Newsflash

A new month and the 119th issue of Viewpoint from **Imperium Capital**.

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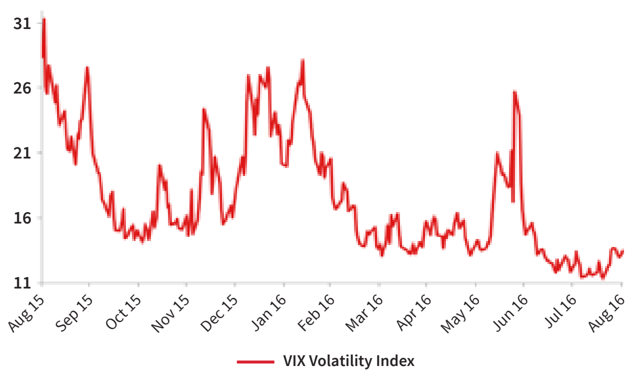
Market Commentary

August proved to be a particularly quiet month for markets, with low levels of volatility across equities and bonds, and little by way of significant news flow. Overall the 'risk on' environment of July, post the UK Brexit referendum, broadly continued in August: most equity markets rose modestly higher, with emerging markets leading the way and adding 2.5% in the month. Within developed markets the US inched 0.1% higher while Asia, Japan, the UK and Europe outperformed in local currency terms, returning 3.0%, 1.3%, 1.5% and 1.0% respectively. In dollar terms, returns were held back by the strength of the greenback, one of the more notable features of the month, which rose by 0.5% against a basket of major currencies. Within fixed income, most government markets produced negative returns whereas credit, especially high-yield bonds, and emerging market debt, performed well.

Figure 1: Strong summer for emerging markets

The most significant development was the change in expectations for US interest rate rises. Post Brexit the market had pushed out expectations for the next rate rise by the US Federal Reserve (Fed) to late 2017, but strong July payroll numbers and generally positive data flows from the labour market and economy, together with a series of more hawkish comments from Fed governors and Janet Yellen (saying at her annual Jackson Hole speech that "the rate hike case had strengthened in recent months") all led to a sharp change in the market's view. Over the month the yield on the two year US Treasury increased by 0.15 percentage points to 0.8% and most commentators now anticipate at least one, possibly two, rate rises before year end. The positive data flow and prospect of higher rates also impacted on equity markets, with financials and cyclicals outperforming more defensive stocks. Banks were particularly strong, continuing the recovery from the post Brexit sell-off globally. Over the month European bank shares rose by close to 10% and from the post Brexit lows, bank shares globally recovered by close to 25%.

Figure 2: Twelve month market volatility troughs in August

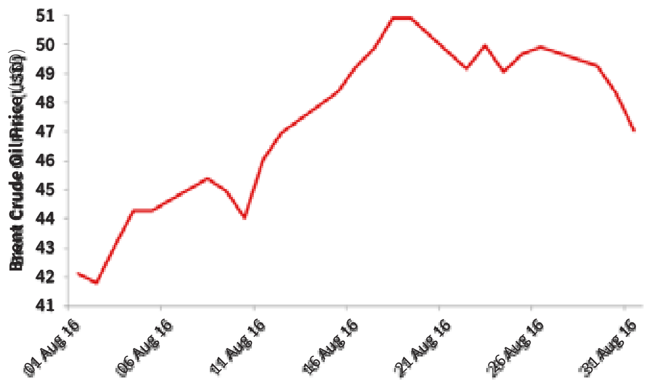


The recovery in UK markets following the immediate post Brexit declines continued through the month and sterling was broadly stable against currencies, other than the US dollar. UK economic data was also reassuring, showing resilient consumer spending and strong retail sales in July. The manufacturing Purchasing Managers' Index, which fell sharply in July as businesses worried about the period of uncertainty ahead, bounced back in August, posting the biggest monthly gain on record. The 11.7% fall in sterling, on a trade weighted basis since the referendum, is undoubtedly helping exporters and supporting confidence, as is the firm resolve of the government under new Prime Minister Theresa May.

In Japan, following the disappointment of last month's underwhelming Bank of Japan (BoJ) and fiscal stimulus packages, which resulted in an unwelcome rise in the yen to JPY 100 to the dollar, Haruhiko Kuroda, Governor of the BoJ, said that he would not hesitate to boost monetary stimulus if needed and that the BoJ has ample space for additional easing measures. The yen finally responded as wished and fell back, helping the equity market to a recovery.

The most volatile moves in markets over the month came in commodities. Gold, after a strong rise this year, fell back by 3.1% as the USD strengthened, and some industrial metals also came under pressure, as well as soft commodities. However the biggest moves came in oil, which initially rallied by over 20% from July lows, in part on the back of rumours of a deal among OPEC and some non-OPEC members to agree on a production curb or freeze at a meeting scheduled for the end of September. However, scepticism about the ability of OPEC to deliver on such a deal, together with increased stockpiles of crude oil in the US, dampened the enthusiasm and the brent crude oil price fell back to USD 47.04 per barrel, still leaving a rise of 10.8% on the month.

Figure 3: Oil prices surge, then falter



The strength in equity and bond markets in the past two months has taken year-to-date returns to 5.0% for global equities, 14.6% for global emerging market equities and 11.2% for government bonds (14.6% for emerging market bonds). At current yields most bonds offer poor value. Almost half of all developed world government bonds offer negative nominal yields, and 75% offer yields of under 1%. They offer no protection against any pick-up in inflation or in short term interest rates and look extremely expensive. Some credit sectors offer better value, while equities are broadly fairly valued, having mostly tracked sideways for the past two years. Given the very considerable uncertainties and headwinds that persist periods of volatility are inevitable and we face the real possibility of a rate rise from the Fed in the next few months, as well as the less likely but not impossible prospect of a Trump presidency. However we continue to see these as an opportunity to accumulate positions and to take advantage of a cycle which is proving to be unusually long and sustainable.

Source: Bloomberg. Returns in US dollars unless otherwise stated. August 2016.

Market Performance

Asset Class/Region	Index	To 31 August 2016		
		Currency	1 Month	Year to date
Developed markets equities				
United States	S&P 500 NR	**USD**	0.1%	7.3%
United Kingdom	MSCI UK NR	**GBP**	1.5%	12.3%
Continental Europe	MSCI Europe ex UK NR	**EUR**	0.8%	-3.6%
Japan	Topix TR	**JPY**	0.5%	-13.0%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	2.1%	10.3%
Global	MSCI World NR	**USD**	0.1%	5.0%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	1.8%	13.1%
Emerging Asia	MSCI EM Asia NR	**USD**	4.0%	11.5%
Emerging Latin America	MSCI EM Latin America NR	**USD**	0.7%	33.3%
BRICs	MSCI BRIC NR	**USD**	4.7%	14.7%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	**USD**	2.5%	14.5%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-0.6%	5.6%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-0.4%	7.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	0.2%	9.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	2.1%	14.4%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	2.8%	17.6%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	3.0%	15.2%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-0.3%	6.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	0.2%	6.1%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	1.6%	7.7%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	-1.2%	5.4%
Australian Government	JP Morgan Australia GBI TR	**AUD**	0.3%	7.4%
Global Government Bonds	JP Morgan Global GBI	**USD**	-0.8%	10.2%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-0.5%	8.7%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	0.4%	2.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	1.8%	15.2%

** estimate*

Source: Bloomberg

Market Performance

Asset Class/Region	Index	To 31 August 2016		
		Currency	1 Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	**USD**	-3.7%	13.1%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	-3.5%	15.6%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-0.9%	7.0%
Global Property Securities	S&P Global Property USD TR	**USD**	-2.2%	11.6%
Currencies				
Euro		**USD**	-0.2%	2.8%
UK Pound Sterling		**USD**	-0.7%	-10.8%
Japanese Yen		**USD**	-1.3%	16.3%
Australian Dollar		**USD**	-1.0%	3.2%
South African Rand		**USD**	-5.7%	5.0%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	-0.5%	5.0%
Agricultural Commodities	RICI Agriculture TR	**USD**	-5.1%	-3.0%
Oil	Brent Crude Oil	**USD**	10.8%	26.2%
Gold	Gold Spot	**USD**	-3.1%	23.3%
Hedge funds	HFRX Global Hedge Fund	**USD**	0.3%*	0.9%*
Interest rates				
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
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Positive
European equities (relative to developed)	Positive
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Positive
Emerging market equities	Positive
Fixed Income	
Government	Negative
Index-linked (relative to government)	Positive
Investment grade (relative to government)	Positive
High yield	Neutral
Loans	Neutral
Emerging market debt	Neutral
Convertible bonds	Positive
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Positive
Euro	Neutral
Yen	Neutral

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