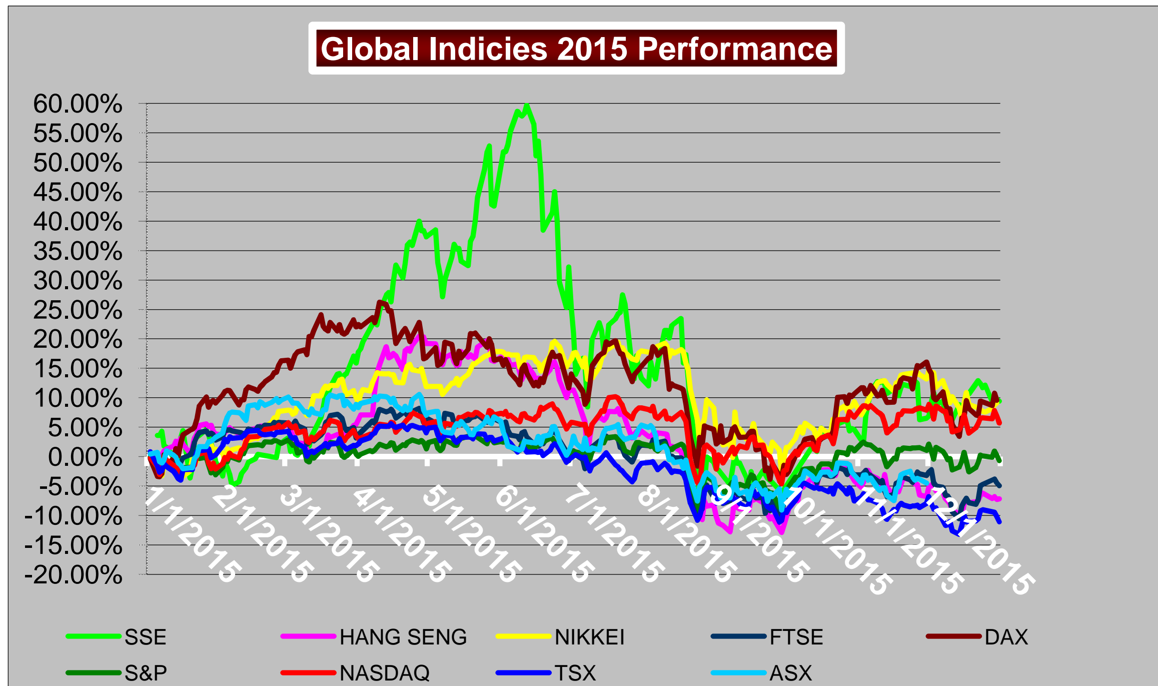
GDB January 2016 Newsletter

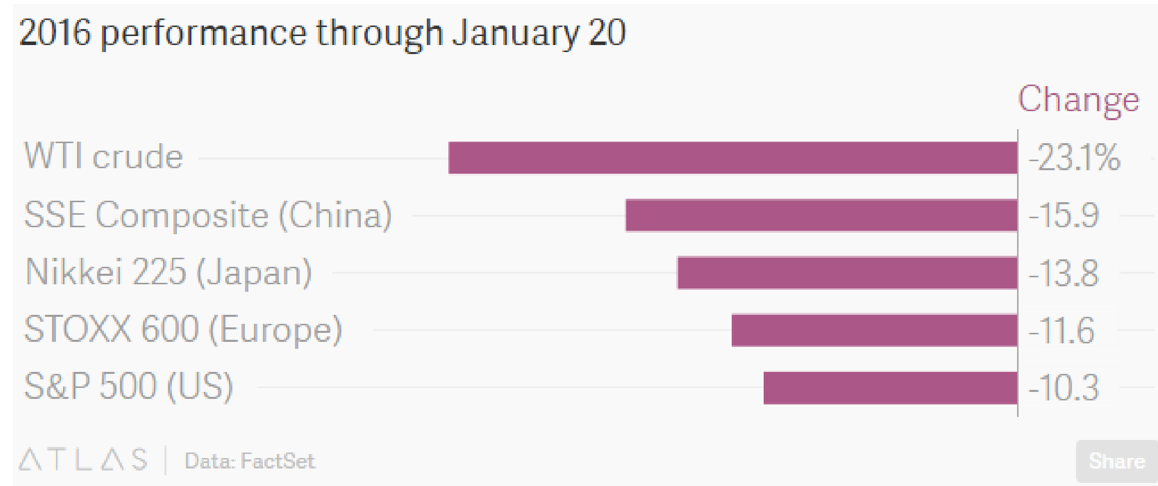
Monthly Market Summary:

2015 December Market Activity		
SSE COMPOSITE	*3,539.18*	+93.78 (+2.72%)
HANG SENG	*21,914.40*	-82.02 (-0.37%)
NIKKEI 225	*19,033.71*	-713.76 (-3.61%)
FTSE 100	*6,242.30*	-113.80 (-1.79%)
DAX	*10,743.01*	-639.22 (-5.62%)
DOW	*17,425.03*	-238.51 (-1.35%)
S&P 500	*2,043.94*	-36.47 (-1.75%)
NASDAQ COMPOSITE	*5,007.41*	-101.26 (-1.98%)
ASX 200	*5,295.90*	+129.40 (+2.50%)
TSX COMPOSITE	*13,010.00*	-459.80 (-3.41%)



Investment Themes:

January started with some of the worst losses in history for US major indices. Concerns with slow down in China and the falling oil prices have injected panic into the markets. The three US indices are in correction territories from their peaks. Outside of the US, the MSCI-All Country World Index, which measures major developed and emerging markets fared even worse, and is officially in bear market territory as of January 20th.



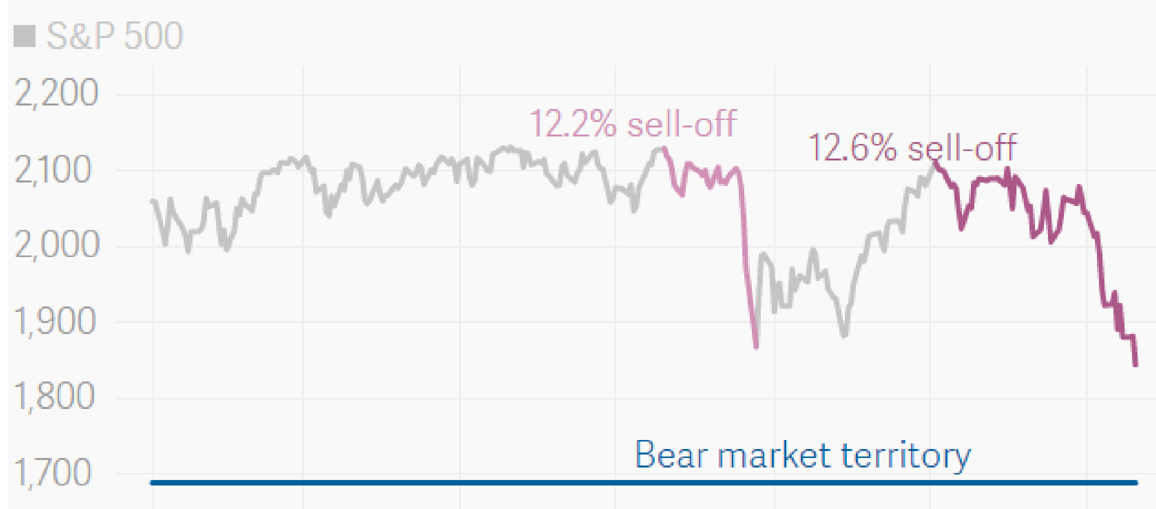
On the macro front, China reported fourth quarter GDP of 6.8%, and full year growth of 6.9%. It was the lowest quarterly expansion since the 2009 global financial crisis. The pain of transforming the nation from an industrial and export powerhouse to a consumer driven economy is taking its toll on traditional business drivers as they struggle with excess capacity and dwindling demand. The weakness in China has reverberated around the world. The capital outflow in China over the past year hit a record of $465.9 billion from data reported by its banks. This figure could be much higher as underground activities which accounts for meaningful amount of capital outflows are not reported in the official figure. In contrast, China had a surplus of capital inflows of $125.8 billion in 2014 and $270.2 billion in 2013. To support the Chinese Yuan, the Chinese government has burnt $512.7 billion of its foreign exchange reserves last year. The current reserve fell to $3.33 trillion at the end of the year.

On the oil front, the current rout is the worst since 1970, with Brent crude slumping from $115 a barrel in the summer of 2014 to a 12 year low of below $30. On the demand side, a slowing industrial China and

weakness in emerging markets cast shadows on the future of oil demands. On the supply side, the oil glut from US shale proves to be quite resilient as firms continue to pump out supplies to sustain interest payments on their debt loaded balance sheets; while the lifting of sanctions on Iranian oil couldn't come at a worser time.

Another factor that we think is the main culprit of the current market sell-off is the Fed interest rate hike in December. The Fed decided to raise interest rate for the first time in a decade in December based on the backdrop of improved labor market conditions and the notion that inflation would meet its medium term objective of 2%. While a nominal increase in interest rate would have minimal impact to the businesses of traditional long only funds, in the market where heavily leveraged funds are dominating the day to day trading, a small increase in base rates can compound to magnified interest servicing liabilities as these players are leverage multiple times over their net asset value. As these leveraged funds shed assets to deleverage, asset prices nose dive.

The chaos in the markets that has erupted in the beginning of this year caught many people by surprise. However, looking at the current decline vs. the previous sell-off in August of last year, investors are better prepared for the current market decline as the reasons for the current sell-offs are more visible. This is evident through the VIX which hit over 40 in August, but only touched 30 in the current market sell-off.



Nonetheless, a hope for a quick rebound does not seem to be in the cards. We have seen on many days where the major US indices would rally at open and in the early mornings, but only to see the gains evaporate at the end of the day. The inflection point is usually when the European markets close at around 11:00am to 11:30am EST. This is concerning as the market sentiments have clearly switched from buy on the dip seen over the last few years to sell on the rally now.

Until we have some technical confirmation from some consecutive days of positive closes, or more importantly, visibility from the Fed interest trajectory in March, we anticipate there will be further softness in the markets in the next couple of months. But without negative feedback loop materializing, the current market sell-off is nowhere near a crisis which we saw in 2008.