

## Market Comment – Q4 2015

Emerging from a third quarter devastated by the Chinese stock market crash and its international repercussion, stressing the growth slowdown in the country, investors breathe again in the fourth one. Let's take a step back and... then dive back in the markets favorite topic: Will the Fed finally perform their first rate hike after almost a decade and what will happen then?

But let's start with **Asia** where so much focus was given during the summer. If the central bank of **China** lowered again its interest rate and the reserve requirement ratios for all banks at the beginning of the quarter, we gradually see Xi Jinping's government and the PBoC interventions coming to fruition. In November we observe improvement in real estate with the first prices increase in more than a year and significant improvement in auto sales reflecting positive development in consumption. Furthermore, at the end of the same month and thanks to the devaluation of the currency, the Yuan finally enters the IMF SDR currency basket, reflecting its importance as well as the progress made by the Chinese authorities toward a more opened economy.

As a close neighbor and important trading partner, **Japan** showed weaker economic data during the period. While the markets still rely on the support of the Bank of Japan, the BoJ refrains as much as possible to nourish expectations of further interventions. On the other hand, the business activity development looks much more appealing, especially as the government started considering a corporate tax reduction.

The Chinese slowdown obviously also impacts **Europe**, mostly through Germany as per its significant international exposure. Against all odds, the peripheral economies surprised on the upside by the pace of the recovery they display at the beginning of the quarter. The region is indeed showing some encouraging signs, but is still facing many challenges. First of all, the refugee crisis is not to be forgotten. Authorities estimate that there have been one million migrants in 2015, between 3-4 times more than in 2014. A situation further complicated by security issues following the terrible terrorists' attacks in the heart of Paris on the 13<sup>th</sup> of November. The Russian military plane shot down by Turkey in the same month at the far reaches of the region clearly didn't help either to lighten the mood. This context as well as several years of austerity measures directly influences the political landscape, another challenge for the economic recovery. During the first round of the regional elections in France for instance, the extreme right party "Front National" was unprecedentedly leading the pool, a symptomatic reaction. In Spain, if the elections resulted in the maintenance of the ruling conservative party the "Partido Popular", Mariano Rajoy failed to conserve the majority. The requirement of a coalition government could potentially jeopardize the significant recovery of the Spanish economy observed over the course of the year. Last but not least, UK polls in November revealed that a majority is favoring an exit of the country from the European Union...

This is why Mario Draghi remains vigilant! Given the above challenges, the threats weighing on the still fragile economic recovery and the risks of deflation, the ECB lowered their deposit rate by 10bps to -0.30%, included regional debt in their monthly purchases and extended the QE program by six months, corresponding to an additional €360bn liquidity injection. They also communicated they were ready to do more if needed.

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What about the United States? Well, without any surprise, the Chinese slowdown didn't spare the business activity and the economic growth at the beginning of the period, but the labor market continued its positive development. From November to mid-December however, the economic news flow is back on its positive track. Yes, the occurrence of the Third Avenue Focused Credit Fund issues reminded everyone the liquidity risks hovering over the fixed income markets, but the labor market continued to improve in a quite stable manner and core inflation continued on the right track. This gave little space to the Fed to avoid the long awaited decision. The time had come to leave almost a decade without any rate increase and exactly seven years of a fund target rate stuck at 0.25 like an electroencephalogram flat signal behind us. On the 16<sup>th</sup> of December, the Fed finally increased its key rate by 25bps to 0.5% following a decision taken unanimously by all the voting members.

Looking at the performances of the markets, the last quarter of the year saw globally a rebound in equities, especially in the developed markets (mostly concentrated in October). The MSCI World Index posted a positive performance of 5.03% while the MSCI Emerging Market was only modestly up by 0.66%. There was again a lot of dispersion: for instance China (Shanghai Index) rebounded by almost 16% while Brazil was down by almost 4%. On the fixed income side, global indices are showing a loss of almost 1% for the period. Despite the rate hike, the USD only moderately appreciated versus the major currencies, with an appreciation of 2.94% vs EUR, 2.66% vs GBP and only 0.28% vs the JPY.