CAERUS
Portfolio Management

CAERUS Market Commentary – September 2016

Market overview

The FTSE World index climbed again in September with a rise of 1.2% in sterling terms. Year to date, central banks around the world still appear willing to do what it takes to generate growth, and avoid recession and deflation. Politics remains important; the new government in the UK has had its first 100 days, there are elections in Europe to look forward to, perhaps influenced by the Brexit vote and, later this month, the final debate between the US presidential candidates takes place. The last quarter of 2016 will be interesting, to say the least.

United Kingdom

Despite some bearish forecasts that the UK economy faced an imminent recession post the Brexit vote in June, so far the UK economy has proved resilient. Consumer confidence has held up and this is reflected in good retail sales. No doubt, the fall in the value of sterling has helped overseas earners in the FTSE100 (overseas earnings account for three quarters of earnings). However, it still remains unclear whether the UK will negotiate a "hard" or "soft" exit from the European Union and, therefore, at the moment it is difficult to have an opinion on the longer term consequences of the vote. In the meantime, Investors can only focus on the economy performing in the present. At the fund level, the resumption of trading in some property funds is welcome. Post the June vote, many property funds suspended dealing as redemptions could not be met from the cash available. Sufficient cash has now been raised from the sale of properties, anecdotally, not at distressed prices.

Emerging Markets

The Emerging Markets asset class has been the best performer year to date. The bounce in commodity prices this year has helped, along with a less volatile dollar. The recent announcement of OPEC to reduce production has also boosted oil prices, the first such agreement in eight years. Again, some concerns were raised over the Chinese banking system during the month. Since the financial crisis of 2007/08, the Chinese government has been trying to maintain growth in the economy, resulting in a growth of credit/loans. Much of that lending has not been productive and the banking system is at risk of large defaults. Some banks have now begun to raise capital to bolster their balance sheets. Elsewhere, the economy continues to progress, retail sales continue to grow at over 10% per year and industrial production at 6% per year. Plus, the economy continues to move way from manufacturing towards services.

Japan

Japan has always been at the forefront on using monetary policy to generate growth and inflation within its economy. In September, the Bank of Japan announced it was going to target interest rates, in particular not to allow 10 year rates to fall below 0%. The new policy is called "yield curve control" and it is an attempt to make longer interest rates higher than short-term rates. This should enable banks to lend as they can borrow cheap, short-term monies, and then make loans for longer periods and charge a higher interest rate. Elsewhere, the news was not encouraging. Looking at the broader economy, prices fell for a straight six months and households spent less. The strength of the yen this year has not helped, by reducing import prices and company profits, making the 2% inflation target harder to achieve.

United States

At the turn of the year, Investors expected four small rate rises by the end of 2016. That has not happened. Last month, the Federal Reserve again did not raise rates, although three members did vote for a rise. It appears more evidence is needed that the economy, in particular jobs, remains on a sustainable growth path. Although the chairman, Janet Yellen, said the decision not to raise rates did not reflect a lack of confidence in the economy and the case for a rate rise had strengthened, the Fed wants the jobs market to improve further before finally making a decision. Thus all eyes are now on the December meeting, a full year after the first rise.

Europe

So far there does not appear to be much contagion from the Brexit vote. More recent news has been dominated by the travails of Deutsche Bank and an impending fine from the US authorities in respect of a mis-selling scandal. Combined with the woes of Volkswagen, two of the largest stalwarts of the German economy may dent confidence in the economy. Meanwhile, euro area inflation reached 0.4%, still way below the target of 2% but the best figure since 2014. Consumer and service sector confidence also improved in the month. Looking further ahead, general elections in Germany and France in 2017 may provide political uncertainty and provide some volatility to the markets in the final quarter of the year.

All performance data quoted in this article is derived from FE Analytics

CAERUS Sentiment Indicator