Macro and Market Review

October 2014

MACRO AND MARKET REVIEW

MACRO REVIEW

In October global markets were affected by **deflation fears in the Eurozone** and **pessimism about the growth outlook**, following an **IMF report**, which revised its expectations of global growth in 2014 and 2015 down to 3.3% and 3.8% respectively, and highlighted increasing economic and monetary policy divergences.

- **Economic divergences**. In the **US**, the economy grew by +3.5%, the unemployment rate dropped to a six-year low of 5.9% and the consumer sentiment reached a seven-year high. In **Europe**, the ECB President stated that the economic recovery remained "weak, fragile and uneven". In Germany factory orders (-5.7%) and industrial output (-4.0%) suffered their biggest fall since 2009. Of note, credit conditions eased and demand for corporate loans strengthened. In **China**, the economy grew by +7.3%, its weakest performance since March 2009 and is about to register its slowest annual pace since 1990. In **Japan**, the economic recovery slowed down.

- **Monetary policy divergences**. The main event was the surprising **BoJ's decision to ramp up its monetary stimulus program**, while the USD 1.2 trillion Government Pension Investment Fund more than doubled its allocation target for Japanese equities from 12% to 25%. Elsewhere, the US Federal Reserve was in no hurry to raise borrowing costs and the **FOMC ended its bond-buying program**, exiting QE3. In Europe, the **ECB began buying covered bonds**.

The **ECB's stress test on the banking sector**, which showed that 25 out of total of 130 Eurozone banks failed, **was deemed a success**. With the termination of the AbbVie/Shire USD 54 billion deal, the value of M&A deals that fail to complete has reached its highest level since 2008. In Brazil's closest election in a generation, Dilma Rousseff won in a vote that split the nation. In Hong Kong, the democracy demonstrations "Occupy Central" have fizzled out.

MARKET REVIEW

Up to the 15th of October, markets experienced their **first major setback since 2011**. Volatility, a measure of fear in the markets, surged. Equity and commodity markets initially fell favoring safe haven assets such as government bonds and gold. However, in the second half of the month, risk appetite returned with a vengeance amid robust corporate earnings, better than expected Chinese GDP data and unexpected monetary decisions from Japan.

- **Equity markets experienced a violent sell-off followed by a sharp V-shaped recovery**. The **S&P 500 (+2.32%)** declined -5.50% almost erasing its year-to-date returns, before gaining +8.30% to finish at a new all-time high of 2'018.05. The Japanese **Nikkei (+1.49%)** ended on a seven-year high. After being down almost -10%, the **MSCI Europe (-1.90%)** partially recovered. Unlike the **MSCI World (-0.57%)**, the **MSCI EM (+1.07%)** was positive.

- **Volatility surged** with the VIX reaching 30, a level not seen in the last three years, before sliding back to 14.03. This was among the sharpest moves in recent history, not as bad as August 2011, but comparable to the 2008 financial crisis.

- In **fixed income**, the yield on the 10-year US treasuries was very volatile. It reached a high of 2.43% then dropped to a low of 1.86%, in a "bond flash crash", before ending the month at 2.34% (-15 bps). Credit markets were less volatile with investment grade, US and EM high yield ending in positive territories, unlike European high yield.

- In currencies, the **USD strengthened** against the EUR (+0.84%) at 1.2530, and against the Japanese Yen (+2.44%), which slumped to its weakest in more than six-years at 112.32.

- Aside from grains, **commodity prices fell**. Gold (-2.87%) reached a four-year low to USD 1'172. In crude oil, the **WTI (-11.65%)** and the **Brent (-9.31%)** prices went down to USD 80.54 and USD 85.86 respectively, at levels not seen in years.

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