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CAERUS Market Commentary – January 2016

Market overview

Any respite from market volatility in December proved to be short lived and markets have had a particularly difficult start to 2016. Volatility has been on the rise again since November as a result of continued concerns over China, the oil price and recession risks in the US.

Despite a rally over the last few days in the period, equity markets around the world ended the month in negative territory with UK large caps being the worst performer finishing down 4.92% and the US market being the best but still losing 1.29%.

'Safe haven' assets performed strongly in the risk-off environment with gilts and index linked gilts gaining 2.79% and 4.07% respectively. Corporate credit fared less well, returning 0.65% and strategic bonds ended the month virtually flat.

United Kingdom

As we have mentioned previously, the UK stock market is heavily exposed to the oil and gas and mining sectors, both of which suffered on the back of a renewed plunge in the oil price. This, combined with wider Investor concern over the strength of the global economy, meant that UK equities were the worst performing asset class this month. However, the lower oil price should help bolster consumer confidence in the short term, as this feeds into real wage growth. Volatility in UK markets, particularly sterling, is likely to remain high as we approach the EU membership referendum. Uncertainty over the outcome is likely to defer Investment in the UK by corporations, which may have an adverse impact on growth and financial markets in the short term.

United States

A potential knock-on effect of the lower oil price is that the US Fed might not be able to enact its anticipated four interest rate rises this year, as inflation will take longer to come through. This means that the path of rate rises is likely to be shallower with perhaps only two or three hikes, which is more in line with market expectations.

As per the UK, the lower oil price is a good thing for the consumer as real wage growth is rising in the US, as is household credit growth, which points towards a confident consumer and a continuing recovery. Whilst the outlook for the US economy is still uncertain, there are other reasons to be confident that a recession is not looming, such as jobless claims trending lower and increasing housing starts. Having said that, the risks of recession have certainly risen over the past few weeks.

Europe

The ongoing threat of deflation in the eurozone still looms over the economy and the ECB. Whilst the core rate of inflation reached 1% in January, the headline rate came in at a mere 0.40%, well short of the 2%, or just below 2%, target. This has prompted further words of reassurance from Mr Draghi, along with a hint that monetary policy

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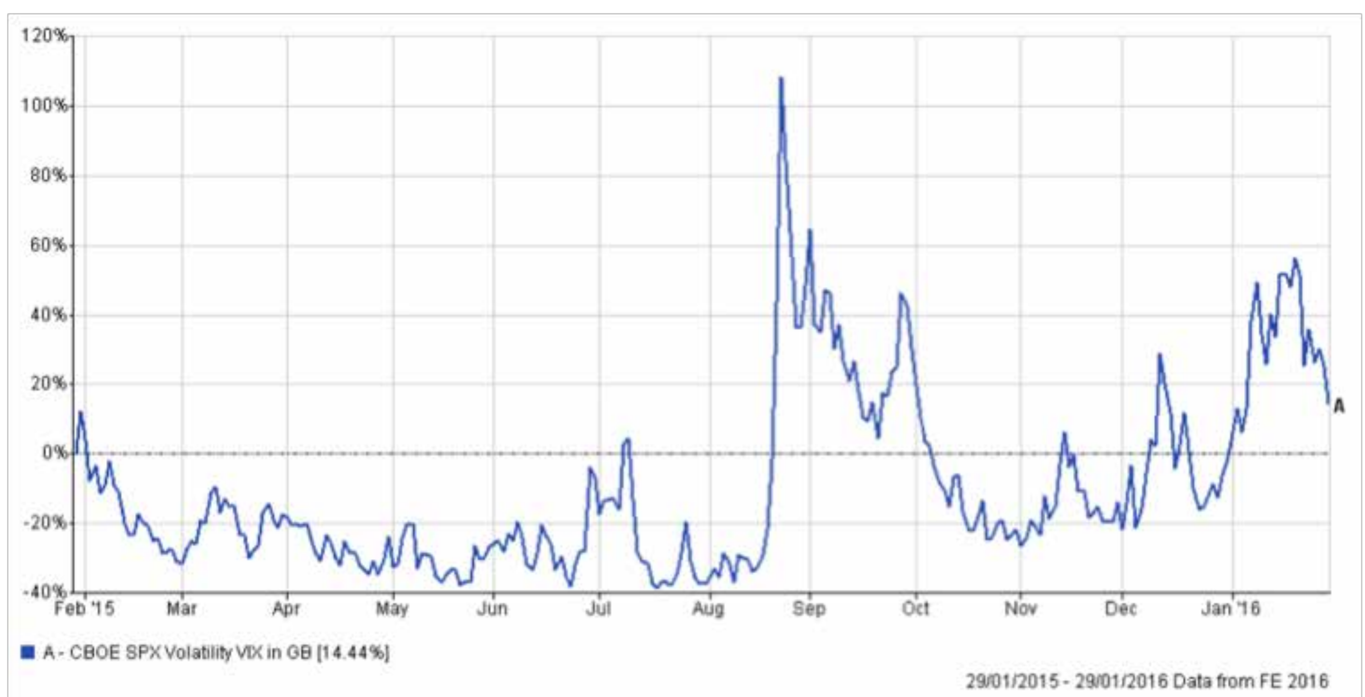

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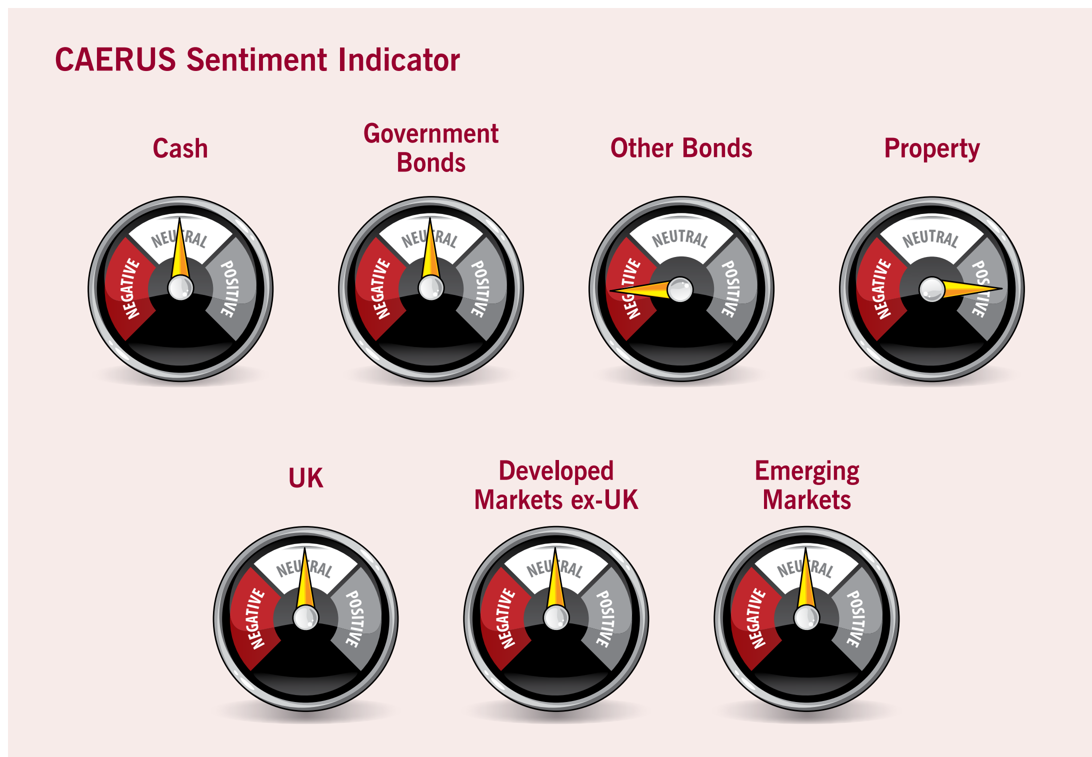
will be eased yet further in March. All eyes then will be on the ECB, in March, for signs of further QE or a deeper cut to central bank deposit rates. Central bankers have demonstrated an ability to move markets over the past few years and one hopes that Mr Draghi manages to placate markets once again.

Japan

Governor Kuroda surprised the markets by introducing negative deposits rates, just 12 days after they were ruled out as a possibility. This sent the Yen tumbling versus the Dollar and markets around the world rallied. The hope is that the move will encourage banks to lend to the real economy which will, in turn, lead to greater consumer confidence and spending. Combined with the external pressures on the Japanese economy from a slowing China and struggling emerging economies, this would point to domestically orientated companies being the primary beneficiaries if the policy is successful.

Emerging markets

As a reminder, 'emerging markets' are a diverse and broad set of economies each with their own tailwinds and headwinds. This makes selectivity in the emerging markets key, and manager experience and skill are as important as ever. Generally speaking, the emerging markets have been hit with an almost perfect storm of a strong US dollar, plunging oil price and a slowing China. All of this has led to extremely negative sentiment towards the sector as a whole and depressed valuations. Therefore, on a long-term view, the emerging markets are beginning to look attractive. However, there may be more volatility to come until the paths of the Chinese economy and US rate rises appear more certain.



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