CAERUS Portfolio Management

CAERUS Market Commentary – September 2015

Market overview

September rounded off the worst quarter for global equity markets in around four years with most of the pain being felt from mid-August onwards. The month has been characterised by increased volatility with the VIX Index (a measure of the volatility of the S&P 500) some 40% higher, on average, than in July and August.

Equity markets fell between 1.58% (Asia Pacific) to 6.95% (Japan).The importance of holding a well-diversified portfolio is demonstrated during volatile markets with UK Gilts posting a mild gain of 1.31% for the month. Corporate bonds and Index Linked Gilts were virtually flat.

Last month, we referenced a chart from Goldman Sachs which suggests that pullbacks of more than 5% have taken, on average, 28 days to bottom and then 30 days to recover. It is interesting to note that equity markets have not yet retested their August lows. Whether this means the pullback has bottomed or not is difficult to tell.

A note about Bonds

We have been warning for some time that volatility can be expected to rise as central banks in the US and UK approach the point of change in monetary policy. Whilst equity market moves have felt uncomfortable of late, the bond market deserves some attention.

TD Securities analysts Priya Misra and Gennadiy Goldberg write:

"Our findings show that daily changes in 10-year Treasury yields exceeded one standard deviation 58% of the time so far in 2015 – considerably higher than the 49% observed last year. The 58% measure is the highest reading going back to 1975, suggesting that recent volatility in Treasury markets is unprecedented."

Source: TD Securities & www.Bloomberg.com

Clearly, volatility is rising across traditional asset classes.

United Kingdom

Despite a relatively strong economy and consumer spending power being the highest for many years, the UK market continues to struggle somewhat, falling 2.73% over the month. The UK market derives over 70% of its earnings from overseas and has a high weighting to commodity linked sectors so is far from insulated from the troubles in the emerging world. Domestically orientated areas of the market have fared a little better.

United States

All eyes were on the Fed in September and, once again, rates were held at close to zero. Markets sold off on the news but then rebounded slightly after Janet Yellen reiterated the Federal Open Market Committee's expectation to raise rates before the year is out. These moves indicate a market which is concerned about global growth and looking for hints of sufficient confidence in the world's largest economy to withstand a rate rise. There is huge scope for policy error and one hopes that the Fed will not look foolish in the fullness of time.

Europe

Europe slipped back into deflation as a result of low energy prices and deflationary forces from the emerging world. This raises the question of whether the European Central Bank (ECB) will expand their, already massive, quantitative easing (QE) programme. Draghi has hinted that the ECB will step in to provide further support to the economy if needed, so more QE is a distinct possibility.

Japan

Again, Japan's economy has disappointed of late and inflation is nowhere near the central bank's target of 2.00%. Some commentators expect to see yet more QE as early as November, but whether this transpires or provides a boost to equity markets remains to be seen. Having said that, earnings growth is positive in Japan and the market is attractively valued relative to its own history and the rest of the developed world.

Emerging markets

The emerging and Asia Pacific markets were the "best" performers over the month, losing 1.58% and 1.87% respectively. Could this be an indication from the market that we have seen the worst of the bad news from China? As we have mentioned before, some areas of the emerging markets look cheap relative to the rest of the world but the region faces a multitude of headwinds which show no sign of abating for the time being.

CAERUS Sentiment Indicator