## Friday, September 26th 2014

Today is the first day of the Jewish New Year 5775! “Shana Tova” to all! In celebration of this day, stocks plunged yesterday in one of the worst trading days of the year as markets reacted to headlines on China and Russia, while weighing the potential impact of higher U.S. rates and the rising dollar. Bonds rallied against the swift drop in stocks, and dollar traders said a Wall Street Journal report on changes in the leadership of China's central bank added an edge of uncertainty, leading to selling in risk assets and further firming of the greenback and Treasuries.

Did the huge Alibaba IPO [BABA] of last Friday suck the air out of the market? BABA did soar from the IPO price of $68.00 to a high of $100, only to slump to $89 at the close Thursday.

Friday's markets are expected to be volatile, as investors weigh up whether this week's selloff is the start of a bigger pullback or just end-of-quarter profit-taking. A negative for stocks on Friday is the fact that key indices closed near the lows of the day Thursday, with all major S&P industry sectors lower, whilst bonds and the dollar rose. The S&P 500 fell through its 50-day moving average—at 1,976—and fell to 1,966, a decline of 1.6%. Economic reports due today for second-quarter GDP, are expected to be revised to show increased growth of 4.6%, from 4.2%—a big spring back from the weather-impacted weak Q1. Consumer sentiment is to be released and is expected to show improvement over last month. "I'm worried about tomorrow," said Art Cashin, director of floor operations at UBS. "This is historically the weakest week of the year for stocks. This could be the beginning of one of those September–October thingies." The quarter-end is Tuesday, and while stocks are lower for the month of September, they are generally higher for the quarter. The Dow is up about a half percent, and the S&P is up 0.3%. The “animals” attack! The market is being mauled by a Fed hawk (Fisher) and the Russian bear (Putin) hinting at enacting laws to seize foreign assets. Despite the concerns, keep in mind that the rise in the CBOE Volatility Index (VIX), at 15.8, is still relatively muted. As a rule of thumb, it starts to get important when this goes over 20, which hasn't happened since February. And remember that the “Hawk” Fischer is leaving the FOMC in April… (Plosser, the “other” hawk leaves in March!).

Next week we enter Earning Season again…. Q3 results will start coming in and are expected to be pretty good. The Street estimates are around 6% growth, as we had expected for Q2 and ended up with almost 10% growth in earnings, another record. If the usual pattern holds, a few more days like this and buyers will likely come out of the woodwork. The dollar index, meanwhile, rose to a four-year high as the euro slid to a near two-year low on expectations the European Central Bank will go further into easing mode as the Fed pulls back. Is a carry-trade on the cards? Long US$ vs. Euro?

Thomas Lee, former chief U.S. equity strategist at JPMorgan, said on Tuesday that the DJIA and S&P 500 should increase 5% each from current levels by the end of the year, despite traditional October jitters about when the Fed might start hiking rates. Such a move would put the Dow over 18,000 and the S&P around 2,100 to finish 2014. During the same period last year, stocks climbed 10%, "We've got, I think, a much stronger economic outlook today. And I think a similar level of underinvestment." "The reason people get scared is (that) a quarter of all crashes do happen in October. But I think we've got a lot favouring stocks in the fourth quarter," "A lot of fund managers are behind. This is the worst year for fund manager performance since 1997."

We would like to come back to our long-standing adage whereby one should read the markets to predict tomorrow’s news and not vice-versa. We choose today to look at the ongoing slide in oil prices, with WTI now at $92.50- Is the energy market telling us that an economic slow-down is on the cards? Before jumping to conclusions, we remind ourselves that as everything trades in pairs, we question if this is truly a fall in the intrinsic value of Oil or is it a rise in the value of its measurement unit, the US$? We tried to neutralize the US$ effect by valuing Oil in Gold terms- Over the past 15 years, an ounce of Gold cost on average 12.4 BBLs of WTI crude. Today we are at 13.20, above average. So indeed, Oil is down, in “true” terms…When focussing just on 2014, the average was 13BBLs/Oz and we can’t discern a real decline. And this in the face of the impending US “energy-independence”. So, perhaps we should not worry too much about a slowdown in the making? And for the USA, the drop in the US$ price is tantamount to a tax-cut…!

Scotland's independence referendum now over, a vote few thought would ever happen and it did, if failed. In a World that has about 200 recognized countries (54 at the end of WWII), we may have new surprizes- Texas independence sentiment has been steadily rising over the last decade. Reuters recently found that 51% of Texans support the independence of Texas. It will never happen in the USA. Or could it? You saw what the story did to the British Pound… Enjoy your weekend!

## Market outlook

**<u>Core View</u>:** We hold our long-standing base-view that the world's economies are mending from the fallout of the "Great Recession" if at a slower pace than hoped for. The economics are settling back into a reasonable growth pattern and with stability that creates a positive bias that is expected to continue. We maintain this "bullish" view, although European economies remain weak. We expect the ECB to add fuel to these economies and act as a back-stop against declines, just as the Fed has done over the past several years. And now, the Bank of China is said to join the "party" supporting the rising Japanese support…
As a group, most Central Banks are targeting an elusive 2% inflation rate. As the industrialized economies are running with excess labour and industrial capacity, the return of inflation appears to be in the distance and as such, short term interest rates are unlikely to rise anytime soon. This in itself lightens the risk of significant changes to the yield-curves. Whilst this suggests that there is little "duration-risk" in the fixed-income sector, *there is little upside to holding bonds. Total-returns from fixed-income will not replicate the stellar returns of the past decade and are likely to remain in the very low single digit.*

1. **Geopolitics in connection with the Islamic radicalisation in Iraq and Syria, accentuated by the risk of spill-over into Saudi Arabia, in-fighting in Libya, and the ongoing quarrels in the Sea of China.**
2. **Russia-Ukraine conflict - the risk of escalation remains severe despite the talks towards a definitive settlement.**
3. **Economic slowdown in Europe, noted above, combined with dangerously <u>low</u> inflation.**
4. **The health-scare of Ebola spreading beyond West Africa - with risks of quarantines, reduced air-travel and eventual repercussions on economies.**

*These risks don't produce predictable outcomes or effects in our markets.*

- **Fixed Income -** As all Central Banks are seeking somewhat higher inflation than they have, it is hardly reasonable that they raise rates. Vigilance is important. Short maturities/low duration are, and remain, appropriate - virtually no upside exists in the sector and expected returns at the 3% level (coupons with eventual capital gains/losses) are insufficient to offset the underlying risks. We find that the reward for assuming credit-risk has become too small and we have been observing ongoing exits from the "High Yield" sub-sector.

- **Equities -** We feel secure in owning equities. We remain positive inspite of recent volatility and recommend exposures to be maintained or even increased - we say this even with indices at or near all-time highs! We suggest using global-diversified equity funds, some niche themes or allocating some fixed income holdings into convertible bonds for bond-oriented investors.

- **Alternatives -** With relative economic stability and a clearing horizon, fundamentals are returning to text-book norms of relative values. We expect this active management allocation to maintain, if not exceed, its relatively low recent results and possibly returning to past highs - with low correlation to any particular sector and significantly lower volatility than equities. We have seen the landscape improve for both the Macro and CTA Funds which has led to improved performance after a tough H1 of 2014. We hold our view that a well-diversified Fund-of-Funds is the best way to express this allocation. We reiterate the role of hedge funds in a portfolio is <u>to attenuate</u> volatility and risks <u>and not</u> as an enhancement of returns!

- **Currencies/Commodities -** The markets' low volatility relative to the past 5 years may be changing with an uptick in option-volatility appearing. The USD is gaining versus almost all its major trading counterparts, now trading at about $1.2740 against the EUR and up to 0.9480 against the Swiss Franc. We maintain our belief in the fundamental strength of the US$ and would not bet against it at this time. The Japanese Yen has steadied at around 109.00 vs. the US$. Gold has continued drifting down as the US$ rises, now around $1,220, we note that Oil trading has been anaemic whilst risks to its supply are rising. WTI is now at 92.30 to the USD.

## This Week's Highlights:

- In the FX markets the EUR dropped again this week as the USD rallied further, sending the pair as low as 1.2697 only to see it retrace a little to be back at almost 1.2750 this morning. With the Scottish vote behind the markets, the fact that we are unchanged still seems to sum up the markets take on the Pound. GBP is now at 1.6320, having spent most of the week at, or about, 1.64. The JPY is unchanged on the week at 109.10. The movers this week have been the antipodeans… AUD dropped from 0.8950 to 0.8750 as Chinese data was not stellar and the NZD also dropped from 0.8150 to 0.7900 as the RBNZ targeted the exchange rate as a booster for the economy stating that the currency was too high.
- US Government bonds strengthened this week and sent the yields lower again. The US 10Yr yields moved from 2.58% to touch 2.48% this morning. The UK Gilt traded in lockstep, moving from 2.54% to hit 2.42% by this morning – looks like the Scottish Referendum may have moved off the headlines but the Bond market is still worried! The Bund yields attacked the 1% level, surging from 1.04% to 0.93%. The yields on the French OAT 10 year bonds are now trading at 1.29% having dropped from 1.40%!!! Overall, the bond markets globally have risen and would appear to be at near all-time highs in Europe, bringing yields closer to their recent, all-time lows. The trend of narrowing of the periphery yields continues and we are almost back to the lowest spreads in 4 years for Spain , Italy, France… However… Ireland is now trading at a spread over the Bund that is equivalent to that of August 2008, or on the short end, they are effectively trading pari passu – looks like the bailout worked for Ireland.
- With all of the new highs that were reached last week, we have seen a reasonably strong global retracement. Equity markets around the globe took a tumble this week (except for Japan that was +1.0% on the week!). Europe awoke this morning with a bit of a bump with most markets having lost 3.0% on the week, EM's look like they will average a poor -4.0% for the week, with Brazil taking a pounding at -4.2% and the market is not yet open for trade to play catch up with the European declines as well... This all seems to be on light volume and with little conviction; we will wait a little longer as we remain positive on equities. It is but a bump on the road higher.

Highlighted items are interesting data points for the week

## MARKET INDICES PERFORMANCE

25/09/2014

| INDEX NAME | CCY | Last Price | 1D | 5D | MTD | 1M | 3M | 6M | 1Y | YTD | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | PRICE CHANGE IN % (unless indicated) | | | | | | | | |
| **EQUITY MARKET INDICES - BY REGION** | | | | | | | | | | | P/E |
| MSCI WORLD | USD | 1,703.09 | -1.19 | -2.14 | -2.61 | -2.63 | -1.97 | 2.95 | 9.40 | 2.53 | 15.78 |
| MSCI WORLD LOCAL | - | 1,238.99 | -1.10 | -1.89 | -1.23 | -1.08 | 0.38 | 5.04 | 12.07 | 4.60 | - |
| MSCI AC WORLD | USD | 418.78 | -1.16 | -2.20 | -2.96 | -2.98 | -1.98 | 3.25 | 8.60 | 2.50 | 15.18 |
| MSCI EM | USD | 1,025.63 | -0.92 | -2.68 | -5.72 | -5.71 | -2.02 | 5.93 | 2.26 | 2.29 | 11.55 |
| S&P 500 INDEX | USD | 1,965.99 | -1.62 | -2.26 | -1.87 | -1.70 | 0.45 | 6.12 | 15.74 | 6.36 | 16.43 |
| DOW JONES INDUS. AVG | USD | 16,945.80 | -1.54 | -1.85 | -0.89 | -0.94 | 0.59 | 4.16 | 10.55 | 2.23 | 15.00 |
| NASDAQ COMPOSITE INDEX | USD | 4,466.75 | -1.94 | -2.76 | -2.48 | -2.27 | 2.00 | 7.02 | 17.94 | 6.95 | 19.08 |
| RUSSELL 2000 INDEX | USD | 1,110.24 | -1.60 | -4.23 | -5.46 | -5.52 | -5.97 | -3.92 | 2.95 | -4.59 | 18.32 |
| EURO STOXX 50 | EUR | 3,202.31 | -1.29 | -2.42 | 0.67 | -0.11 | -1.21 | 2.04 | 9.27 | 2.73 | 14.56 |
| CAC 40 INDEX | EUR | 4,355.28 | -1.32 | -2.58 | -0.79 | -1.07 | -2.10 | -0.89 | 3.81 | 1.17 | 14.83 |
| DAX INDEX | EUR | 9,510.01 | -1.57 | -3.33 | 0.03 | -1.20 | -3.39 | 0.26 | 9.33 | -0.83 | 13.45 |
| FTSE 100 INDEX | GBP | 6,639.71 | -0.99 | -3.14 | -2.88 | -2.92 | -1.66 | 0.27 | 0.88 | -1.86 | 13.78 |
| SWISS MARKET INDEX | CHF | 8,772.76 | -0.28 | -1.25 | 0.82 | 0.65 | 2.21 | 4.74 | 8.29 | 6.42 | 16.89 |
| NIKKEI 225 | JPY | 16,374.14 | 1.28 | 1.01 | 5.22 | 4.57 | 6.02 | 12.11 | 9.67 | -0.38 | 17.87 |
| HANG SENG INDEX | HKD | 23,768.13 | -0.64 | -2.72 | -4.44 | -5.70 | 1.92 | 8.02 | 2.24 | 1.45 | 10.87 |
| SHANGHAI SE COMPOSITE | CNY | 2,345.10 | 0.07 | 0.78 | 5.89 | 6.37 | 15.16 | 13.76 | 8.90 | 10.95 | 9.20 |
| S&P BSE SENSEX INDEX | INR | 26,468.36 | -1.03 | -2.82 | -1.17 | -0.44 | 5.05 | 19.16 | 32.34 | 24.36 | 16.88 |
| RUSSIAN RTS INDEX $ | USD | 1,175.59 | -1.15 | -0.27 | -1.95 | -7.34 | -15.27 | -2.65 | -19.60 | -19.11 | 4.99 |
| BRAZIL IBOVESPA INDEX | BRL | 55,962.08 | -1.52 | -4.13 | -8.69 | -6.45 | 4.59 | 16.67 | 4.05 | 8.65 | 12.08 |
| **EQUITY MARKET INDICES - BY SECTOR** | | | | | | | | | | | P/E |
| MSCI ENERGY | USD | 279.34 | -1.61 | -3.37 | -7.52 | -7.08 | -9.64 | 2.17 | 6.81 | 1.36 | 13.69 |
| MSCI MATERIALS | USD | 237.77 | -1.33 | -2.14 | -4.96 | -5.41 | -5.32 | -0.71 | 1.75 | -0.93 | 16.01 |
| MSCI INDUSTRIALS | USD | 197.67 | -0.92 | -2.32 | -2.42 | -2.93 | -3.73 | -0.18 | 5.41 | -2.12 | 16.22 |
| MSCI CONS DISCRETIONARY | USD | 176.46 | -0.93 | -2.25 | -2.69 | -3.13 | -2.65 | 0.62 | 4.28 | -2.92 | 16.71 |
| MSCI CONS STAPLES | USD | 193.50 | -1.09 | -1.72 | -1.98 | -2.08 | -2.30 | 2.77 | 6.22 | 1.59 | 18.55 |
| MSCI HEALTH CARE | USD | 194.98 | -1.14 | -1.07 | 0.60 | 0.90 | 3.44 | 8.79 | 23.23 | 13.46 | 18.10 |
| MSCI FINANCIALS | USD | 102.49 | -1.06 | -2.21 | -2.37 | -2.51 | -1.28 | 1.60 | 6.77 | 0.59 | 13.49 |
| MSCI INFO TECH | USD | 134.44 | -1.91 | -2.37 | -1.95 | -1.85 | 3.11 | 8.40 | 20.41 | 9.16 | 16.95 |
| MSCI TELECOMS | USD | 70.52 | -0.75 | -1.91 | -1.49 | -0.75 | -2.42 | 0.64 | 5.97 | -2.04 | 15.84 |
| MSCI UTILITY | USD | 117.96 | -0.62 | -1.67 | -2.83 | -1.96 | -5.12 | 1.12 | 8.31 | 7.35 | 15.81 |
| MSCI WORLD REAL ESTATE | USD | 184.29 | -0.21 | -1.51 | -5.81 | -5.95 | -3.20 | 5.93 | 2.75 | 5.32 | 22.63 |
| **HEDGE FUND INDICES** | | | | | | | | | | | |
| HFRX GLOBAL HEDGE FUND | USD | 1,245.27 | 0.13 | -0.12 | -0.34 | 0.06 | -0.01 | 0.89 | 3.79 | 1.61 | |
| HFRX EQUAL WEIGHTED | USD | 1,217.16 | 0.05 | -0.14 | -0.32 | -0.05 | -0.05 | 0.63 | 3.41 | 1.68 | |
| HFRX GLOBAL EUR | EUR | 1,151.34 | 0.14 | -0.13 | -0.39 | 0.02 | -0.13 | 0.72 | 3.48 | 1.37 | |

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25/09/2014

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|---|---|---|---|---|---|---|---|---|---|---|
| | | | PRICE CHANGE IN % (unless indicated) | | | | | | | |
| **FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)** | | | | | | | | | | |
| US 3 MONTH | USD | 0.01 | 0.00 | -0.01 | -0.02 | -0.02 | -0.02 | -0.04 | 0.01 | -0.06 |
| US 2 YEAR | USD | 0.56 | 0.73 | -0.01 | 0.07 | 0.06 | 0.09 | 0.11 | 0.21 | 0.18 |
| US 10 YEAR | USD | 2.50 | -0.14 | -0.08 | 0.16 | 0.10 | -0.03 | -0.19 | -0.15 | -0.53 |
| **FIXED INCOME INDICES - BY TYPE OF ISSUER** | | | | | | | | | | |
| GLOBAL AGG TR HEDGED | USD | 465.26 | 0.15 | 0.55 | -0.31 | 0.11 | 1.26 | 3.26 | 5.49 | 5.26 |
| US GOVERNMENT TR | USD | 2,039.33 | 0.27 | 0.57 | -0.51 | -0.23 | 0.57 | 1.79 | 2.30 | 3.01 |
| US CORPORATE TR | USD | 2,549.58 | 0.32 | 0.67 | -1.17 | -0.77 | 0.40 | 3.08 | 6.78 | 5.89 |
| US HIGH YIELD TR | USD | 1,641.77 | -0.39 | -0.89 | -1.83 | -1.74 | -1.61 | 0.97 | 7.18 | 3.77 |
| EU GOVERNMENT TR | EUR | 232.74 | 0.11 | 0.72 | -0.04 | 0.62 | 2.71 | 5.95 | 10.59 | 9.44 |
| EU CORPORATE TR | USD | 241.69 | 0.09 | 0.31 | 0.17 | 0.61 | 1.82 | 4.33 | 7.75 | 6.68 |
| EU HIGH YIELD TR | EUR | 267.68 | -0.05 | -0.13 | -0.18 | 0.18 | -0.29 | 2.41 | 9.46 | 5.40 |
| JACI GLOBAL | USD | 252.72 | -0.12 | -1.12 | -2.39 | -2.28 | -4.55 | -3.67 | 3.29 | -0.25 |
| GLOBAL EM TR (HEDGED) | USD | 327.47 | 0.10 | 0.54 | -0.56 | -0.18 | 0.21 | 5.42 | 8.37 | 7.34 |
| S&P/LSTA U.S. LEV LOAN | USD | 97.42 | -0.13 | -0.34 | -0.86 | -0.82 | -1.48 | -1.00 | -0.15 | -0.83 |
| **COMMODITY INDICES - BY TYPE OF ISSUER** | | | | | | | | | | |
| GSCI INDEX TOTAL RETURN | USD | 4,521.24 | -0.09 | -0.49 | -4.93 | -3.69 | -12.51 | -8.14 | -6.90 | -6.38 |
| GSCI ENERGY TR | USD | 1,049.55 | 0.15 | -0.05 | -4.56 | -3.23 | -12.89 | -6.23 | -5.87 | -6.80 |
| GSCI INDUSTRIAL METALS TR | USD | 1,349.42 | -0.83 | -1.75 | -5.77 | -5.80 | -1.63 | 4.84 | 0.03 | -1.27 |
| GSCI PRECIOUS METALS TR | USD | 1,522.01 | 0.00 | -1.05 | -5.74 | -5.15 | -8.98 | -7.70 | -10.37 | -0.09 |
| GSCI AGRICULTURE TR | USD | 496.82 | -1.00 | -2.66 | -11.05 | -10.30 | -22.04 | -28.45 | -24.14 | -18.10 |
| GENERIC 1ST 'CL' FUTURE | USD | 92.53 | -0.06 | 0.77 | -2.98 | -0.79 | -8.03 | -1.67 | -5.04 | 1.08 |
| GOLD SPOT $/OZ | USD | 1,221.53 | 0.39 | 0.87 | -4.78 | -4.29 | -6.86 | -6.00 | -7.39 | 1.71 |
| **CURRENCIES** | | | | | | | | | | |
| DOLLAR INDEX SPOT | USD | 85.20 | 0.05 | 0.59 | 3.00 | 3.13 | 6.25 | 6.50 | 5.85 | 6.50 |
| Euro Spot | EUR | 1.28 | 0.00 | -0.61 | -2.90 | -3.16 | -6.33 | -7.47 | -5.47 | -7.22 |
| Japanese Yen Spot | JPY | 108.75 | -0.21 | 0.06 | -4.49 | -4.51 | -6.65 | -6.37 | -9.17 | -3.37 |
| British Pound Spot | GBP | 1.63 | -0.04 | 0.15 | -1.72 | -1.38 | -4.20 | -1.63 | 1.69 | -1.48 |
| Brazilian Real Spot | BRL | 2.43 | -1.83 | -2.59 | -7.90 | -5.74 | -9.06 | -4.80 | -8.08 | -2.71 |
| China Renminbi Spot | CNY | 6.14 | 0.15 | 0.22 | 0.26 | 0.42 | 1.59 | 1.32 | -0.11 | -1.20 |
| Singapore Dollar Spot | SGD | 1.27 | 0.00 | -0.24 | -1.70 | -1.61 | -1.66 | -0.21 | -1.21 | -0.57 |
| Norwegian Krone Spot | NOK | 6.40 | -0.04 | -0.76 | -3.20 | -3.47 | -4.18 | -5.46 | -6.57 | -5.17 |
| **VOLATILITY / LIQUIDITY INDICES** | | | | | | | | | | |
| CBOE SPX VOLATILITY INDX | USD | 15.64 | 17.86 | 30.01 | 30.55 | 34.48 | 34.48 | 4.76 | 11.24 | 13.99 |
| USD SWAP SPREAD SEMI 2YR | | 22.50 | 0.27 | -5.01 | 0.80 | 0.27 | 84.16 | 108.70 | 71.82 | 114.86 |
| TED SPREAD | | - | - | -1.75 | 5.02 | 2.85 | 4.53 | 13.22 | -3.61 | -84.72 |

All data is compiled from Bloomberg

## Disclaimer