

Market Commentary

October 2015

After the agreement was reached on the Greek debt and austerity measures, investors seemed to concentrate more on the support lent by Mr. Draghi's QE (Quantitative Easing). Markets rallied over 10% from their early July lows and economic numbers in Europe looked encouraging. However, August brought renewed turbulence caused by Chinese currency devaluation and fears of deflation. European indices dropped almost 20% in less than two weeks, then bounced 10% and revisited their lows in the last week of September. The drop in September was mainly caused by soft growth numbers from China. The US FED postponed their rate rise once again pointing to uncertainty regarding global developments as a reason for the delay. This added to market worries as investors started to be concerned that governments and central banks would not be able to bring about a sustained improvement in their respective economies despite all the monetary easing. Though the US markets were less effected, emerging markets, especially commodity producers fared the worst, with Brazil and Russia falling over 20% each. After rallying strongly in the first half of the year, the Chinese and European Indices gave up all their gains in just a few weeks. The result was the worst quarter for equity market performance in over four years.

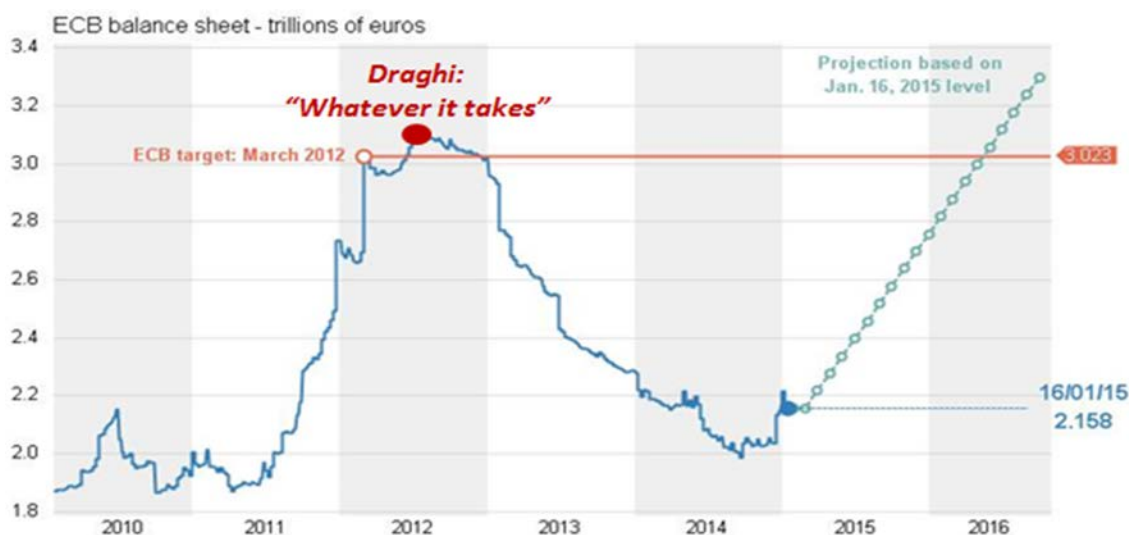


Fig. 1: ECB Balance sheet projection

Source: Reuters Datastream

We had booked profits for clients in June and July and had positioned the portfolio more defensively. However, we did not wish to be too defensive in light of the QE in Europe which has brought bond yields to very low levels and made equities very attractive. Additionally, growth figures from the major economies in Europe were showing improvement. QE usually starts to show results about six months after implementation and having started in March, this would imply a good set of numbers in September. In fact this is what happened. September numbers were better than expected for the major European economies. However, by the time this good news arrived, all of the above mentioned fears had already had their effect. The worst few days followed the admission by Volkswagen (VW) that they had manipulated emissions tests for some of their most popular diesel models. This resulted in a major slump in VW shares and a loss of faith in other diesel car manufacturers, especially the German ones. The negative sentiment then spread to the broad German and European markets. Investors had hardly finished dealing with this news, when markets were hit by analysts downgrading Glencore, one of the leading copper miners and commodity traders. There were major concerns that Glencore was over leveraged and would not be able to service its debt if copper prices remained at current levels. The company's shares fell 30% in one day and had a very negative effect on commodity producers globally.

In the past few days, better news seems to have calmed market nerves. The Purchasing Managers Index (PMI) from China was better than expected, and Glencore has spoken to investors and come up with a plan to handle its debt. As a result markets are up about 4% from their lows and Glencore shares have recovered all the recent losses. The timing of the first FED interest rate rise is still a matter of much

debate. Expectations are that if the first rise is implemented this year it will be in December and there will be very slow progress after that. Many investors believe there will be no rate rise in 2015 and some are already convinced that instead of a rate rise a new QE programme will be launched. We believe that the FED will raise interest rates in December or at the latest in January. Recent fears regarding global growth and the threat of deflation should have subsided by then, as European and Chinese economic numbers should show improvement. The situation in China is not rosy but the government has implemented several measures to prevent a major slowdown. Some of the stimulus brought into force last year and early this year seems to be having an effect now, i.e. with the usual approximately six month delay. Additionally, the ECB recently reiterated that they *will* increase the QE in volume and duration if necessary in order to prevent any undesirable tightening of financial conditions or a renewed surge in macroeconomic uncertainty. All of this makes us optimistic that European equity indices will renew their rally in the fourth quarter and that conditions in emerging markets, especially commodity producers will calm down as the Chinese economy shows progress.

Gold has been rising on weak equity market days and shows signs of having formed a base from which to rally. Several countries, including Russia and China have been steadily increasing their gold reserves. China recently announced that their holding increased almost 60% since 2009. Russia added 1 million ounces to its reserve in August alone. Indian demand has also started to rise strongly since import restrictions have been softened. These indications of rising demand in the physical market are in stark contrast to the very negative (short) positions of speculators on the paper market. We believe that this discrepancy will result in higher gold prices.

General Thoughts

We are of the opinion that equity markets will stabilise and rally for the rest of 2015. We recently bought back some of the equity positions sold at higher levels in June and July this year. Markets have shown signs of stability in the past few days and as fear subsides, investors start hunting for yield. The search should lead them to the equity market, as high grade bonds yield very little and high yield bonds suffered as much as equities in the recent market turbulence. However, a return to equity market volatility cannot be ruled out. The situation in China is just showing early signs of stabilising and the recent employment numbers in the US were weaker than expected. We continue to hold gold in all portfolios as we see signs of strong demand in the physical market starting to influence pricing in the paper market. Gold was a source of stability in the recent market turbulence and we believe that it will continue to fulfil this role if volatility returns.

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