

Monthly Commentary 3rd February 2015

January was one of the most exciting months in markets for a long time. It was marked by the unprecedented decision by the ECB for full-blown QE, a completely surprising move by the Swiss National Bank which led to a historic one-off gain for the Swiss Franc, new historic highs for many government bond markets and continuing major turbulence in the energy markets as crude oil continued its slide to multi-year lows.

There were also lots of divergences in equity market performance as US equities, which had led the world in 2014, fell more than 3% whereas European equities were up by 7%.

What is in store of the rest of the year?

We are being asked all the time about our outlook for financial markets for this year. We'll be happy to provide our opinions but as the events of the first paragraph have proven, most forecasts turned out to be woefully wide of the mark. So wide in fact that basing investment strategy on forecasts alone would have had disastrous consequences.

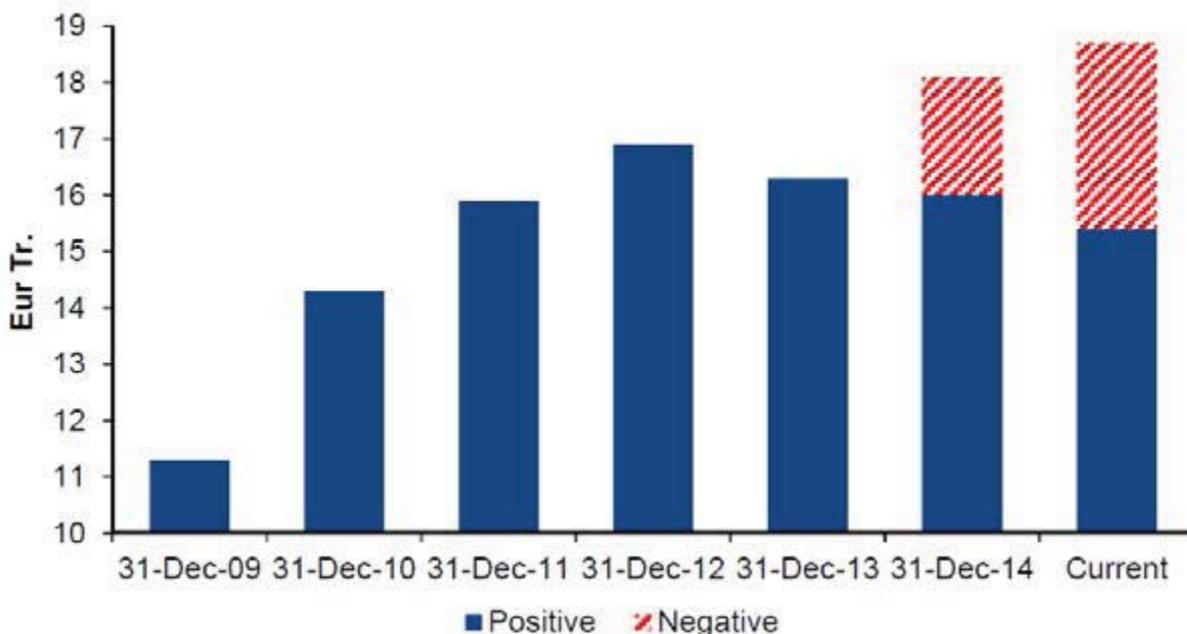
Let us first ask: What are the markets telling us?

Falling oil prices and falling bond yields have historically been a double signal that global growth is weakening and that a recession is imminent. This explains why the likes of IMF and World Bank have been lowering their global growth forecasts. This, in turn has created a lot of nervousness among equity investors. This is evidenced by the facts that mutual fund cash positions are at the same levels of where they were at the peak of the 2008/09 crisis and pension fund equity weightings are down to where they were 50 years ago.

With regards to falling bond yields, "Negative Yields" are becoming the new buzzwords in the investor lexicon. As we write this, the 2-yr bonds of nine European countries have negative yields, as do six countries' 5-yr bonds! Japan and Europe are the leaders in this negative yield sphere, where almost a quarter of all outstanding government debt has yields of less than zero.

The chart below from Merrill Lynch highlights this.

The real story of late, though, is the decline in positive yielding global government debt (BofAML global government bond index, split by positive and negative yields)



Source: BofA Merrill Lynch Global Research. WOG1 index, converted into Euros.



So where are the positives in all this?

I shall quote from Martin Taylor of Nevsky, who summed it up eloquently below:

“With BoJ and ECB buying, a record global savings rate and near-record equity buybacks, the current wave of inflows into investment institutions will continue to accelerate. This money has to go somewhere so - Ceteris Paribus - ten-year yields in Germany and Japan will soon be at zero. In the US, the Fed, faced with the scary global deflationary message this gives, spillovers into their own bond markets and worried by their current ultra-low wage inflation, will keep US rates at zero far longer than currently forecast; while China, where CPI is heading negative, is likely to cut rates and print money. In stasis this means sovereign cost of capital globally is heading towards zero.

This is obviously madness and collective and unprecedented loss of nerve by the investor community. We have seen such risk aversion in panics and crises but not when in 2015 we see the US economy is cantering at 3%, China at near 7%, India at 6% and even Japan and the Eurozone managing about 1%. No recession here in aggregate or alone.”

So our opinion is that the world is not coming to an end. Continuing, and massive stimulus in Japan and Europe, coupled with low oil prices, low inflation and low cost of capital is a strong tail wind for equities. The worries will always be there - and we can list many global worries. But the markets have found a way to climb this wall of worries, and for good reason. As such, in our portfolios we remain tactically overweight equities even though we expect much higher volatility this year. On the tactical side, we like high-yielding Eurozone equities, transportation and consumer discretionary (which should benefit from low oil prices), Japan, Health Care and Technology. We are also keeping an eye on listed real estate which would be a beneficiary of low rates and QE.

The Elgin Analyst Team

Disclaimer

All information contained herein and any opinions expressed in it are intended solely for the use of customers of Elgin AMC (“Elgin”). This document is not, and should not be construed as an offer or solicitation to buy or sell any product, security or any other financial instrument. Any opinions expressed in this document are subject to change in that notice. This information is a marketing communication for the purpose of the European Markets in Financial Instruments Directive (MiFID) and CySEC’s Rules. It has not been prepared in accordance with the legal requirements designed to promote the independence or objectivity of investment research. This document is not based upon detailed analysis by Elgin of any, market, issuer or security named herein and does not constitute a formal research recommendation, either expressly or otherwise. It is not investment advice and does not take into account the investment objectives and policies, financial position or portfolio composition of any recipient. This document should not be relied upon as authoritative or taken in substitution for the exercise of your own commercial judgment. This document has been prepared on the basis of economic data, trading patterns, actual market news and events, and is only valid on the date of publication. Elgin does not make any guarantee, representation or warranty, (either expressly or impliedly), as to the factual accuracy, completeness, or sufficiency of information contained herein. This document has been prepared by the author based upon informational sources believed to be reliable and prepared in good faith. Elgin does not make any representation or warranty, express or implied, as to the accuracy, completeness or correctness of this information. Elgin does not accept any liability for any loss or damage, howsoever caused, arising from any errors, omissions or reliance on any information or views contained in this document. The value of any securities mentioned in this document may move up or down, and the value of securities denominated in other currencies will also be subject to fluctuations in the relevant exchange rates. Securities issued in emerging markets are typically subject to greater volatility and risk of loss. Elgin’s officers, directors and employees may own or have positions in any investment(s) mentioned herein or related thereto and may, from time to time, add to or dispose of any such investment(s). This information is the intellectual property of Elgin. Redistribution or dissemination of this document is prohibited.

Elgin AMC is a trading name of Numisma Capital Ltd. Numisma Capital Ltd is regulated by the Cyprus Securities and Exchange Commission (CIF licence no. 122/10) Additional information from Elgin AMC is available upon request at info@elgingamc.com