - Large Cap	MSCI UK LARGE CAP NR	GBP	-2.8%	1.1%
UK - Mid Cap	MSCI UK MID CAP NR	GBP	-3.5%	-2.4%
UK - Small Cap	MSCI SMALL CAP NR	GBP	-3.6%	-4.6%
United States	S&P 500 NR	USD	-1.4%	7.8%
Continental Europe	MSCI Europe ex UK NR	EUR	1.1%	6.6%
Japan	Topix TR	JPY	4.5%	3.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-7.2%	3.6%
Global developed markets	MSCI World NR	GBP	-0.5%	6.1%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	-5.3%	4.6%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	-0.6%	7.5%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	0.0%	1.2%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	-0.3%	6.5%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	-1.4%	13.4%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-0.9%	9.7%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	-1.1%	5.6%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	-0.9%	13.7%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-0.5%	7.7%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.6%	3.7%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-1.4%	5.6%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-2.1%	3.5%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.1%	10.1%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.2%	6.7%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-5.0%	-4.1%
Global Government Bonds	JP Morgan Global GBI	GBP	-0.8%	3.8%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	GBP	-0.5%	3.8%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	-1.6%	1.5%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	-0.4%	9.5%

Source: Bloomberg.

Asset class/region	Index	Currency	Month	Year to date
		To 30 September 2014		
Property				
UK Direct Property	UK IPD All Property TR	GBP	0.0% e	12.4% e
Global Property Securities	S&P Global Property USD TR	GBP	-4.1%	9.0%
Currencies				
Euro		GBP	-1.5%	-6.2%
US Dollar		GBP	2.4%	2.1%
Japanese Yen		GBP	-2.8%	-1.9%
Commodities & Alternatives				
Commodities	RICI TR	GBP	-4.5%	-5.3%
Agricultural Commodities	RICI Agriculture TR	GBP	-5.4%	-10.4%
Oil	ICE Crude Oil CR	GBP	-3.7%	-11.7%
Gold	Gold Spot	GBP	-4.1%	2.4%
Interest rates			**Current rate**	**Change at meeting**
United Kingdom	4 September 2014	GBP	0.50%	-
United States	17 September 2014	USD	0.25%	-
Eurozone	4 September 2014	EUR	0.05%	-
Japan	4 September 2014	JPY	0.10%	-

Source: Bloomberg.

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
Client Relations Manager
E: Russell.andrews@momentumgim.com
T: +44 (0)207 618 1803

Important notes

This document is only intended for use by the original recipient, either a Momentum GIM client or prospective client, and does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient. The original recipient is solely responsible for any actions in further distributing this document, and in doing so should be satisfied that there is no breach of local legislation or regulation. This document should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this document is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, Momentum GIM does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at The Rex Building, 62 Queen Street, London EC4R 1EB.

Momentum Global Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom, and is an authorised Financial Services Provider pursuant to the Financial Advisory and Intermediary Services Act 37 of 2002 in South Africa.