Monthly Commentary 3rd September 2015

August was not a good month for financial markets. In fact it was a very bad month, as equities fell between 6% and 13%. Bonds fared better but still ended the month down about 1% on average. Commodities see-sawed and were largely flat. Many year-to-date numbers are now firmly in the red.

You have all read the news that the main reason for the falls was China's double-whammy of yuan depreciation and a slowing manufacturing sector. Unlike Russia's woes of last year, which hardly affected markets - after all Russia is an insignificant cog on the wheel that is the world economy - China's slowdown is far more worrisome.

Is the market reaction warranted? While no serious investor can ignore what is happening in China, we need some perspective. What we are seeing is a slowdown in China's rapid growth. This has been well telegraphed and expected. Back in 2007 China's economy grew at a 14% clip. Today it has likely slowed to about 5% (officially it is closer to 7% but many economists believe it is closer to mid single digit growth). As China was the largest single contributor to world growth, it is no wonder that investors are taking cover. Still, if one looks at China's contribution to growth in USD, back in 2007 its GDP, according the World Bank, was $3.5 trillion. At a 14% rate, it contributed $490 billion in growth. This year, the economy is $10.4 trillion, so even at a 5% rate, it will contribute $520 billion, which is more than at the time when it was growing at almost triple the rate.

A recent report by UBS on China sums up the "big-picture bottom line" for China quite well:

Although there remains downward risk to our 2015 growth forecast of 6.8%, we think that China's recent property sales revival and intensified government policy support have lowered risks of a sharp hard economic landing this year. In addition, despite ongoing stock market gyrations, we expect the government will be able to manage domestic liquidity to ensure financial system stability. We anticipate headwinds from slowing property investment and industrial activity to be largely offset by stronger policy-driven infrastructure support, allowing for growth to grind down rather than drop off sharply in the next couple of years.

How about Western markets?

While the short-term technical signals are ominous - pointing to possible further market drops -we view the ongoing falls as an excuse for a correction that the market needed to happen, and to shake off excesses that occur in a secular bull market. The fundamentals are actually quite OK, both in the US and Europe, and both economies are only slightly impacted by exports to China.

The table on the next page, also from UBS, is from a research paper that argues that the **Eurozone is actually in much better shape this year than it has been for many a year.**

Fundamental changes over 2014 things did get better over the year

Indicator	Start 2015 / today	Start 2014	Good for Europe	Comments
Euro / USD	1.13	c. 1.40	✓	Positive for profits
Oil price	<50	112	✓	Avoid oil price deflation line of fire and a positive
HICP Inflation	0.2%	0.8	mixed	See as good deflation – not about falling wages
Real wage growth	Higher	1.1	✓	Better
Chance of QE	YES	NO	✓	A support when Europe in recovery mode
Single banks regulator	ECB the single regulator	No single regulator	✓	More influence over Banks
Stress test	Done	Lurking	✓	Had big provisions ahead of AQR/stress tests
Bank provisions & lending growth	Provisions now stabilizing (4 years behind US)	Ongoing	✓	ECB survey still best in c. 7 years & M3 growth the best since 2008
Fiscal Drag	Over!	Ongoing for 6 years	✓	Finally turning to support from a drag
US unemployment	5.3%	6.7%	✓	US economy holding up
Global macro & Political risk	Bigger today	Lower	✗✗	China/EM growth & political risk heightened

Source: UBS

Similarly, U.S. economic growth could average close to 3% in the second half of this year, hardly gloomy conditions associated with a bear market. As Goldman Sachs recently noted, only 2% of sales generated by companies in the Standard & Poor's 500 index come from China, and less than 1% of U.S. exports go to China. As such, the U.S. economy will avoid contagion and continue to expand.

How are your portfolios faring?

It is difficult to go against the grain, so all portfolios have suffered in August. As we noted in our note last week, even some of the world's best known investors like Warren Buffet and the massive Norwegian sovereign wealth fund suffered big losses. What is important to us, as it is for them, is that we allocate judiciously and invest in good assets.

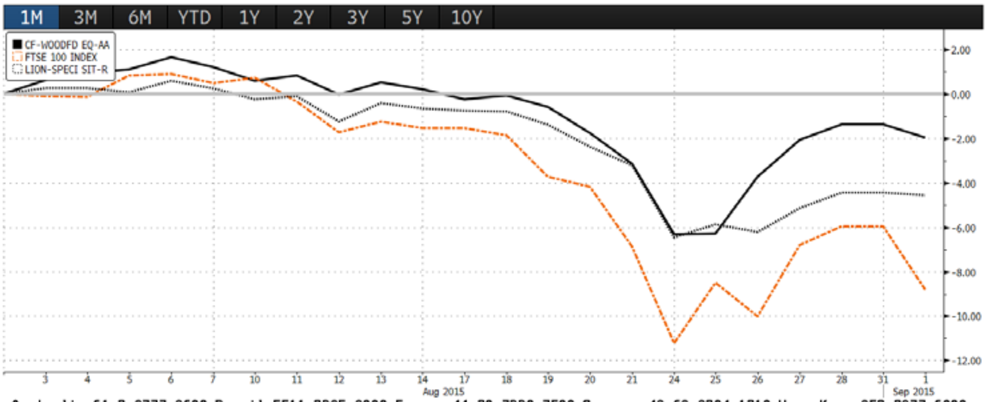
Proof of the above is that the core funds we invest in have actually held up quite well. If we look at how they performed in the last month, and also Year-to-Date, you will see in the following charts, where we compare our two largest core funds to their indices, that:

- In the last month all core funds in their respective currencies (USD, EUR, GBP) did better than their indices. I.e. they all fell less on the way down.
- Year-to-Date, the core GBP and EUR funds had positive returns. I.e. better on the way up.
- Year-to-Date the core USD funds slightly underperformed the S&P 500, an index that is very hard to beat. This is the reason why in early June, anticipating more volatile markets, we structured a note that can withstand up to a 15% drop in the S&P 500 without loss. {Note that this note has held up reasonably well, but the benefits will only appear closer to its maturity in June 2016}.

GBP Funds vs the FTSE 100, 1-month and YTD

Range 07/31/2015 - 09/01/2015 Period Daily No. of Period 32 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	CFWEIAA LN Equity	GBp	-1.98%	-1.98%	6.83%	-20.38%
2)	UKX Index	GBP	-9.52%	-8.80%		-65.05%
3)	LIONFIO LN Equity	GBp	-4.56%	-4.56%	4.24%	-41.29%



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Range 12/31/2014 - 09/01/2015 Period Daily No. of Period 244 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	CFWEIAA LN Equity	GBp	10.84%	10.84%	15.90%	16.64%
2)	UKX Index	GBP	-7.73%	-5.06%		-7.47%
3)	LIONFIO LN Equity	GBp	3.89%	3.89%	8.95%	5.88%

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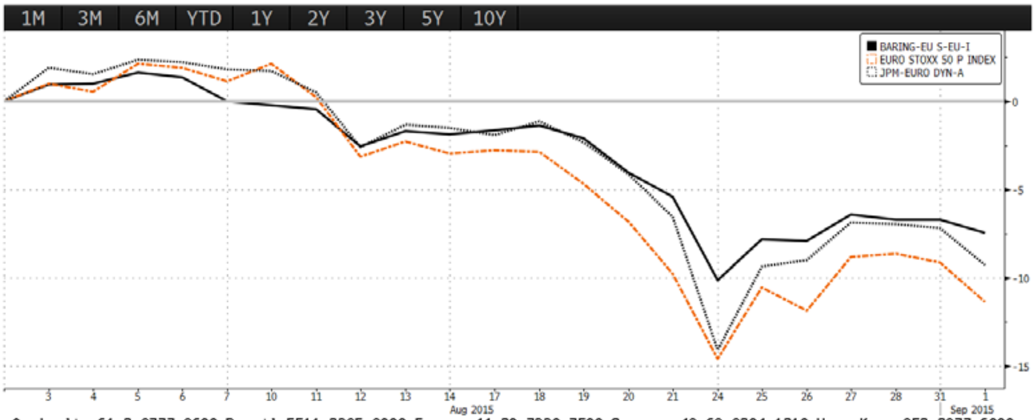
EUR Funds vs Eurostoxx 50, 1-month and YTD

Range 07/31/2015 - 09/01/2015 Period Daily No. of Period 32 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	BAREUSE LN Equity	EUR	-7.43%	-7.43%	3.93%	-58.55%
2)	DJST Index	EUR	-11.44%	-11.37%		-74.75%
3)	JPEDEAA LX Equity	EUR	-9.27%	-9.27%	2.10%	-67.01%



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Range 12/31/2014 - 09/01/2015 Period Daily No. of Period 244 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	BAREUSE LN Equity	EUR	13.24%	13.84%	9.72%	21.40%
2)	DJST Index	EUR	1.34%	4.12%		6.23%
3)	JPEDEAA LX Equity	EUR	8.14%	8.14%	4.02%	12.42%

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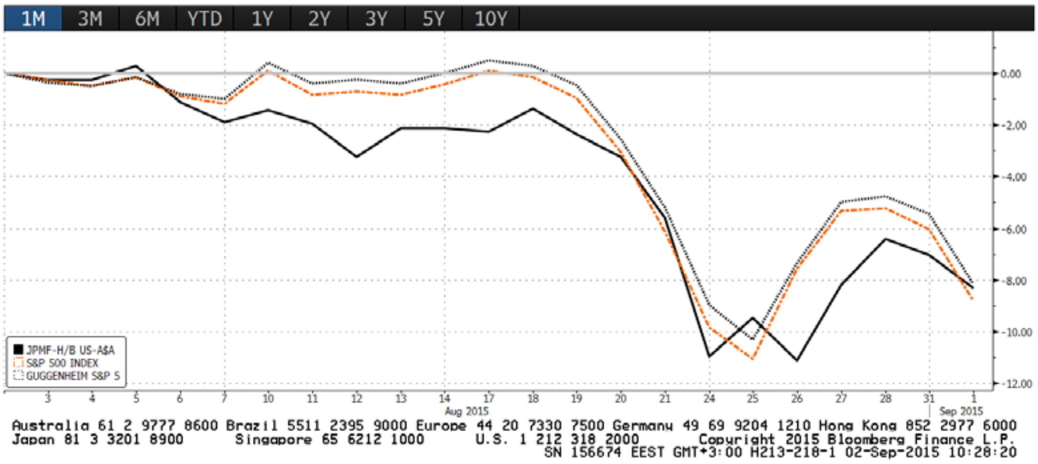
USD Funds vs S&P500, 1-month and YTD

Range 07/31/2015 - 09/01/2015 Period Daily No. of Period 32 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	JPHUSUA LX Equity	USD	-8.32%	-8.32%	.49%	-62.85%
2)	SPX Index	USD	-9.03%	-8.81%		-65.07%
3)	RSP US Equity	USD	-8.15%	-8.15%	.65%	-62.10%



Range 12/31/2014 - 09/01/2015 Period Daily No. of Period 244 Day(s)

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	JPHUSUA LX Equity	USD	-7.58%	-7.58%	-1.83%	-11.13%
2)	SPX Index	USD	-7.05%	-5.75%		-8.48%
3)	RSP US Equity	USD	-7.56%	-6.83%	-1.08%	-10.04%

The Elgin Analyst Team

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