Macro and Market Review

September 2014

MACRO AND MARKET REVIEW

MACRO REVIEW

In September, the focus of global markets was on the economic divergence between Europe and the US, and consequently the monetary policies pursued by the ECB and the US Federal Reserve:

- **Diverging economic cycles**. In the US, the real GDP growth number was revised up to 4.6% as a result of higher exports, retail sales and business investment. In Europe, the economic recovery slowed to a standstill with leading indicators pointing downwards with stagflation in France, a deteriorating economy in Italy and growth in Spain.

- **Diverging monetary policies**. The **Fed will end its quantitative easing program by October** and will not raise rates before the second quarter of 2015. With no real inflation threat, the priority remained to support the economy recovery. Ready to do whatever it takes to reflate the economy, the **ECB** surpassed expectations by adopting expansionary measures. It **cut key interest rates to a record low** of 0.05% and the rate on the ECB's deposit facility by 10 bps to -0.2%. The aim being to weaken the EUR. It also announced it will start buying private sector assets.

The US has issued sweeping rules to crackdown on companies that use deals to move overseas their headquarters in tax-driven manoeuvres known as inversions. In **China,** aside from a **weak industrial output** and a **flagging property market**, rising exports and falling imports pushed the trade surplus to a record high underlining the **challenges to revive a tepid domestic demand**. **Alibaba**, the Chinese ecommerce company, became the world's largest-ever stock market floatation with its shares soaring by more than a third. In **Japan**, the revised second quarter GDP number shrank an annualized -7.1%. Elsewhere, the **Scottish Referendum e**nded with the Scots voting to remain in the UK.

MARKET REVIEW

Divergent economic and monetary policies between the US and other developed markets became a key driver of relative valuations among global assets, especially in currencies. Most markets went in a "risk-off" mood.

- Despite a good start, **most equity markets ended in negative territories**. The **S&P 500 (-1.55%)** made a new all-time highs at 2'011.17, but ended the period in negative territories. The **MSCI Europe (+0.27%)** was hurt by the poor performance of the German DAX (-3.65%), and of the FTSE 100 (-1.80%), which hit a 14-year high earlier in September. The **MSCI World (-2.88%)** and the **MSCI EM (-7.59%)** did poorly unlike **Japan (+4.86%)**. **Volatility rose**, with the VIX moving from 11.98 to 16.31.

- **Fixed income markets declined**, with **high yield hurt by** technicals such as an over supply of bonds due to new issuances related in part to M&A and to a lesser extent to Bill Gross's departure from PIMCO, the USD 2 trillion bond manager. High yield's fundamentals are attractive again with a yield-to-worst on the US high yield market of 6.1%. Government bonds weakened a little.

- In currencies, the **USD strengthened further** hitting a six-year high against the Yen at 109.65 (+5.34%) and a two-year high against the EUR at 1.2630 (-3.82%), up almost 10% since it almost touched USD 1.40 in early May.

- **Commodity prices fell sharply**, hit by a stronger USD, rising supply and concerns over faltering economic growth and rising inventories in China. **Gold (-6.18%)** and base metals were particularly affected. In crude oil, the **WTI (-5.00%)** and the **Brent (-8.26%)** retreated to levels not seen in two years. Also notable was the narrowing of the WTI/Brent spread. Agricultural prices fell significantly as supportive weather bolstered crop yields in the US.

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