Issued in September 2015

Schroders

Monthly markets review

Overview of markets in August 2015

Highlights:

- Global equities experienced sharp declines in August as worries over slowing Chinese growth sparked significant volatility across markets.
- In the US, the S&P 500 fell by 6.0% with the decline led by some of the year's hitherto best performers. The sell-off came despite continued strong macroeconomic data, most notably for the US consumer.
- Eurozone and UK equities also delivered negative returns. Amid the global growth worries, declining energy and metals prices weighed on the resources sectors.
- Emerging markets also registered steep negative returns, underperforming their developed market counterparts amid the volatility in China and ongoing economic weakness in Brazil.
- In fixed income markets gilt, Treasury and Bund yields rose over the month. Riskier fixed income assets, such as high yield bonds, underperformed.

US

The S&P 500 fell by 6.0%, led by some of the year's hitherto best performers, including the consumer discretionary and healthcare sectors. While events in China were the trigger, the declines were also interpreted as an overdue correction. This was in the context of commentators having long highlighted the relatively overvalued state of US equities versus other regions. The prospect of an interest rate hike from the Federal Reserve (Fed) appeared to recede amidst the turmoil with New York Fed chairman William Dudley saying that the case for a September rise now appeared 'less compelling'. However, Fed vice-chair Stanley Fischer emphasised at Jackson Hole that a September increase remains a possibility.

Equities fell amid continued strong forward-looking macroeconomic data, in particular for the US consumer with the Institute for Supply Management's service sector index striking a 10-year high of 60.3. Meanwhile, the Conference Board's consumer confidence index jumped to 101.5, from 91 in July, while US auto sales for July comfortably beat expectations and remained in fine fettle.

As the 'risk off' Chinese-induced sentiment set the tone, even the prospect of a resilient US consumer could not support many of the consumer-focused companies. Underlining the undiscerning nature of markets, Apple shares were sold off sharply on 'Black Monday' (24 August), only to recover all of the intra-day losses after chief executive officer Tim Cook sent an email to a US TV show to offer reassurance that consumer demand in the company's most important growth market remained 'strong'. Healthcare was another notable underperformer, as the biotechnology names which had also performed so well previously went into reverse.

There were some fundamental drivers, with Walt Disney's cautious outlook in its third-quarter results weighing heavily on the media companies within the consumer discretionary space. The cause here was more structural than cyclical, due to a worsening outlook for the company's cable business as consumers switched to video streaming. Merger and acquisition activity provided a few bright spots, notably Warren Buffett's Berkshire Hathaway announced its biggest acquisition yet, to buy engineering group Precision Castparts for $32.5 billion.

Eurozone

Eurozone equities registered sharply negative returns in August as worries over slowing growth in China dented appetite for risk assets. The MSCI EMU index returned -8.4%. The possibility of an imminent US rate hike was another focus for investors but China was the main area of concern amid weaker macroeconomic data, Beijing's mid-month devaluation of the renminbi and significant volatility on Chinese stockmarkets.

The Chinese volatility and expectations of slower global growth weighed on metals and oil prices, which in turn pressured the eurozone's materials and energy sectors. Other areas of the market with significant exposure to China – such as luxury goods – also lagged behind. The euro appreciated by 2.1% against the US dollar in the month, impacting exporters. European Central Bank chief economist Peter Praet said the bank's inflation target was potentially at risk amid the softer commodity prices and that policymakers are ready to act if needed.

Prior to the China-induced volatility, the month had started on a relatively positive note as a deal was reached to provide €86 billion of bailout funding to Greece. Splits within the ruling Syriza party saw Prime Minister Tsipras tender his resignation, with fresh elections scheduled for 20 September. Macro data suggested that the eurozone's economic recovery is continuing, albeit at a slow pace. GDP growth for the region was 0.3% in the second quarter, slowing from 0.4% growth in the first quarter. The flash composite purchasing managers' index rose to 54.1 in August from 53.9 in July while Germany's Ifo business climate index rose to 108.3 from 108.0. Inflation remained stable at 0.2% in August.

UK

UK equities performed poorly, in line with global markets, amid fears that China's currency devaluation indicated a deeper slowdown in the world's second-largest economy. In turn, growing worries of an across-the-board deceleration in emerging markets growth precipitated a sharp retreat in metal and energy prices, which weighed heavily of the UK's dominant resources sectors. This was reflected in a 6.0% decline in the FTSE 100, in excess of the FTSE All-Share's 5.3% retreat.

Mid and smaller-cap companies outperformed as some of the more domestically-orientated sectors provided much-needed ballast with the immediate outlook for the UK consumer remaining positive. Merger and acquisition activity was a feature again, including Shire's hostile bid for US drugmaker Baxalta, news that US activist hedge fund ValueAct Capital had taken a stake in industrial conglomerate Smiths, the planned disposal by HSBC of its Brazilian unit Brandesco and confirmation that online sports betting group Betfair was in merger discussions with bookmarker Paddy Power.

Corporate newsflow, albeit thin on the ground, was of little consequence in guiding the market, as the 'risk-off' sentiment that resulted from China's actions set the tone. HSBC's better-than-expected interim results were quickly forgotten and it, together with rival Asian-focused bank Standard Chartered, was among the worst-performing UK-quoted stocks in the month. Disappointing interim results from Rio Tinto and Glencore added to the gloom surrounding the mining sector, while the integrated energy giants suffered as the oil price fell.

Construction and materials was the only sector to record meaningful absolute returns in the month, led by international infrastructure specialist Balfour Beatty as its half-year results underlined that the turnaround strategy implemented by the new management team is gaining traction. UK macroeconomic data continued to point to a resurgent consumer, with GfK's UK Consumer Confidence Index striking a 15-year high

Japan

August started brightly enough for the Japanese equity market, following on from the end of the quarterly reporting period. However, from 19 August, domestic factors were overridden by global macro events and the negative sentiment which engulfed most world markets. As a result, the Japanese market ended the month down 7.4% in yen terms. Heightened levels of uncertainty led to a sharp strengthening of the yen against major currencies, reversing most of the weakness seen year-to-date. Against sterling, the yen gained 3.9%, which restricted the negative return from the equity market to 3.6% for a sterling-based investor.

The equity market was led downwards by many cyclical sectors such as steels and machinery, together with autos and banks. The strongest performing sectors were a slightly random collection of sectors with specific incentives, including construction and textiles.

Although July's Greek crisis quickly faded from investors' minds, the renewed doubts over China's rate of growth, plus ongoing concerns on deflationary trends globally, dominated investor sentiment throughout August. There was also further weakness in commodity prices during the month.

Against this backdrop there was little significant corporate news, although the Toshiba accounting scandal continued to drag on with a further delay in the filing of full-year accounts. The domestic political situation also took a back-seat this month. With attention shifting back to the domestic economy, Prime Minister Abe has seen some recovery in his approval rating following the negative reaction to strengthen Japan’s military capacity.

Asia (ex Japan)

Asia ex Japan equities continued their descent in August as global worries over an intractable slowdown in Chinese growth sparked a worldwide sell-off in stocks, with Asian markets delivering their worst monthly performance since May 2012. Chinese equities led the region’s losses as a ‘Black Monday’ for global equity markets in late August was fuelled by a near-9% one-day fall in the Shanghai Composite Index. Investor sentiment in China was hit by data that continued to highlight the weakening pace of growth in the world’s second-largest economy. Further uncertainty over the Chinese government’s willingness to support the stockmarket also stoked the selling frenzy. These falls came despite a further reduction in both interest rates and reserve ratio requirements.

In Hong Kong, stocks saw large declines on worries over China and on weak data for the local economy. Over the strait in Taiwan, stocks fell sharply in August as the global sell-off hit the island’s technology firms. Korea stocks posted losses as a weak Korean won and declining exports weighed on returns. In ASEAN, all markets saw heavy selling as Indonesia, the Philippines and Thailand were adversely affected by the devaluation of the Chinese yuan, slowing domestic growth and expectations of an interest rate rise from the US Federal Reserve. Meanwhile, Indian stocks fell following sharp falls in global markets and on the continued slowdown in domestic rural demand.

Emerging markets

Emerging market equities came under pressure in August, despite a rebound towards month end, and the MSCI Emerging Markets (EM) index declined sharply to underperform the MSCI World.

Latin American equities registered the sharpest drawdowns with currency weakness magnifying declines across all regional markets. Amid a weaker demand outlook from China, commodity price falls weighed on a number of mining stocks in the region. Brazil was the weakest regional market as an economic crisis appeared to deepen; Q2 GDP contracted 2.6% year on year, consensus GDP forecasts for 2015 and 2016 were cut back and a credit ratings agency lowered its sovereign debt outlook to negative, raising concerns Brazil may lose its investment grade status. Meanwhile political news remained in the headlines with the president’s approval rating reaching a record low as anti-government protests took place during the month. The more defensive Chilean market held up best in the region.

Emerging EMEA equities experienced a wide range of returns. In Greece, the equity market re-opened following its closure in late June. Local equities fell sharply as prices adjusted following the government’s imposition of deposit withdrawal limits. Banks were hardest hit, given the sector is now expected to require a sizeable recapitalisation. Meanwhile, the government called a snap-election after Prime Minister Tsipras required opposition support to vote through legislation required to unlock a third bailout. The Qatari market held-up best but finished firmly in negative territory.

Emerging Asian equities experienced large declines. Malaysia recorded the steepest falls, with oil price volatility and political uncertainty over state-run fund 1MDB a drag on performance. In China, the PBoC altered the way it fixes the renminbi, to be more market driven. This led the currency to devalue and raised concerns regarding the health of the economy and uncertain future policy responses from the Chinese authorities. A deterioration in data including manufacturing PMI, trade figures and industrial production heightened concerns. Korea was the firmest market, given that the economy is relatively well positioned to weather an environment of global interest rate rises. An uptick in tensions with North Korea midway through the month was negative for sentiment although tensions were reduced following successful diplomatic talks.

Global bonds

In August, pronounced volatility in Chinese equities bled into international bond markets, leading riskier fixed income assets to significantly underperform. The People’s Bank of China (PBoC) devalued the renminbi for three successive days in the month; the currency falling -2.96% against the US dollar between 10th and 13th August. The PBoC also moved to curb capital outflows by making further cuts in the benchmark interest rate and the reserve ratio requirement. The announcements – alongside more stable macroeconomic updates from the US, the UK and the eurozone – helped to settle investor concerns by month end.

In spite of the market's fluctuations gilt, Treasury and Bund yields largely recovered from mid-month lows to be flat or higher by the end of August. The 10-year gilt rate rose from 1.88% to 1.96%, the 10-year Treasury yield rose from 2.18% to 2.22% and the 10-year Bund yield rose from 0.64% to 0.80%. The Italian 10-year yield rose from 1.77% to 1.96% and the Spanish equivalent rose from 1.84% to 2.11%.

In corporate bond markets, the investment grade BofA Global Corporate Index returned -0.69%, outperforming the high yield index which declined -1.71% (in local currencies)[1]. Sterling denominated bonds were the weakest among major investment grade indices in the month, followed by euro and dollar indices; all produced negative total returns. In high yield indices, dollar-denominated bonds led declines, followed by the euro and sterling equivalents.

[1] Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

Overview: total returns (%) – to end of August 2015

	1 month			12 months		
Equities	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
MSCI World	-7.88	-6.58	-5.21	13.31	-3.61	4.09
MSCI World Value	-7.74	-6.43	-5.06	8.37	-7.81	-0.46
MSCI World Growth	-8.02	-6.72	-5.35	18.32	0.65	8.68
MSCI World Smaller Companies	-6.60	-5.27	-3.89	14.35	-2.73	5.03
MSCI Emerging Markets	-10.28	-9.01	-7.68	-9.10	-22.67	-16.50
MSCI AC Asia ex Japan	-11.05	-9.79	-8.47	-1.06	-15.83	-9.12
S&P500	-7.35	-6.03	-4.66	18.12	0.48	8.50
MSCI EMU	-8.42	-7.12	-5.76	9.59	-6.78	0.66
FTSE Europe ex UK	-8.28	-6.98	-5.61	10.29	-6.18	1.31
FTSE All-Share	-7.99	-6.69	-5.32	6.32	-9.55	-2.34
TOPIX*	-6.61	-5.28	-3.90	23.47	5.03	13.41

	1 month			12 months		
Government bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
JPM GBI US All Mats	-1.35	0.05	1.51	20.55	2.55	10.73
JPM GBI UK All Mats	-2.51	-1.12	0.32	16.09	-1.24	6.64
JPM GBI Japan All Mats**	0.98	2.41	3.91	3.07	-12.33	-5.33
JPM GBI Germany All Mats	-0.92	0.48	1.95	2.16	-13.10	-6.16
Corporate bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
BofA ML Global Broad Market Corporate	-1.92	-0.53	0.93	11.37	-5.26	2.30
BofA ML US Corporate Master	-2.06	-0.67	0.78	17.07	-0.41	7.54
BofA ML EMU Corporate ex T1 (5-10Y)	-1.02	0.39	1.86	0.82	-14.24	-7.39
BofA ML £ Non-Gilts	-3.49	-2.12	-0.69	13.08	-3.81	3.87
Non-investment grade bonds	**EUR**	**USD**	**GBP**	**EUR**	**USD**	**GBP**
BofA ML Global High Yield	-2.91	-1.54	-0.10	11.49	-5.16	2.41
BofA ML Euro High Yield	-0.95	0.45	1.92	1.78	-13.42	-6.51

Source: DataStream. Local currency returns in August 2015: *-7.36% **0.17%. Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of any overseas investments to rise or fall.