IMPERIUM CAPITAL

momentum

easton Asset Management

Weekly Digest

Week ending **31 July 2016**

Stock market's Brexit bifurcation

A little over a month on from the UK's surprise vote to leave the EU, casual market observers would be forgiven for thinking that the market has largely moved on. As of the end of last week, global equity was up 1.9% in US dollar terms, with 3.0% returns from the US, 2.2% from Japan and 0.0% for Europe-ex-UK in their respective local currencies from 23 June 2016. Crucially the UK market is up 6.2% and midcaps are flat in sterling terms. While global equities have rallied, safe haven government bonds have done the same highlighting the arguably inconsistent behaviour of sovereign bonds and equities in this post financial crisis world. Equity markets have risen suggesting that there are positive views abound on the earnings cycle from here, the S&P is at all-time highs, for example, and yet government bond yields are at or close to all-time lows. One of the few UK assets to have lost value over this post Brexit period is sterling cash, which has devalued: approximately 10% on a trade weighted basis. This week brings with it the Bank of England's Monetary Policy Committee meeting which is expected to result in an interest rate cut from the current level of 0.5%.

Turning to the UK, what the headline performance data hides is that there is a clear bifurcation in returns between stocks which are best thought of as domestic names and those that are outward looking, with overseas earners performing strongly thanks to sterling's weakness. The UK's top 100 companies are regularly cited as demonstrating this international quality but this is also confirmed by the performance differentials amongst the second size tier of the UK stock market. Yet, as the FT noted last week "contrary to expectations, a number of domestic-focused companies have posted positive results in recent weeks". There has also been a surprising resilience to GDP data thus far, but the majority of the period captured in these company results and earnings numbers are pre-Brexit and as a result they may prove to be the calm before the storm later in the year.

Producers of consumer staples and other relatively low value discretionary items still see reasonable activity, which makes sense given the vast majority of the population has been largely unaffected in the immediate term from the Brexit decision. There may be longer term anxieties which will weigh on larger and discretionary purchases, but for most people today it is 'business as usual' and it is logical, therefore, that spending on day-to-day necessities continues. There are, however, signs of some weakness and softer sentiment with respect to larger, discretionary purchases. The UK domestic property market, for example, has come under pressure with estate agents and construction companies warning of tough conditions ahead. It is understandable that people that do not need to undertake a property transaction or other large discretionary purchase at the present time might defer the decision until there is greater clarity in the UK's medium term economic outlook.

Yet it is tempting to think that there was some truth in the Exit campaign's branding of the Remain campaign as 'project fear'. It is also worth noting that while the UK market has rallied in base currency it still remains more than 5% lower in US dollar terms as sterling's weakness provides a headwind to returns. This makes the UK's asset base relatively attractive to foreign buyers and there is also anecdotal evidence of commercial property and other assets being snapped up by opportunistic overseas buyers. Future activity and opportunity has not been wiped out at a stroke, rather the consumer is being sensible for the time being. Should there be any increase in certainty in terms of the UK's position with respect to the EU, animal spirits could quickly return.

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

The **Marketplace**

- European banking stress test results yield no major surprises
- Eurozone and UK GDP growth beat expectations
- US economic growth disappoints
- Japan: fiscal stimulus expected, monetary stimulus disappoints
- Oil enters a bear market

Market **Focus**

Europe

- The results of the banking stress tests conducted by the European Banking Authority largely found that Europe's top 51 banks had enough capital to survive another financial crisis – Italy's Monte dei Paschi was the only bank where insolvency was considered a risk when the three year adverse scenario test was applied.
- UK economic growth was 0.6% for the second quarter which was above expectations and means that gross domestic product has risen by 2.2% over the last year.
- Meanwhile both European growth and inflation came in +0.1% above expectations. Euro Area GDP growth was 1.6% year-on-year whilst initial estimates for Eurozone Consumer Price Inflation came in at 0.2% for July. Continental European equities were up 0.6% for the week and 4.1% for the month.

US

- The US economy grew 1.2% from March through June, below expectations of 2.5% growth, although household consumption for the quarter was up 4.2% compared to 1.6% throughout the first quarter.
- Amid this lacklustre growth, the Federal Reserve rate was kept at 0.25-0.5% on Wednesday. The expected probability of a rate hike by December was reduced from 44.9% to 34.4%; the dollar currency index was consequently down 1.9% for the week.

Japan

- The Bank of Japan continued monetary easing by extending ETF (Exchange Traded Funds) purchases to JPY 6 trillion, but the maintenance of both the base rate at -0.1% and Japanese government bond purchases at JPY 80 trillion per year was seen as disappointing.
- Prime Minister Shinzo Abe did also propose a JPY 28 trillion fiscal spending package on Wednesday; more specific details of the package are to be announced today.
- Japanese equities were 0.4% down for the week, whilst the yen recorded a weekly appreciation of 4.0% against the dollar after the lack of monetary easing.

Commodities

- Brent crude oil entered a bear market on Friday as it dropped towards USD 42 per barrel for the first time since April. It reached a year high of USD 52.86 in June and has since fallen by over 20%. Energy traders have started storing more oil off the UK coast as they struggle to source buyers and find it more attractive to hold extra supplies.
- Oil prices fell 7.1% over the week.

James Klempster, CFA & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 29 July 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	-0.1%	3.6%	7.3%	4.7%
United Kingdom	GBP	0.0%	3.5%	10.6%	5.4%
Continental Europe	EUR	0.6%	4.1%	-4.3%	-10.4%
Japan	JPY	-0.4%	6.2%	-13.5%	-17.3%
Asia Pacific (ex Japan)	USD	0.9%	5.6%	8.1%	0.2%
Australia	AUD	1.2%	6.3%	7.4%	3.7%
Global	USD	0.9%	4.2%	4.9%	-0.2%
Emerging Market Equities					
Emerging Europe	USD	0.4%	1.2%	11.2%	-5.9%
Emerging Asia	USD	0.4%	4.8%	7.2%	-0.7%
Emerging Latin America	USD	0.0%	5.5%	32.4%	6.8%
BRICs	USD	0.0%	4.8%	9.5%	-4.4%
MENA countries	USD	-1.1%	1.7%	0.9%	-17.0%
South Africa	USD	2.6%	8.8%	25.9%	-2.9%
India	USD	1.8%	5.6%	8.9%	-0.2%
Global Emerging Markets	USD	0.5%	5.0%	11.8%	-0.6%
Bonds					
US Treasuries	USD	0.7%	0.4%	6.2%	6.6%
US Treasuries (inflation protected)	USD	0.6%	0.6%	7.2%	5.3%
US Corporate (investment grade)	USD	0.5%	1.5%	9.3%	9.2%
US High Yield	USD	-0.3%	2.7%	12.0%	5.3%
UK Gilts	GBP	1.6%	2.0%	14.4%	15.7%
UK Corporate (investment grade)	GBP	1.2%	4.2%	11.8%	12.4%
Euro Government Bonds	EUR	0.8%	0.8%	6.6%	7.9%
Euro Corporate (investment grade)	EUR	0.3%	1.7%	5.8%	5.8%
Euro High Yield	EUR	0.2%	2.2%	6.0%	4.4%
Japanese Government	JPY	-0.3%	-1.0%	6.7%	8.5%
Australian Government	AUD	0.3%	0.9%	7.0%	7.8%
Global Government Bonds	USD	2.1%	0.5%	11.1%	11.8%
Global Bonds	USD	1.6%	0.8%	9.2%	9.3%
Global Convertible Bonds	USD	1.5%	2.6%	1.9%	0.8%
Emerging Market Bonds	USD	-0.2%	0.9%	13.3%	14.1%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 29 July 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	0.7%	4.2%	17.4%	21.1%
Australian Property Securities	AUD	0.5%	5.4%	19.8%	19.1%
Asia Property Securities	USD	0.5%	4.7%	7.9%	2.4%
Global Property Securities	USD	1.5%	4.8%	14.1%	13.4%
Currencies					
Euro	USD	1.8%	0.7%	2.9%	1.7%
UK Pound Sterling	USD	0.8%	-0.6%	-10.2%	-15.2%
Japanese Yen	USD	4.0%	1.1%	17.8%	21.4%
Australian Dollar	USD	1.8%	2.0%	4.3%	4.1%
South African Rand	USD	2.9%	6.0%	11.4%	-9.7%
Swiss Franc	USD	1.8%	0.7%	3.4%	-0.1%
Chinese Yuan	USD	0.7%	0.0%	-2.2%	-6.6%
Commodities & Alternatives					
Commodities	USD	-1.3%	-4.8%	5.5%	-12.2%
Agricultural Commodities	USD	-0.5%	-2.8%	2.2%	-2.7%
Oil	USD	-7.1%	-14.5%	13.9%	-20.5%
Gold	USD	2.2%	2.2%	27.3%	23.2%
Hedge funds	USD	-0.1%	1.3%	0.4%	-4.2%

Source: Bloomberg

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