MARKET COMMENT – Q2 2016

The temptation to summarize the second quarter in a single word is overwhelming. The so called “Brexit” was indeed a considerable point of focus of the markets, but the UK referendum concerning its European Union membership was not the only major event for the period.

April started with the mediatized Panama Papers which put a lot of pressure on some political figures. More fundamentally, its longer term impact will support the decrease of the offshore structuring business, legal or not, as per the bad publicity it has created. Then there was the attempt to reach an agreement on a possible oil production freeze discussed in Doha, a meeting attended by most of the OPEC members and other major producers including Russia, which failed. Ironically enough, this didn’t stop the price rally we had for the month where the crude gained more than 13% for the WTI and more than 21% for the Brent. Nonetheless, investors were globally reassured by the Chinese first quarter GDP published at 6.7% which was better than expected (despite all the caution required regarding macroeconomic figures are provided by the government), and the earning season which in average surprised in the upside as per the excessive negative expectation from analysts that prevailed earlier this year.

In May, the tensions regarding the coming UK referendum grew following the various surveys on the subject, while on the other side of Europe some additional financial relief was provided to Greece. The Eurozone continued its timid recovery path, with Spain surprising significantly on the upside. In the US, the Fed hinted a potential rate hike for the end of June, while Hillary Clinton and Donald Trump were on their way to become their respective party’s candidates for the US elections. In South America, Brazilian president Dilma Rousseff was suspended from her duties on allegations of her potential involvement in the Petrobras scandal.

But it is in June when higher volatility came back to the markets. Starting with the US economy reporting a worrying figure on the labor market with the non-farm payroll indicating that only a small number of jobs were added in May. This raised concerns about the recovery path of the world’s largest economy. Investors got then obsessed with the UK referendum and the tights odds announced by the various surveys. In the UK, tensions peaked when Helen Joanne Cox, from the Labor party, was murdered on the 16th. From then, a reassuring trend in surveys pointing toward a “Bremain” supported a relief rally in equity markets for a couple of days before the votes. The outcome of the referendum on the 23rd nonetheless showed that a majority of UK citizens (51.6% of the votes) wanted to leave the European Union. The end of the month saw the resignation of Prime Minister

David Cameron, rating agencies downgrading UK and the EU and a reminder from the major central banks that they would remain supportive.

In a nutshell, what needs to be remembered for the second quarter of the year is that markets dropped out the Chinese worries and focused again on Europe concerns in the aftermath of the Brexit vote, oil prices rebounded strongly despite all negative forecasts, and finally that we reached USD 11 trillions worth of government debt with negative yield towards the end of June.

In conclusion, we have today a very challenging environment. In addition to the modest recovery in the US and the weak one in Europe, the Chinese growth deceleration and all the other geopolitical tensions, the Brexit raised the question of the sustainability of the European Union. Yes, central banks over the world remain supportive of their economies, but are also are engaged in a taboo currency war. Moreover, the unbelievable amount of government debt with negative yield may well be a reflection of their policy limits. Following waves of indiscriminate investment and divestment flows, the set of opportunities in financial markets is undeniable, but the related risk significant. Accordingly, we tend to favor absolute return strategies with a limited net long exposure in general in order to ensure a stable ship in turbulent and rough waters.

19th Floor, Newton Tower
Sir William Newton Street
Port Louis, 11328
Mauritius

+230 405 9000
+230 405 9001
gmgfinancial.com

Co Reg.: 69627 C1/GBL