

# VIEWPOINT

## Newsflash

A new month and the 120<sup>th</sup> issue of Viewpoint from Imperium Capital.

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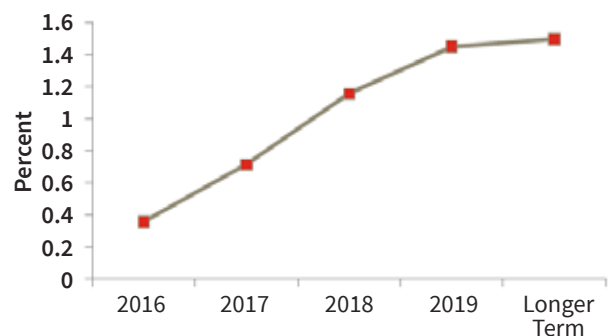
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## Market Commentary

The modest returns seen in the majority of markets over the month masked some sharp moves over the same period. In most cases these were triggered once again by central bank policy decisions, as well as moves by OPEC and Russia to curb oil production. Markets initially sold off quite sharply, disappointed that the European Central Bank (ECB) failed to loosen policy further, while also becoming increasingly worried that – in the face of broadly positive economic data from the US – the Federal Reserve (Fed) would raise rates at its September meeting.

In the event, the Fed not only kept rates on hold but was more dovish than expected on their future course, motivating markets to recover lost ground and end the month largely unchanged. Based on the median forecasts of Federal Open Market Committee members, the Fed is now expecting to raise rates only once this year, and has lowered its median expectations for rate rises in both 2017 and 2018 by 0.5%, leaving the median 2017 and 2018 forecasts at 1.1% and 1.9%, respectively. However, a series of strong economic data releases together with a rising chorus of hawkish comments from Fed governors have increased the probability of a December hike to around 60%. Bond markets as well as interest rate sensitive equities such as utilities and REITS have been trending weaker on the news.

Figure 1: The average of Fed members predicted future base rate

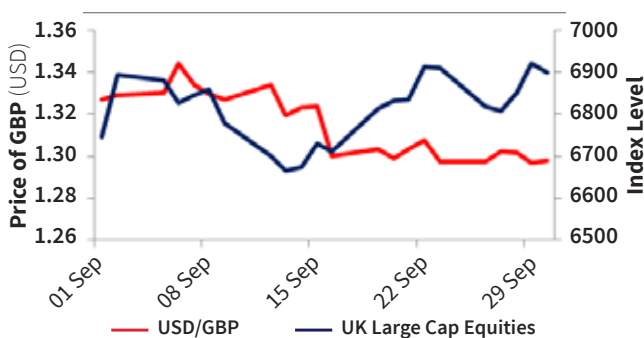


The other much anticipated central bank announcement came from the Bank of Japan's (BoJ's) policy meeting and review. It is now aiming to over-shoot its 2% inflation target while sticking to its quantitative easing annual target of buying JPY 80tn of Japanese Government Bonds (JGBs) until this inflation target is met. A further surprise was its announcement to focus on yield-curve control rather than a defined expansion in the monetary base. The BoJ will now target a specific yield on ten-year JGBs, initially set at zero. Although the yen and JGBs were little moved on the announcement this was undoubtedly a significant shift in policy and highlights the growing concern among central banks, financial institutions and investors that monetary policy is losing its effectiveness.

The other significant development during the month was OPEC's preliminary agreement to curb oil production. Plans are to cut to 32.5 million barrels per day, lowering 2017 expected production by circa one million barrels per day. Precise country level production quotas will be decided at the end of November, but there remain doubts around the ability to implement the cuts. The oil price responded with a rise of over 10% from its mid-month lows and is now back above USD 50 per barrel for Brent crude. The oil price is now likely to be in a fairly narrow trading range, supported by slowly rising global demand and OPEC output management and capped by the likelihood of rising shale production at prices above USD 50.

In Europe the problems of the banking system came back to haunt markets as the shares of Deutsche Bank came under severe pressure on concerns that the bank will need a large capital raising. The problems for banks in the Eurozone are several: weak profitability as a result of negative rates; large non-performing loans which have yet to be fully recognised; regulatory problems and massive fines from pre-crisis legacy problems. Further capital raising and equity dilution appears inevitable, and although Deutsche is too important systemically to be allowed to fail, the fact that EU banks remain weak eight years after the crisis is clearly unhealthy for the economy and a constraint on growth.

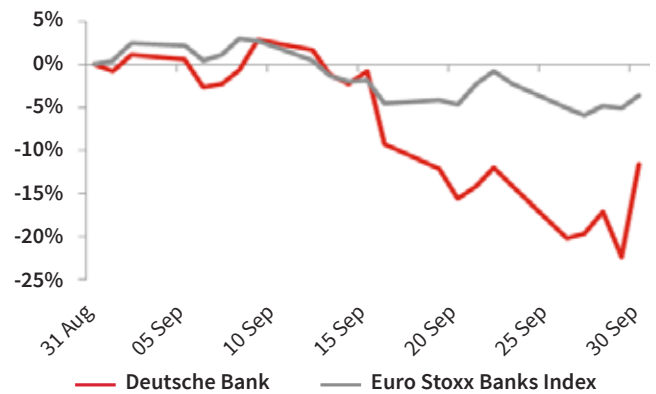
Figure 2: Deutsche Bank's toils weigh on European Banks



The UK economy continued to surprise on the upside with a series of strong data and growth forecast upgrades. However,

Prime Minister Theresa May's announcement that Article 50 will be invoked by the end of March 2017, together with a clear signal that the government will prioritise restrictions on immigration over access to the single market, as well as cautious comments from the Chancellor of Exchequer on the future of economy in the short-term, triggered a renewed slide in sterling to a thirty-one year low against the US dollar. Although this benefits the export sector there are concerns that inflation will begin to rise as higher imported prices feed through. Sterling meanwhile is likely to remain out of favour given the high level of uncertainty regarding the terms of Brexit, and is getting to levels which are reaching good value.

Figure 3: UK equities have benefitted somewhat from sterling's weakness



Most markets have performed well so far this year, with yields on bonds falling sharply and bond markets delivering strong returns (especially in credit, high yield and emerging markets) while equity markets have produced sharp gains since the big sell-off in January and early February. This has taken valuations to high levels across most asset classes, and to extreme levels of over-valuation in safe haven government bonds. Ultra-loose monetary policy has been a driving force for these returns as investors seek yield in a very low return environment. The Fed is keen to continue the process of policy normalisation that it started last year. As economic data improves and inflation begins to pick up, the likelihood is that there will be a rate rise in December. The US Presidential election introduces a level of uncertainty before any potential hike, however; Hillary Clinton would represent continuity and is the market's preferred choice, while Trump is an unknown and unpredictable, with the risk of causing market disruption in the short term. Meanwhile the effectiveness of ultra-loose monetary policy is increasingly being called into question and being seen as a risk. This is putting financial institutions under increasing strain and creating asset bubbles. The current cycle has further to run but the strong rise in markets in the past eight months has taken valuations to levels which are vulnerable to a setback. Investors should remain invested as we believe the global economy will continue to grow modestly without triggering a sharp increase in inflation while central banks will keep policy loose for a long time to come, but short term caution is warranted.

## Market Performance

| Asset Class/Region                  | Index  | To 30 September 2016 |         |              |
|-------------------------------------|--|----------------------|---------|--------------|
|                                     |  | Currency             | 1 Month | Year to date |
| <b>Developed markets equities</b>   |  |                      |         |              |
| United States                       | S&P 500 NR   | USD                  | 0.0%    | 7.3%         |
| United Kingdom                      | MSCI UK NR   | GBP                  | 1.8%    | 14.4%        |
| Continental Europe                  | MSCI Europe ex UK NR                                 | EUR                  | -0.1%   | -3.7%        |
| Japan                               | Topix TR   | JPY                  | 0.3%    | -12.7%e      |
| Asia Pacific (ex Japan)             | MSCI AC Asia Pacific ex Japan NR                     | USD                  | 1.8%    | 12.3%        |
| Global                              | MSCI World NR  | USD                  | 0.5%    | 5.6%         |
| <b>Emerging Market Equities</b>     |  |                      |         |              |
| Emerging Europe                     | MSCI EM Europe NR                                    | USD                  | 1.4%    | 14.7%        |
| Emerging Asia                       | MSCI EM Asia NR                                      | USD                  | 1.3%    | 13.0%        |
| Emerging Latin America              | MSCI EM Latin America NR                             | USD                  | -0.8%   | 32.2%        |
| BRICs                               | MSCI BRIC NR   | USD                  | 1.6%    | 16.5%        |
| Global Emerging Markets             | MSCI EM (Emerging Markets) NR                        | USD                  | 1.3%    | 16.0%        |
| <b>Bonds</b>                        |  |                      |         |              |
| US Treasuries                       | JP Morgan United States Government Bond Index TR     | USD                  | -0.1%   | 5.4%         |
| US Treasuries (inflation protected) | Barclays Capital U.S. Government Inflation Linked TR | USD                  | 0.5%    | 7.7%         |
| US Corporate (investment grade)     | Barclays Capital U.S. Corporate Investment Grade TR  | USD                  | -0.2%   | 9.2%         |
| US High Yield                       | Barclays Capital U.S. High Yield 2% Issuer Cap TR    | USD                  | 0.7%    | 15.1%        |
| UK Gilts                            | JP Morgan United Kingdom Government Bond Index TR    | GBP                  | -2.5%   | 14.7%        |
| UK Corporate (investment grade)     | BofA Merrill Lynch Sterling Non Gilts TR             | GBP                  | -1.2%   | 13.7%        |
| Euro Government Bonds               | Citigroup EMU GBI TR                                 | EUR                  | 0.2%    | 6.4%         |
| Euro Corporate (investment grade)   | Barclays Capital Euro Aggregate Corporate TR         | EUR                  | -0.1%   | 6.0%         |
| Euro High Yield                     | BofA Merrill Lynch Euro High Yield Constrained TR    | EUR                  | -0.6%   | 7.0%         |
| Japanese Government                 | JP Morgan Japan Government Bond Index TR             | JPY                  | 0.0%    | 5.4%         |
| Australian Government               | JP Morgan Australia GBI TR                           | AUD                  | -0.4%   | 7.0%         |
| Global Government Bonds             | JP Morgan Global GBI                                 | USD                  | 0.5%    | 10.8%        |
| Global Bonds                        | Citigroup World Broad Investment Grade (WBIG) TR     | USD                  | 0.5%    | 9.2%         |
| Global Convertible Bonds            | UBS Global Focus Convertible Bond                    | USD                  | 0.8%    | 3.1%         |
| Emerging Market Bonds               | JP Morgan EMBI+ (Hard currency)                      | USD                  | 0.5%    | 15.8%        |

\* estimate

Source: Bloomberg

VP.IC.V.2.0

## Market Performance

| Asset Class/Region                           | Index                         | To 30 September 2016 |         |              |
|--|-------------------------------|----------------------|---------|--------------|
|  |                               | Currency             | 1 Month | Year to date |
| <b>Property</b>                              |                               |                      |         |              |
| US Property Securities                       | MSCI US REIT NR               | USD                  | -2.0%   | 10.8%        |
| Australian Property Securities               | S&P/ASX 200 A-REIT Index TR   | AUD                  | -4.4%   | 10.5%        |
| Asia Property Securities                     | S&P Asia Property 40 Index NR | USD                  | 2.6%    | 9.8%         |
| Global Property Securities                   | S&P Global Property USD TR    | USD                  | -0.6%   | 10.9%        |
| <b>Currencies</b>                            |                               |                      |         |              |
| Euro   |                               | USD                  | 0.7%    | 3.5%         |
| UK Pound Sterling                            |                               | USD                  | -1.2%   | -11.9%       |
| Japanese Yen                                 |                               | USD                  | 2.1%    | 18.7%        |
| Australian Dollar                            |                               | USD                  | 1.9%    | 5.1%         |
| South African Rand                           |                               | USD                  | 7.3%    | 12.7%        |
| <b>Commodities &amp; Alternatives</b>        |                               |                      |         |              |
| Commodities RICI TR                          |                               | USD                  | 4.0%    | 9.3%         |
| Agricultural Commodities RICI Agriculture TR |                               | USD                  | 2.8%    | -0.3%        |
| Oil Brent Crude Oil                          |                               | USD                  | 4.3%    | 31.6%        |
| Gold Gold Spot                               |                               | USD                  | 0.5%    | 24.0%        |
| Hedge funds HFRX Global Hedge Fund           |                               | USD                  | 0.4%*   | 1.1%*        |
| <b>Interest rates</b>                        |                               |                      |         |              |
| United States                                |                               |                      | 0.50%   |              |
| United Kingdom                               |                               |                      | 0.25%   |              |
| Eurozone                                     |                               |                      | 0.00%   |              |
| Japan  |                               |                      | -0.10%  |              |
| Australia                                    |                               |                      | 1.50%   |              |
| South Africa                                 |                               |                      | 7.00%   |              |

\* estimate

## Asset Allocation Dashboard

■ Positive
 ■ Neutral
 ■ Negative

| Asset class                               | View |
|---|------|
| <b>Equities</b>                           |      |
| 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                  | ●    |
| <b>Fixed Income</b>                       |      |
| Government                                | ●    |
| Index-linked (relative to government)     | ●    |
| Investment grade (relative to government) | ●    |
| High yield                                | ●    |
| Loans                                     | ●    |
| Emerging market debt                      | ●    |
| Convertible bonds                         | ●    |
| <b>Alternatives</b>                       |      |
| Commodities                               | ●    |
| Property (UK)                             | ●    |
| <b>Currencies</b>                         |      |
| GBP                                       | ●    |
| Euro                                      | ●    |
| Yen                                       | ●    |

## Important Notes

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