MACRO AND MARKET REVIEW

July 2014

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MACRO REVIEW

July was a challenging month as the **global market's sentiment was dominated by geopolitical issues**, namely tensions in Russia and Ukraine, sanctions against Russia, Israel and Palestine, the Mideast conflict, and the Argentinian default situation, which all weighted on markets. Other important events were the following:

- **In the US, the economic data releases continue to improve** with better payrolls and ISM non-manufacturing employment cost index, not to mention the second quarter US GDP, which surprised significantly to the upside with an expansion rate of 4% annualized versus an average forecast of 3%.

- In contrast, **Europe's macroeconomic data was mixed**. PMI's numbers were better and unemployment number in the Eurozone fell to 11.5%. However, the economic activity and credit growth remained at very low levels with limited prospects of acceleration in the coming quarters. **Inflation (+0.4%) remained well below the ECB's target**, which kept interest rates on hold. Of note the instability in the Portuguese banking system.

- In EM, **China's economy may have bottomed out** in the second quarter as a result of better than expected macroeconomic data. The second quarter GDP number accelerated to 7.5%.

Of note, Europe was affected by the ancillary effects of the tensions surrounding Russia. This is particularly the case of Germany given the close trading ties between the two countries. The sanctions will likely create a limited, but unwanted, drag on the European economy.

MARKET REVIEW

In July, the technical structure of the market weakened. Many global markets gave up their gains. **In the last few days**, prices fell for both higher-risk assets and lower-risk assets. **Both equity and bond markets sold off while the USD strengthened**.

- In equities, **EM outperformed DM**, with the MSCI EM (+1.43%) doing better than the MSCI World (-1.67%). In the US, the S&P 500 (-1.51%) fell by 2% on the final day of the month. The S&P is now 4% below its highs. In Europe, the MSCI Europe (-1.59%) declined with Portugal (-12.1%) falling after the failure of Banco Espirito Santo. Other poor performers were Italy (-3.35%), France (-4.00%) and **Germany (-4.33%)**. At a sector level, **cyclicals underperformed** together with Consumer Discretionary, Energy and Industrials. Information Technology, Materials and Financials did well. **Volatility for most asset classes rose**. The VIX after reaching its lowest level in several years just above 10, spiked to finish the month at 16.95.

- In fixed income, markets were mixed. **EM debt performed well unlike high yield** and MBS. **Credit spreads widened** mostly as a result of increased new issuance. In the US the short-end of rates rose as investors started to adjust to the expectation of higher rates, while in Europe the **yield on the 10-year Bund came down further** to 1.26.

- In currencies, the **USD strengthened**, in part as a result of a flight to quality, against most currencies including the EUR up +2.21% at 1.3390, the GBP up +1.29% at 1.6890, the CHF up +2.48% at 0.9090 and the Yen, up +1.45% at 102.80.

- In commodities, the most notable feature was the **decline in energy prices**, with crude oil (Brent) down -5.64% to 106.02, due in part to rising inventories despite geopolitical tensions. Gold (-3.08%) fell to 1281.30. Base metals did well, while agriculturals delivered overall negative results.

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