Market commentary

SIGNATURE GLOBAL ASSET MANAGEMENT™

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The Signature portfolios are generally positioned with a defensive bias. Our balanced funds have been underweight equities vs. their neutral level with slightly higher cash levels, while our equity funds all have decent cash levels ranging from 5-15%, depending on the mandate.

We are watching the current sell-off very closely and are not panicked by it, but we have also not yet stepped in to buy. At this point, the market sell-off is more of a "risk-off" confidence and growth scare than a reflection of deteriorating fundamentals. Indeed, fundamentals in the developed world (U.S. and Europe) continue to improve, which is why the U.S. Federal Reserve is talking about a first rate increase. On one level this is also a showdown between the Fed and the bond market, which is addicted to low rates and desperately hoping to delay any rate increase indefinitely. If it were just about the U.S. and developed markets in general, I would want to be buying any sell-off. That may yet be the correct call if developed market fundamentals remain intact – which for now we believe to be the most likely outcome. However, the current risks are not emanating from the developed world, but rather from the underlying deterioration in the broader emerging markets and through the commodity complex, with the risk of contagion into developed markets through both credit and foreign exchange channels.

While the over-exaggerated devaluation of the Chinese yuan was a catalyst for the current growth and confidence scare, we do not see China as a big global risk. Yes, they face significant challenges in transforming their economy to a services and consumption-driven one, and yes, the economy has and will continue to slow down. But in our opinion, they remain in control of the process with significant policy flexibility to respond if and when they deem appropriate. The risk lies elsewhere. Namely, the risk is in the fragile state of several key commodity-producing emerging market economies (Brazil, Indonesia, Russia, etc.) that have seen their structural deficiencies exposed by the ebb of the commodity supercycle. These countries are now facing a significant loss of global confidence that has manifested itself through dramatic currency weakness and that risks tipping into credit stress for both sovereign and corporate issuers in these jurisdictions.

We would also be buyers of the current sell-off if we become more confident that the emerging market foreign exchange markets would stabilize as some degree of confidence and flows return, or if any emerging market crisis appeared to remain isolated and unlikely to derail the broader developed market economies. Key areas we continue to monitor are the foreign exchange, commodity and credit markets. Broadly speaking, all of these markets are currently oversold IF we are in a world where the U.S., European Union and Chinese economies continue to stabilise and improve in the back half of the year. But there are also times when the tail can wag the dog, such that the current volatility in asset markets derails the current improving economic trends. At this point we want to respect the markets, and would rather err on the side of caution.

To wrap: We are happy to be in a defensive position and believe the current market will offer an attractive entry point for risk assets, but are not quite ready to jump back in. It is important to respect the degree of market dislocation and the risk of further contagion.