

So far, so bad

It's a good week for top drawer statistics and there are so many, it's hard to know where to start. Sterling has hit a 5 ½ year low against the US Dollar. The Eurostoxx 600 Index has had its worst week in four years. The FTSE has posted its worst first week since the year 2000. The Japanese stock market has had its worst opening week since 1949. And trumping them all, the New York's S&P500 has put in the worst 5-day start to the year…ever.

All very interesting, but to put some perspective on the moves, and because things are changing so fast, the one month falls to 12th January are as follows: China -13%, Japan -7.9%, USA -4.8%, Europe -3.5%, UK –0.0%.

The zero performance of the UK stands out as being almost respectable but one has to bear in mind that the FTSE 100 Index already received a thumping back in September owing to the index's heavy weighting in oil and mining shares which fell sharply when fears over China's slowing economy resurfaced. China is, of course, the main culprit for the current sell off now that concerns have widened to include not just

manufacturing data but the falling Yuan currency and a complete lack of response from the Chinese authorities.

In a sense, not much has changed. On the face of it, the official Chinese economic data still looks reasonably OK. The problem is that nobody believes many of the economic statistics issued by the Chinese authorities and hasn't done for some time. The lack of credibility on GDP growth, for example, has made it increasingly difficult to get a handle on what is going on at a time when China is trying to manage a transition from an all-out industrial manufacturing economy to one with a far bigger services sector.

Furthermore, the US Dollar has strengthened appreciably since cracks appeared in China and other emerging markets back in September. This has put additional pressure on already struggling emerging market stocks which have built up large US Dollar debt piles but are losing the power to raise earnings domestically to offset the damage. In the absence of a genuine recovery in the Chinese economy, which was great for emerging economies during the consumption boom in commodities, the likelihood of countries like Brazil, Russia and South Africa slipping from recession into outright depression has understandably increased.

There is an optimistic view that troubles in China can be contained because they have, among other things, a closed capital account which limits contagion to the developed economies. Indeed, the fall in the price of commodities, notably oil, should be good news because it puts more money in the pockets of western consumers.

As long as the US economy carried on growing, these sorts of arguments made it easier to overlook the dangers posed by the difficulties facing China which has grown to be the world's second largest economy. The problem now is that whilst the US is still growing, the rate of growth has slowed more sharply than expected. Combined with the Federal Reserve now hiking rates after having kept them on hold for 7 years, the increasingly uncertain outlook has raised fears of policy error in an already difficult to read.

This morning's headlines included a comment from the Royal Bank of Scotland credit team advising their clients to "sell everything" except high quality bonds. This is a big call, and potentially a bad one. For a start, bonds, generally, yield very little for the risk that they carry, in our view. Also, policy risk can also swing the other way. If the Chinese authorities suddenly decide to unleash their own QE to deal with their principal problem of too much debt, being out of the equity markets could be a costly mistake.

Events are moving quickly but we note that the large swings in the global stock markets this week are on quite low volume and having, we believe, an exaggerated effect which is unlikely to last. We will shortly be putting out our longer term view of 2016 in our next note but want to assure TAM clients that the diversified strategy that characterises all portfolio mandates, has stood the test well in previous years and we expect to weather

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