Macro and Market Review

August 2014

MACRO AND MARKET REVIEW

MACRO REVIEW

Geopolitical issues remained a source of concern. The situation in the Middle East continued to deteriorate, while the tensions between Russia and Ukraine, and the West continued to dominate the headlines for much of August. Nevertheless, aside from deflation risks, the attention of global markets was on:

- **More divergent global economic data between the US and Europe.** In the US, there were strong second quarter earnings, continued improvement in the housing market, and better revised GDP numbers (+4.2%), while in Europe, there were lackluster economic data. Inflation fell to 0.3%, a five year low, moving further away from the ECB target of 2%, while growth in the Eurozone stagnated in the second quarter, with Italy and Germany contracting.

- **More divergent central banks' monetary policy actions.** In the US, the Federal Reserve Bank is in the process of ending its quantitative easing, while in Europe, the ECB indicated the likelihood of embarking on quantitative easing. In Jackson Hole, the **ECB's President** stated that policies will remain accommodative, in part as a result of a declining inflation, and that he **was ready to adjust its policy stance** further. Of note, the timing of rate rises in the US and UK was less apparent due to a lower inflation outlook.

Elsewhere in Europe, there was a government reshuffle in France prompted by the austerity debate. In EM, Brazil literally plunged into recession before presidential elections. There were growing expectations that the President Dilma Rousseff will be replaced by a more business friendly leader. Argentina pursued its arm wrestling against some of its debt holders in the US. Economic data improved in some emerging markets such as India and China. **Japan suffered** its worst **economic contraction** since about three years ago. Consumer and business confidence remains fragile.

MARKET REVIEW

In August, **global equity and bond markets maintained their upward momentum** surmounting geopolitical crises.

- **In equities, most markets recovered after an initial fall.** In the US, the **S&P 500 (+3.77%) made a new all-time high** to 2'003.37 level. The MSCI World (+2.00%) and the MSCI Europe (+1.75%) did well, although performance was mixed. France (+3.16%) and the UK (+1.33%) were notable strong performers, unlike Spain (+0.20%) and Italy (-0.58%), while Germany (+0.67%) made modest gains in light of Russia's trade disputes. From a sector perspective, Healthcare, Information Technology and Consumer Staples were notable outperformers unlike Materials. Elsewhere, the **MSCI EM (+2.07%)** did well with strength in Brazil (+9.78%). Mexico (+4.13%) and India (+2.87%) unlike Korea (-0.6%) and Russia (-1.5%). China was flat unlike **Japan (-1.26%)**. Unlike in July, **volatility declined** with the VIX down to 11.98 versus 16.95 last month.

- **In fixed income, many markets reached new yearly highs.** The yield on the US 10-year Treasury Bond reached 2.344%, a 20bps tightening. In Europe, government bond yields moved lower across the curve with yields in short term Bunds in negative territory and for the 10-year bund at a record-low of 0.890% at the end of the month. Peripheral government bonds continued to rally. **Credit spreads tightened**, especially in high yield.

- In currencies, the **USD strengthened further** against the EUR (-1.93%) at 1.3130, the GBP (-1.71%) at 1.6600, the CHF (-1.03%) at 0.9180 and the Yen (-1.25%) at 104.09.

- In commodities, **industrial metals** and **agriculturals were mixed. Energy prices weakened** with Crude Oil (Brent), down -2.67% to a 13-month low as supplies remain intact. Gold (+0.41%) was marginally positive at USD1'287.8.

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