# REVIEW & Outlook

**Q3 2016**
**Q4 2016**

## Global Financial Markets

BIAS

INVESTMENT MANAGERS - SECURITIES ANALYSTS

SEPTEMBER 30, 2016

# Contents

## Review Q3 2016



## Outlook Q4 2016

# World Markets Quarterly Review

**September 30, 2016**


| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | DJIA | 2.8% | 3 | BSX | 33.7% | 7 | UK FTSE | 4.7% | 11 | Nikkei | 8.2% |
| 1 | S&P 500 | 3.9% | 4 | Bolsa | -1.5% | 8 | CAC | 6.7% | 12 | Hang Seng | 12.9% |
| 1 | NASDAQ | 10.0% | 5 | Bovespa | 11.2% | 9 | DAX | 10.1% | 13 | Straits Times | 1.6% |
| 2 | TSX | 4.3% | 6 | Merval | 11.2% | 10 | Kospi | 8.7% | 14 | ASX | 8.2% |

* Source: Bloomberg

*The S&P Global 1200 Index advanced 5.1 percent for the quarter ended September 30, 2016. All returns are expressed in US dollars.*

# Stock, Bond, Currency Overview

## Global Stock Markets

- Global equity markets rose in the Third Quarter on improving economic data and accommodative monetary policies.
- In the US the technology heavy NASDAQ advanced the most supported by better than expected earnings of major tech companies.
- European markets rallied amid expectations of an extended era of low interest rates.
- Asian Emerging Markets experienced a revival and was the best performing region in the global benchmark.

## Bond Markets

- Bond yields fell early in the quarter after voters in Britain voted to leave the EU driving a rush for the relative safety of fixed-income securities.
- Treasury yields in the US ended the quarter higher on solid economic data and expectations the Fed was getting closer to raising interest rates.
- The Bank of England cut the benchmark interest rate to ward off Brexit recession risk.
- Investment grade corporate bonds outperformed US Treasuries in the quarter.

## Currency Markets

- The US dollar weakened against both the euro and the Japanese yen as the Fed held interest rates unchanged and lowered its path (dot plots) for expected future hikes.
- Sterling slid against all majors following the Brexit vote and uncertainty over the UK's upcoming negotiations with the EU.
- Contrary to commodity peers, the Canadian dollar depreciated versus the US dollar amid expectations the Bank of Canada will be forced to lower the benchmark rate amid low economic growth.
- The Mexican peso plummeted against the US dollar as polls showed the race between the two US Presidential candidates narrowed.

# North American Stock Markets

| Indices | 30 Jun 2016 | 30 Sept 2016 | Total Returns Local Curr. | Total Returns US$ |
|---|---|---|---|---|
| US Dow Jones Industrial | 17,929.99 | 18,308.15 | 2.78% | 2.78% |
| US S&P 500 | 2,098.86 | 2,168.27 | 3.85% | 3.85% |
| US NASDAQ | 4,842.67 | 5,312.00 | 10.02% | 10.02% |
| Canada TSX | 14,064.54 | 14,725.86 | 5.45% | 4.34% |
| S&P Global 1200 | 1,832.92 | 1,914.82 | 5.09% | 5.09% |

*Source: Bloomberg*

*The NASDAQ outperformed the global index in the quarter.*

- **On July 25** Verizon Communications Inc. agreed to buy Yahoo! Inc.'s web assets for $4.83 billion. Verizon will pay cash in a deal that includes Yahoo real estate, but excludes some intellectual property, which will be sold separately. Verizon, the largest US wireless carrier, will get Yahoo's web services including mail, news, sports content, and financial tools. Yahoo will be left with its stakes in Alibaba Group Holding Ltd. and Yahoo Japan Corp., with a combined market value of about $40 billion. On the day of the announcement Verizon and Yahoo fell 0.4 and 2.6 percent, respectively.

- **On July 29** the technology heavyweight NASDAQ Composite Index hit an all-time high after a positive earnings report from Apple Inc., which followed strong reports from Alphabet Inc., Facebook Inc., and Amazon.com, Inc. earlier in the week. On the day Apple's share price climbed by as much as 6.5 percent after the company reported selling nearly one million more units of iPads than analysts had estimated. Earlier in the week Google parent Alphabet posted strong second quarter results with revenues growing 21 percent year-over-year and Facebook surpassed the market capitalization of Berkshire Hathaway after the company dropped yet another strong quarterly earnings report. Finally, Amazon announced record profits for a third straight quarter and announced plans to double spending on video content in Second Half 2016 as well as open up 18 new warehouses.

- **On August 30** Potash Corp. and Agrium Inc. said they are in talks about a merger of equals. The companies have a current combined market capitalization of $28 billion and bring together Saskatoon-based Potash's fertilizer mines with Agrium's extensive global direct-to-farmer retail network. The merger creates an agricultural colossus that would be the world's number one producer of potash and second largest producer of nitrogen fertilizer.

- **On September 6** Enbridge Inc. closed an all-stock acquisition of Spectra Energy Corp, creating the largest infrastructure firm in North America with a combined enterprise value of $127 billion. Enbridge shareholders will own 57 percent of the new company.

- **On September 8** Wells Fargo & Company, the largest US bank by market cap was fined $185 million for illegal banking practices. For years, employees of the bank secretly opened bank accounts and applied for 565,000 credit cards without consent. Many of the accounts were created by moving a small amount of money from a customer's current account to a new account and shortly after the opening of the bogus account the bank employees closed it down and moved the money back.

# Latin American Stock Markets

| Indices | 30 Jun 2016 | 30 Sept 2016 | Total Returns Local Curr. | Total Returns US$ |
|---|---|---|---|---|
| Mexico Bolsa | 45,966.49 | 47,245.80 | 3.19% | -1.47% |
| Brazil Bovespa | 51,526.93 | 58,367.05 | 13.27% | 11.19% |
| Argentina Merval | 14,683.49 | 16,675.68 | 13.57% | 11.17% |
| Chile IPSA | 3,995.91 | 4,015.25 | 0.48% | 0.92% |
| S&P Global 1200 | 1,832.92 | 1,914.82 | 5.09% | 5.09% |

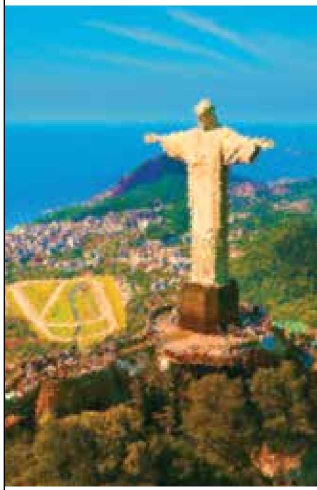
*Source: Bloomberg*

- **On July 29** Embraer S.A. reported a surprise loss of $99.4 million for the Second Quarter 2016 due to setting aside $200 million in connection with a US Department of Justice probe under the Foreign Corrupt Practices Act. Embraer said it is talking to US authorities about aircraft sales outside of Brazil and a settlement is likely to include possible fines, a deferred prosecution agreement, and the imposition of an independent monitor to assess compliance. The company also cut its sales forecast because of a diminished outlook for business-jet deliveries. Embraer's shares fell 15.4 percent in Sao Paolo trading on the day.

- **On August 31** Dilma Rousseff became the second president to be impeached in Brazil's 31-year-old democracy as the Senate found her guilty of bypassing Congress to finance government spending, paving the way for her vice president Michel Temer to serve out the term until general elections in 2018. In the first two months of the quarter the Ibovespa surged 12.3 percent on wagers that President Dilma Rousseff was about to be ousted and new leadership would restore growth and curb a record fiscal deficit. On the day of the vote Brazil's real gained 0.2 percent against the US dollar, while the benchmark Ibovespa stock index pared earlier losses of as much as 1.8 percent to trade 0.9 percent lower.

- **On September 6** Argentina's Supreme Court rejected an injunction that blocked electricity providers from raising prices in Buenos Aires province, handing a victory to President Mauricio Macri who has tried to cut back on fiscally expensive subsidies to close one of the largest fiscal deficits in decades. The previous day Energy and Mining Minister Juan Jose Aranguren had told union leaders the government was proposing to raise gas prices for domestic consumers by an average of 203 percent but may introduce a more gradual price increase scheme for small- and medium-sized companies. Shares of Pampa Energia SA, Argentina's biggest electricity company, rose 6.5 percent after the ruling was published. Shares of Empresa Distribuidora & Comercializadore Norte, the country's largest electricity distributor, rose 4.6 percent on the day.

*Latin American markets rose on stability in the political arena.*



# European Stock Markets

| Indices | 30 Jun 2016 | 30 Sept 2016 | Total Returns Local Curr. | Total Returns US$ |
|---|---|---|---|---|
| UK FTSE | 6,504.33 | 6,899.33 | 7.06% | 4.66% |
| Germany DAX | 9,680.09 | 10,511.02 | 8.58% | 10.10% |
| France CAC 40 | 4,237.48 | 4,448.26 | 5.21% | 6.68% |
| Spain IBEX 35 | 8,163.30 | 8,779.40 | 8.33% | 9.85% |
| S&P Global 1200 | 1,832.92 | 1,914.82 | 5.09% | 5.09% |
| S&P Europe 350 | 1,338.64 | 1,387.86 | 4.15% | 5.60% |

*Source: Bloomberg*

*European markets advanced on expectations of an extended era of accommodative monetary policy.*

- **On July 7** France's Danone announced a $10 billion takeover of US-based WhiteWave Foods Co. Danone, best known for its yogurts Activia and Actimel, will pay $56.25 a share, a 24 percent premium over WhiteWave's 30-day average closing price of $45.43. The acquisition makes Danone the global leader in fresh dairy and health-food brands. The deal includes brands such as Horizon Milk, Wallaby Organic Yogurt, and Earthbound Farm packaged salads. On the day WhiteWave soared 18.5 percent in US trading while Danone rose 3.9 percent in Paris trading.

- **On August 1** Google parent Alphabet Inc. and British pharmaceutical giant GlaxoSmithKline plc announced plans to create a new company, Galvani Bioelectronics that will be engaged in development of bioelectronics medicines. The new company will be headquartered in the UK, and 45 percent of it will be owned by Alphabet's Verily Life Sciences division. Alphabet and GlaxoSmithKline will spend as much as £540 million over seven years. The joint venture will be focused on the development of small, implantable devices to modulate and intervene in nerve signals. Galvani's President Kris Famm said that medicines using miniaturized implants could be submitted for regulatory approval by 2023.

- **On September 6** General Electric Corporation announced a $1.4 billion cash deal to purchase Arcam AB and SLM Solutions Group AG, two European 3D metal printing suppliers. Swedish Arcam produces 3-D cost-efficient metal products to orthopaedic implant and aerospace consumers, while German SLM has a core focus in multi laser and hull-core 3D technology. Pending regulatory approval the deal will be the biggest acquisition in the 3D printing industry and will mark GE's move beyond being just the world's largest user of metal 3D printing technologies to also becoming a leading supplier of them. On the day of the announcement Arcam and SLM rose 53.2 and 39.1 percent, respectively, while GE slipped 0.7 percent.

- **On September 14** Bayer AG, a German multinational, announced a deal to acquire US seed giant Monsanto Company after four months of talks. At $66 billion the deal is the biggest all-cash buyout in history and could create an agricultural giant big enough to influence the way the planet gets food. Antitrust regulators are expected to scrutinize the deal, looking at whether it would increase prices and reduce choices for seeds and chemicals essential to farming. Bayer rose 1.1 percent while Monsanto was up 0.9 percent on the day.

# Pacific Rim Stock Markets

| Indices | 30 Jun 2016 | 30 Sept 2016 | Total Returns Local Curr. | Total Returns US$ |
|---|---|---|---|---|
| Japan Nikkei | 15,575.92 | 16,449.84 | 6.33% | 8.18% |
| Hong Kong Hang Seng | 20,794.37 | 23,297.15 | 12.86% | 12.92% |
| Hang Seng Red Chip | 3,624.86 | 3,861.20 | 7.46% | 7.52% |
| Korea Kospi 100 | 1,970.35 | 2,043.63 | 3.72% | 8.70% |
| Singapore STI | 2,840.93 | 2,869.47 | 2.71% | 1.62% |
| Taiwan TWSE | 8,666.58 | 9,166.85 | 8.87% | 12.06% |
| Australia ASX 200 | 5,233.38 | 5,435.92 | 5.14% | 8.19% |
| S&P Global 1200 | 1,832.92 | 1,914.82 | 5.09% | 5.09% |
| FTSE Pacific ex-Japan | 412.18 | 444.32 | 9.14% | 9.14% |

*Source: Bloomberg*

- **On July 6** Nintendo co., Ltd released Pokémon Go, a game that works like a treasure hunt where players use Global Positioning System (GPS) and their smartphone cameras to collect virtual monsters which appear in real world locations. The game is an unprecedented co-production between Japanese Nintendo and US private company Niantic, Inc. as Nintendo had long focused only on its console-based business model and resisted games for smartphones, fearing it would undermine the value of its rich catalogue of games. Nintendo's share price skyrocketed over 200 percent in the two weeks following the release but declined 17.7 percent on July 25 after the company said Pokémon Go, despite spectacular popularity, probably won't generate enough profit to boost Nintendo's earnings outlook.

- **On July 18** SoftBank Group Corp. agreed to buy UK chip designer ARM Holdings Plc for £24.3 billion, securing a slice of virtually every mobile computing gadget on the planet and future connected devices in the home. ARM has come to dominate the design of smartphone chips and its designs are found in 95 percent of all smartphones. The deal is the biggest ever for SoftBank and will get the Japanese company control of a cash-generating mobile industry leader that earns royalties every time clients such as Apple, Samsung, or Qualcomm adopt its designs. On the day, SoftBank's shares fell 10.3 percent in Tokyo while ARM jumped 40.8 percent in London trading.

- **On August 30** South Korea's Hanjin Shipping Co. Ltd elected to file for court receivership, the first step towards what will be the largest container line bankruptcy in history. Hanjin operates 98 container ships totalling 600,000 TEU, 11 port terminals and 74 sea routes, in addition to bulker operations. The long-term fallout from Hanjin Shipping's insolvency will have far-reaching effects, but the impact is already being felt as ports around the world have announced they will no longer accept Hanjin ships and containers over concerns that the firm cannot pay port and stevedoring costs. Hanjin's shares fell 24.1 percent on the day.

- **On September 9** Samsung Electronics Limited urged owners of its Galaxy Note 7 phones to stop using or exchange the devices as they risk exploding. In total, the company seeks to replace 2.5 million Note 7 phones, which could cost as much as two billion dollars. The Note 7, which was rolled out in August, was supposed to stand out with its stylus, large display and faster charging technology. At issue are the phones' lithium-ion batteries, while more efficient than conventional batteries, they are also more flammable. In the two days following the announcement Samsung's share price dropped 10.8 percent.

*Asian emerging markets rebounded amid improved prospects of economic recovery.*

# Bermuda & Cayman Stocks

| | | | Total Returns | |
|---|---|---|---|---|
| **Benchmark Indices** | **30 Jun 2016** | **30 Sept 2016** | **Local Curr.** | **US$** |
| BSX Index | 1,179.60 | 1,564.72 | 33.66% | 33.66% |
| BSX Insurance Index | 1,693.66 | 1,659.29 | -2.03% | -2.03% |
| S&P Global 1200 | 1,832.92 | 1,914.82 | 5.09% | 5.09% |
| **Stocks** | | | | |
| Ascendant Group Ltd. | 5.06 | 6.20 | 24.06% | 24.06% |
| Butterfield Bank | 16.11 | 24.00 | 48.91% | 48.91% |
| Caribbean Utilities | 11.55 | 12.69 | 11.29% | 11.29% |
| Consolidated Water Co. | 13.06 | 11.62 | -10.44% | -10.44% |
| XL Group PLC | 33.31 | 33.63 | 1.56% | 1.56% |

*Source: Bloomberg*

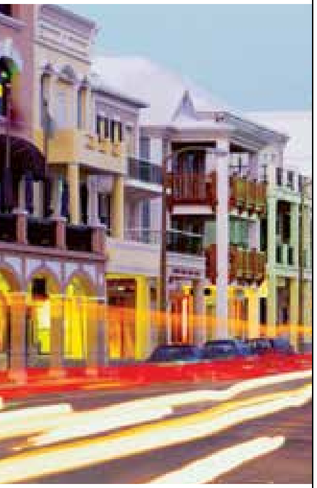
*Local shares were mixed in Third Quarter 2016.*

- **On July 25** XL Group Ltd, parent company of Bermuda reinsurer XL Catlin, completed the re-domestication from Ireland to Bermuda. The company cited Bermuda's reputation in the international re-insurance market as well as Bermuda obtaining Solvency II third-country equivalency from the EU for the re-domestication. Two days later XL reported strong earnings with better than expected revenue of $2.8 billion up 19 percent over the same period last year driven by growth in insurance and reinsurance premiums mainly through their merger with Bermuda based Catlin Group Limited. XL Group ended the week up 5.4 percent.

- **On July 29** Caribbean Utilities Company Limited (CUC) announced second quarter sales growth of seven percent. Sales for the quarter increased 10.2 million kWh over the same period last year. The increase was attributable to warmer weather, which increased household air conditioning loads. CUC also announced and increased participation to their Consumer-Owned Renewable Energy Generation (CORE) programme, which allows consumers to be compensated for energy generated from their household renewables. Caribbean Utilities advanced 3.2 percent on the day.

- **On September 12** BF&M Group reported net earnings of $13.2 million for the first half of 2016. About half of the company's earnings were generated in Bermuda, while the rest came from its operations in 15 islands in the Caribbean. Gross premiums for the period were $183.5 million, an increase of one percent from the same period in 2015. BF&M also said that a large fire claim will be recorded in the third quarter 2016 financial statements as the company insured the Ann Cartwright DeCouto Building on Front Street, Bermuda, which was gutted by fire on July 21, 2016. BF&M's shares rose 4.2 percent following the earnings report.

- **On September 16** Bank of N.T. Butterfield & Son Limited successfully launched its initial public offering (IPO) on the New York Stock Exchange (NYSE). Of the 10.6 million shares being sold in the IPO, $140 million will be raised by the bank from the sale of new shares for general corporate purposes and $110 million from existing shareholders selling some of their stock. Almost 4.9 million shares were sold on the day and Butterfield's shares closed at $24.75, 5.3 percent higher than the IPO pricing of $23.50.



# Global Bond Markets

| Indices | (Yield to Maturity) 30 Jun 2016 | 30 Sept 2016 | Total Returns Local Curr. | US$ |
|---|---|---|---|---|
| US 2 Year | 0.58% | 0.76% | -0.11% | -0.11% |
| US 10 Year | 1.47% | 1.59% | -0.75% | -0.75% |
| US 30 Year | 2.28% | 2.32% | -0.26% | -0.26% |
| Canadian 10 year | 1.06% | 1.00% | 0.86% | -0.70% |
| Australian 10 year | 1.98% | 1.91% | 1.08% | 3.97% |
| UK Gilt 10 Year | 0.86% | 0.75% | 2.54% | -0.07% |
| German Bund 10 Year | -0.13% | -0.12% | 0.38% | 1.54% |
| Japanese 10 Year | -0.23% | -0.09% | -1.21% | 0.60% |
| **Citigroup** | | | | |
| 3-7 Year Treasury Index | 1,455.06 | 1,450.58 | -0.31% | -0.31% |
| 7-10 year Treasury Index | 1,900.01 | 1,890.00 | -0.53% | -0.53% |
| 1-10 Year US Corp. Bond Index | 1,757.19 | 1,767.95 | 0.61% | 0.61% |
| World Gov't 7-10 Yr Bond Index | 1,258.16 | 1,270.26 | 0.96% | 0.96% |

*Source: Bloomberg*

- **On August 2** the Reserve Bank of Australia cut the benchmark interest rate by 25 basis points to an all-time low of 1.50 percent. The interest rate cut was widely anticipated following record-low inflation, a slowing jobs market, weaker exports, and as building approvals unexpectedly fell for a second month in June. The Australian dollar spiked lower by about half a cent but quickly rebounded, helped by flows in the bond market as the 1.80 percent yield on the nation's 'AAA' rated 10- year sovereign bond was attractive for overseas investors reaching for yield.

- **On August 4** the Bank of England cut interest rates for the first time since 2009 to ease the blow of Britain's June 23 vote to leave the EU. The bank cut the main lending rate to a record low 0.25 percent from 0.50 percent, in line with market expectations. Further, the BOE announced £100 billion in bank loans to ensure liquidity reaches the economy in addition to buying £60 billion of government bonds over six months and £10 billion of corporate bonds over 18 months. Sterling fell one percent against the dollar following the announcement and British government bond yields hit new record lows.

- **On August 31** Bloomberg reported that investment-grade corporate bond sales topped $115 billion in August, making it the busiest August in 12 years. The extra yield US investment-grade corporate bonds offered over Treasuries was 1.35 percentage points, down from 2.15 percentage points in February, according to Bloomberg Barclays Index data. Corporate bond sales in Europe, also reached a milestone of €12.6 billion in August. Junk-rated issuers raised €3.3 billion, the most for the month since the introduction of the common currency in 1999.

- **On September 21** the Bank of Japan left the benchmark rate unchanged at minus 0.10 percent and shifted the focus of the monetary stimulus program from expanding money supply to controlling interest rates along the yield curve. The bank said it would adjust the volume of asset purchases in the short term to control bond yields, while keeping the volume unchanged at about ¥80 trillion annually over the long term. The central bank also scrapped a target for the average maturity of its government bond holdings. The yield curve in Japan steepened upon the announcement and the 10-year government bond yield hit positive territory for the first time since March 2016.

*Treasury yields rose on solid economic data.*

# World Currency Markets

**Value of Currency** US$1 = value in local currency

| Currency | 30 Jun 2016 | 30 Sept 2016 | Change |
|---|---|---|---|
| Australian Dollar | 1.3421 | 1.3049 | 2.9% |
| Brazilian Real | 3.2130 | 3.2624 | -1.5% |
| British Pound | 0.7512 | 0.7709 | -2.6% |
| Canadian Dollar | 1.2924 | 1.3127 | -1.6% |
| Euro | 0.9004 | 0.8901 | 1.2% |
| Japanese Yen | 103.2000 | 101.3500 | 1.8% |
| Swiss Franc | 0.9760 | 0.9714 | 0.5% |

*Source: Bloomberg*

*Sterling continued to slide against all majors on Brexit concern.*

- **In the week** ended July 15 the Japanese yen depreciated against all major currencies on speculation Prime Minister Shinzo Abe's stimulus plan will weaken the currency. Further, demand for the perceived yen safe haven lessened after new UK Prime Minister Theresa May formed a government, ending a political stalemate that followed the nation's vote to leave the EU, and better-than-expected Chinese economic data spurred risk appetite. In the week the yen depreciated 4.1 percent against the dollar.
- **In August** the Russian ruble advanced one percent against the US dollar as a 12.7 percent gain in Brent crude, used to price Russia's main export oil blend, combined with the central bank leaving the interest rate at 10.5 percent supported the ruble in a traditionally weak month for the currency. The ruble had only gained against the dollar in August on three occasions since the collapse of the Soviet Union and the month has come to be associated with Russian catastrophes as well as the summer doldrums.
- **On September 9** the Canadian dollar fell to a one-week low against the US dollar as better job gains in August was not seen by the market as enough to reverse the Bank of Canada's concern that risks to economic growth have increased. On September 7 the central bank said that risks to inflation had "tilted somewhat to the downside" and called into question its long-standing view that exports, particularly in non-commodity industries, would lead the country out of its economic malaise. In the quarter the loonie weakened 1.6 percent against the US dollar.
- **In September** volatility reawakened in the $5.1 trillion foreign-exchange market as traders started to imagine a life without ultra-easy monetary policy following comments from ECB President Draghi who downplayed the need for an expansion of quantitative easing, while speculation grew that the Bank of Japan could scale back longer-term bond purchases, and odds increased of the Fed raising interest rates by year-end. An increase in measured volatility was seen in high yielding currencies such as the Australian, New Zealand and Canadian dollars while Emerging Market currencies suffered bigger sell-offs. In the four weeks ending September 15 the South African rand and Mexican peso were the worst performing major currencies, depreciating more than six percent against the US dollar.
- **On September 16** the Mexican peso depreciated to a new record low against the US dollar and was the poorest performer among Emerging Market currencies in the week. Many analysts linked Donald Trump's rise in the tightening US Presidential contest to the weakness in the peso. The peso depreciated 5.7 percent against the dollar in the quarter.

# *Outlook*
# FOR THE FOURTH QUARTER 2016

**Global growth will largely be carried by the consumer as capital expenditure remains subdued with corporations hesitant to invest amid low expected returns.**

- Solid job growth and rising house prices are boosting consumer confidence in the US.
- The weak European banking sector will be a drag on economic growth in the region.
- Sterling depreciation following the Brexit vote has started boosting the economy and should prevent the UK from falling into recession near term.
- Activity in emerging economies could pick up a little at the end of 2016 and in 2017 as growth in China stabilizes, while Russia and Brazil come out of recession.

**Soft global economic growth and low inflation combined with exceptionally loose monetary policy from major central banks set the stage for relatively unchanged yields in Developed Markets.**

- While the Fed is likely to raise rates at their December meeting, this will not be the beginning of a series of hikes.
- The Bank of Canada is unlikely to alter its accommodative monetary stance while previously announced fiscal policies are taking root.
- Yields in the eurozone will stay low or negative as the economic outlook for the region is forecast to deteriorate.

**Diverging monetary policy will eventually result in the US dollar appreciating against most major currencies.**

- In the very near term uncertainty over the outcome of the US Presidential election could put a dampener on the greenback.
- We expect the euro to trade in a narrow range with the dollar near term as more monetary stimulus from the ECB is already anticipated by the market.
- Low global economic growth and an oversupply of oil will keep commodity currencies soft versus the US dollar.

**Commodity prices reflect soft global economic growth and oversupply.**

- We expect oil prices to stabilize around current levels going into the end of 2016.
- Agricultural commodities prices are unlikely to rise near term as stocks are high following record grains production.
- We could see an excess demand for gold as the four year presidential cycle in the US comes to a close.

**We remain cautious on equities and recognize that the macro environment is highly uncertain.**

- Equity valuations are elevated and volatility is likely to persist across the broad market.
- The US is our preferred play despite the Fed's gradual monetary policy tightening as underlying fundamentals are strong.
- We favour the Information Technology, Health Care, and Consumer Discretionary sectors.

# ECONOMICS

*"While there are some good signs, the overall growth outlook remains subdued."*

Christine Lagarde, IMF Managing Director September 28, 2016

## The World

We agree with Bloomberg consensus estimates that the global economy will grow at annualized rate of 2.9 percent for 2016 and 3.1 percent for 2017. Growth in the US is expected to accelerate in the coming months whilst, in contrast, growth in the eurozone may slow as the boost to the consumer from lower oil prices fades and the banking sector weakens. In the UK, Brexit worries may dampen growth, but we do not expect an outright recession. Global growth will largely be carried by the consumer as capital expenditure remains subdued with corporations hesitant to invest amid low expected returns. Core inflation (excluding food and energy) should be broadly stable at around two percent in advanced economies but headline inflation could climb in 2017 as the drag from past years' lower energy prices drops out of the annual inflation rate. The market expects the Fed to raise interest rates in December whilst the ECB and Bank of Japan are more likely to increase monetary stimulus. We would prefer to see countries implement fiscal and structural policy actions to reduce the over-reliance on central banks but this is unlikely to happen to any real degree. Finally, activity in emerging economies could pick up a little at the end of 2016 and in 2017 as growth in China stabilizes, while Russia and Brazil come out of recession.

## North America

GDP growth in the US is forecast to stand at an annualized rate of 1.5 percent in 2016 before picking-up to 2.2 percent in 2017 mainly led by consumer spending, as per Bloomberg consensus estimates. Job growth in the US has been solid and rising house prices have boosted consumer confidence. US corporates, however, are anticipated to keep capital expenditure low on meager expected returns. In the near term, inflation remains subdued with core PCE inflation, excluding food and energy, well below the Fed's two percent target. We forecast that the Fed will increase interest rates in December and signal that further hikes will be data dependant.

The US Presidential election in November could be a tighter race than what is currently expected and should impact the various asset classes. The S&P 500 has tended to react negatively whenever Donald Trump has moved up in the polls, while the 'risk-off' assets (the US dollar and US Treasuries) strengthened. Regardless of the outcome, market volatility should be elevated in the weeks leading up to the election.

The Canadian economy is running below potential following last year's sharp decline in oil prices but has the advantage of having a monetary-fiscal mix approach. With previously-enacted fiscal policies (child benefit payments and federal infrastructure spending) filtering into the economy, we anticipate economic growth to improve in the fourth quarter. Inflation in Canada lingers around the central bank's target of two percent and as such the Bank of Canada can keep borrowing costs low to prop up some of the more interest rate-sensitive sectors including housing, autos and manufacturing.

## Europe

The eurozone faces modest economic growth of 1.5 percent in 2016 on an annualized basis, declining to 1.3 percent in 2017, as per Bloomberg consensus estimates. We agree with the ECB and the OECD that fiscal stimulus is needed to boost lacklustre inflation and support growth in the region, but EU governments seem committed to strict austerity measures. As such, more monetary stimulus from the ECB is on the cards. The region's weak banking sector, impacted by non-performing loans, will be a further drag on economic growth. Given that the UK is a key trading partner for most of the core European countries, the result of Brexit will have implications for the EU's economy. The near term effects should be limited, but the long run effects will largely depend on how Brexit affects the credibility of the EU. If the populist movement strengthens, European integration will become more difficult and sluggish economic growth is a significant political threat.

The weaker Sterling following the Brexit vote has started working on boosting the economy and should prevent the UK from falling into recession near term. Since the outcome of the EU referendum, both monetary and fiscal policy have become more supportive but will not eradicate the new challenges lying ahead. Foreign direct investment will likely slow in the remainder of 2016 given that no one knows what will happen next and the outcome of the trade negotiations with the EU will be important.

## Pacific Basin/Asia

Economic growth in Japan is bleak, growing at an annualized rate of 0.6 percent in 2016 and 0.7 percent in 2017 as per Bloomberg consensus estimates. The government's extra fiscal stimulus from August could boost private consumption near term as the package includes childcare subsidies and a ¥15,000 payment to 22 million low-income individuals. Weak Asian trade and the strong yen, however, continue to weigh on exports and Japanese companies with invoices in a foreign currency will see their profit margins decrease.

China's economic rebalancing remains a work in progress. Economic growth appears to have stabilised around 6.5 percent supported by infrastructure spending, while the private sector is hardly increasing investments in capital expenditures at all. Importantly, risks have declined significantly from a year ago as yuan depreciation has been under control and capital outflows have eased.

Headwinds persist for economies strongly exposed to Chinese growth such as Hong Kong, Korea, Singapore, and Taiwan – the region's richer economies that are also facing structural problems with an aging population and a slowdown in productivity. Still, we expect their growth near term to be solid as capital inflows have eased financing conditions and consumers have seen lower real interest rates, supporting domestic demand.

The IMF predicts India's economy to expand at a considerable rate, 7.5 percent in 2016 and 2017. Domestic consumption, investment, governmental support and a decline in inflation have been key drivers, factors that are forecast to continue supporting growth in 2017.

## Latin America

Brazil's recession seems to be finally abating and quarterly GDP growth might be above zero again by the turn of the year. The recovery is likely to be investment driven as business sentiment is rebounding as a consequence of Dilma Rousseff having been removed from the presidency allowing for her successor Michel Temer to implement economic and structural reforms. Notwithstanding, our view on Brazil is more about stabilization and the nation's absolute level of growth is subdued compared to other Emerging Market economies.

The Mexican economy is faced with the adjustment to low oil prices and recent weakness in manufacturing exports in addition to the political overlay with the US – how is Mexico going to deal with a potential Trump presidency?

*"Countries must implement fiscal and structural policy actions to reduce the over-reliance on central banks."*

OECD,
Interim Economic Outlook,
September 21, 2016

# BONDS

*"We expect the Bank of Canada to ease again once it realizes that it has been too optimistic on growth and inflation."*

Morgan Stanley, FX Pulse, September 30, 2016

Sluggish global economic growth and soft inflation combined with exceptionally loose monetary policy from major central banks set the stage for relatively unchanged yields in Developed Markets. In the US the Fed is on a path towards higher interest rates, albeit at a very gradual pace, while central banks in the eurozone and Japan ease monetary policy further.

We expect yields to decline near term as Fed policy makers ponder if the economy is strong enough to endure more than one interest rate increase. While the Fed is likely to raise rates at their December meeting, this will not be the beginning of a series of hikes as progress in the labour market is offset by concern about recent slow GDP growth (averaging one percent in the First Half 2016). Further, inflation (as measured by the annual change in the price index for personal consumption expenditures or PCE) is running at 1.6 percent, well below the Fed's two percent target. In our view, the consequences of too rapid rate hikes are more severe than the consequences of too slow rate hikes and we are aware of the fact that Fed Chair Yellen is surrounded by relatively dovish FOMC committee members enabling her to proceed with deliberate caution. Lastly, a search for yield from overseas investors is putting a lid on any upward pressure on yields in the US. Should the Fed redesign their Quantitative Easing (QE) programme and reduce purchases at the long end of the yield curve (which has been the case recently with the Bank of Japan) this could result in a steeper yield curve. This in turn should increase profitability at financial institutions and could help increase bank lending as banks become more willing to take on risk. In the current low interest rate environment US investment grade corporate bonds are attractive for their relatively better yields.

Yields in Canada should move in the same direction as those in the US. The Bank of Canada is unlikely to alter its accommodative monetary stance while previously announced fiscal policies are taking root; both aiding the economic recovery along its path. In the event that the ailing commodity complex and weakness in manufacturing and trade fail to improve, the central bank may be forced to reduce interest rates in the coming months.

Yields in the eurozone will stay low or negative as the economic outlook for the region is forecast to deteriorate and annual inflation is running at just 0.2 percent, well below the ECB's target of close to two percent. The ECB's QE programme is scheduled to end in March 2017 but given the weak economic backdrop and soft inflation an extension is on the cards. This, however, would require the ECB to tweak the purchase programme so as to not run out of eligible bonds to buy.

UK bond yields should be flattish as the Bank of England seeks to bolster the UK economy with an increase to its monthly bond purchase programme following the Brexit vote, putting downward pressure on yields, which could be offset by investor outflows amid uncertainty of the looming EU negotiations. We do not expect the central bank to cut the benchmark rate again this year as it awaits economic data to assess the implications on the economy of Brexit.

Yields in Australia could decline on overseas demand for relatively better yielding assets even as the yield pick-up on Australian 10-year sovereign bonds over US Treasuries has narrowed to a 15-year low. The central bank does not appear to be in a hurry to cut the record low benchmark rate again this year but could be forced to do so as inflation is soft, labour market indicators are weakening, and the economy adjusts to low commodity prices and the slowdown in China, the nation's biggest trading partner.

# CURRENCIES

Diverging monetary policy - the Fed raising interest rates while other central banks keep or increase monetary stimulus - will eventually result in the US dollar appreciating against most major currencies. Near term, however, uncertainty over the outcome of the US Presidential election will give rise to market volatility and put a dampener on the greenback. The dollar will strengthen if Hillary Clinton wins combined with a further boost from a Fed rate hike in December. Should Donald Trump end up being the new US President, the dollar is likely to face weakness on uncertainty despite any Fed action.

We expect the euro to trade in a narrow range with the dollar near term as more monetary stimulus from the ECB is already anticipated by the market and the US Presidential election puts a dampener on US dollar strength. ECB President Mario Draghi has numerous times stressed the need for more fiscal policy to boost growth and inflation in Europe and as such we do not expect the ECB to deliver more than absolutely necessary over the next few months. Oddly enough Germany's Deutsche Bank AG could trigger a sell-off in the euro should the government be forced to step in and support the nation's largest lender who is facing a $14 billion legal settlement from the US Justice Department to close out mortgage-securities probes. While an outright bailout is unlikely and the bank is negotiating terms with the US Justice Department, the euro could depreciate amid heightened investor concern about the financial health of the European banking sector.

Sterling could rally near term against the US dollar and the yen as recent UK data has been surprising on the upside, reducing market fears of a Brexit-related growth slowdown, but caution is warranted. The British pound has depreciated by around twelve percent in trade-weighted terms since the referendum and the weaker currency has started boosting the economy. More positive data points could support Sterling as this would reduce the immediate risk of the central bank having to cut the benchmark rate to support the economy. Longer term, Sterling should face weakness as negotiations with the EU start and the Bank of England ponders more stimulus.

Low global economic growth and an oversupply of oil will keep commodity currencies soft versus the US dollar. The Canadian dollar should be little changed against the US dollar near term as oil prices oscillate around current levels and the central bank keeps interest rates unchanged. The Australian dollar will mainly be affected by action (or in-action) from the Reserve Bank of Australia now that Chinese growth appears to have stabilized. Australia is facing stubbornly low inflation at 1.0 percent, well below the central bank's target of two-to-three percent. If the bank cuts the benchmark rate, the Australian dollar should depreciate possibly making it easier for the central bank to get inflation closer to target.

The strong yen is a headache for Japan. Despite having the most expansionary monetary policy in terms of balance sheet expansion, the Bank of Japan has failed to meet its inflation target. Eventually, an even more aggressive monetary and fiscal policy is needed to weaken the yen, boost the economy and lift inflation. Near term we expect the yen to trade sideways with the dollar as Japanese investors are risk averse ahead of the US Presidential election and the central bank seems reluctant to cut already negative interest rates further.

*"Sterling remains a very vulnerable currency given the scale of the work that needs to be done to take the U.K. from where it is now to a completely new position."*

Jane Foley,
Senior Currency Strategist,
Rabobank International,
September 28, 2016

# COMMODITIES

*"OPEC's change of strategy may not be a panacea for the global oil glut."*

Stephen Brennock, Analyst, PVM Oil Associates Ltd, September 17, 2016

In the commodity space oil volatility is set to persist; gold prices will reflect safe haven demand; and agricultural outputs are delicately poised as all eyes look towards the potential of La Nina 2016 / 2017.

We expect oil prices to stabilize around current levels going into the end of 2016 and agree with the International Energy Agency that global oil demand growth figures will slow in 2017 on the back of an uncertain global economic outlook. Currently, most market caution seemingly stems from the issue of supply. While OPEC has agreed to cut production by nearly 750,000 barrels a day, this should not have any major impact on prices as the market still remains way oversupplied. The United Arab Emirates, Saudi Arabia and Kuwait are all producing at record levels while Libyan and Nigerian exports are bouncing back, further stoking the current global supply glut. In the US oil rig counts have only recently stabilized after a significant uptrend. Iranian production is booming as the country works hard to recapture confiscated market share generated by international trade restrictions. Iraq is still trying to 'fuel' a war on 'ISIS' and Russia needs the income. The most bullish analysts in the market are currently indicating a price ceiling of $60/barrel. We agree with the more reserved estimates which place crude oil in a range of $40 - $50/barrel by the end of the year.

Prices on agricultural commodities are unlikely to rise in the fourth quarter as stocks are high following record grains production. Favourable weather for crop developments, as reported by the US Department of Agriculture (USDA), translated into even higher output forecasts for maize, soybeans and wheat in the third quarter. Moreover, the USDA has increased its projections for wheat output in Russia, Kazakhstan, and Ukraine. Winter harvest output is heavily dependent on a favourable climate and the probability of 'La Nina' forming in the back end of 2016 ranges between 60-to-70 percent. The strength of the phenomenon is yet to be seen but is posing a particular threat to the world's two largest food producers - the US and Brazil. Risks associated with the poor weather are high and could significantly affect agricultural prices; however, as stocks are high, price increases are likely to be contained.

We could see an excess demand for gold in the fourth quarter as the four year presidential cycle in the US comes to a close. At the time of this writing the race between Clinton and Trump is a close call. Market uncertainty pertaining to the popularity of Donald Trump may provide some support to bullion prices with swings expected to take place in the lead up to November 8th election.
US economic data is sending mixed signals and central bank meetings play on investors' minds - all contributing to an interesting dynamic in global gold prices. Further, as global interest rates are low, or even negative, the opportunity cost to investors for holding gold is low, supporting demand.

Our outlook for base metals remains dominated by China and as the nation's economic growth stabilizes, the outlook across commodities is more positive than it has been for some time. Metal prices have rallied since January lows on expectations of stronger demand and ongoing supply rebalancing from production cuts and lack of investment in mining capacity. Zinc, the anti-corrosion fighter, is already this year's top performer among base metals and as the Chinese increasingly demand rust-proof cars, China's automakers will support zinc prices. Recycled metal plays an important role in the global supply chain, competing to some extent with iron ore, copper and other metals mined.

# EQUITY STRATEGY

We remain cautious on equities and recognize that the macro environment is highly uncertain and could result in poor earnings growth. Valuations are elevated and volatility is likely to persist across the broad market.

We favour the US as our biggest geographical exposure despite the Fed's gradual monetary policy tightening. Our optimistic view stems from the fact that underlying fundamentals are strong and the US' relatively low exposure to risks from global trade disruptions. Moreover, strong labour market conditions support consumer spending. Even though valuations are elevated relative to historical averages, further gains are feasible as corporate earnings, the biggest long term driver of stock returns, seem to have troughed and could turn positive in Second Half 2016.

We believe in secular and emerging themes in the global markets to play out well in the medium to long term. We focus on companies with healthy balance sheets complemented by strong valuation support and generating enough free cash flow to explore options for strategic acquisitions, stock buybacks, debt reduction, and higher dividends.

Our biggest relative exposures versus the global benchmark are in the Information Technology, Health Care, and Consumer Discretionary sectors. Our preferred industries offer accretive value through innovation and real growth. By way of example, technology stocks lagged at the start of 2016 as investors rotated to value oriented cyclical stocks in anticipation of a macroeconomic bounce. However positive trends in fundamentals and expectations for better profits (the consensus EPS growth estimate for the tech sector in 2016 is just 0.5 percent but jumps to 12.7 percent next year) make a compelling case for Technology stocks. We also like Health Care because of less stretched valuations, higher growth, and M&A activity, particularly in Biotechnology.

Marked by wide differences on most polices, the two US presidential election candidates agree on one rare idea: The need to increase spending on infrastructure projects. Mrs. Clinton has committed to spend $275 billion over five years on improving the nation's infrastructure while Mr. Trump says he would go even bigger, at least twice as much. This bodes well for equity sectors related to infrastructure.

We have decreased our underweight to Europe as the economy has performed better than estimated post Brexit and earnings are reaching an inflection point in Second Half 2016, supported by declining commodity headwinds, Sterling depreciation, and easier comparatives.

We are underweight in Japanese stocks due to rapid expansion of P/E multiples post Brexit lows and downside risks to earnings from a strong yen, combined with weak domestic consumer spending, despite Bank of Japan keeping monetary policy extremely loose.

We are also underweight in Emerging Market economies in spite of recent signs of economic improvement in certain key countries. Our concerns are tied to sluggish global growth and the possible negative impact on riskier assets from US dollar strength as the Fed begins to raise interest rates.

*"Steady job gains in the US have provided critical fundamental support for financial markets in an environment where growth in many economies is faltering."*

Goldman Sachs, Market Insights, July 21, 2016

# CONCLUSION AND STRATEGY POINTS

## EQUITIES

### Regional Strategy

- Overweight North America at 68.2 percent (versus an index weighting of 59.4 percent).
- Underweight Japan at 6.0 percent (versus an index weighting of 8.1 percent).
- Underweight Europe at 20.4 percent (versus an index weighting of 24.1 percent).
- Underweight Emerging Asia and Australia at 0.1 percent each (versus an index weighting of 4.6 percent and 2.7 percent, respectively).

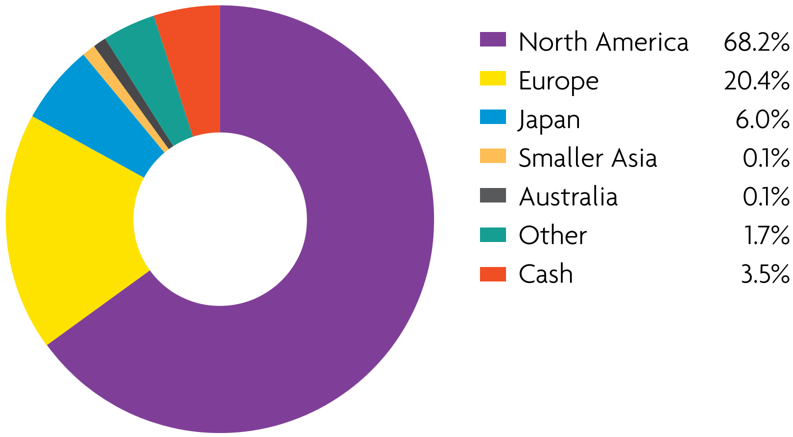
### Sector Strategy

- Overweight Information Technology and Health Care at 20.3 percent and 14.6 percent, respectively (versus an index weighting of 15.6 percent and 12.5 percent, respectively).
- Slightly overweight Consumer Discretionary and Financials at 12.6 percent and 17.5 percent, respectively (versus an index weighting of 11.7 percent and 16.5 percent, respectively.)
- Underweight Consumer Staples and Industrials at 6.7 and 7.2 percent, respectively (versus an index weighting of 10.7 percent and 10.9 percent, respectively.)
- Equal weight Energy and Materials at 7.0 and 5.0 percent, respectively.

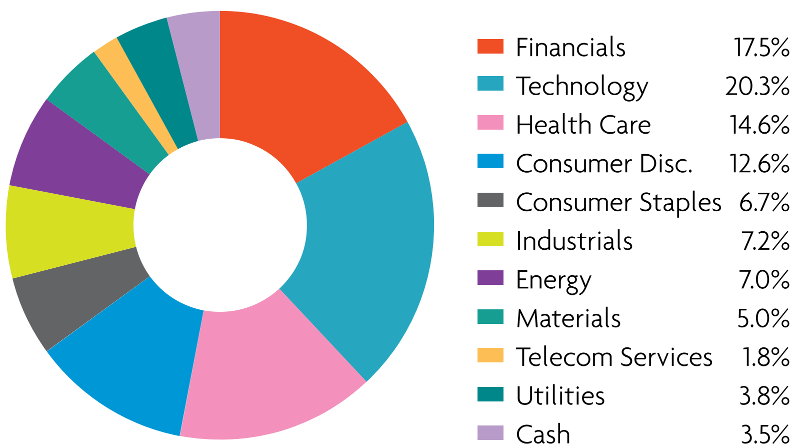
### Currency Strategy

- Overweight US dollar at 89.1 percent (versus an index weighting of 56.1 percent).
- Underweight euro at 5.4 percent (versus an index weighting of 13.8 percent).
- Underweight Japanese yen at zero percent (versus an index weighting of 8.1 percent).

Geographic Allocation

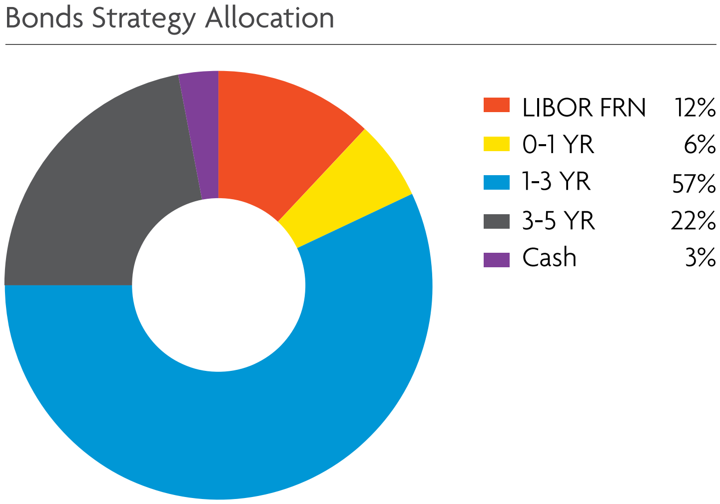


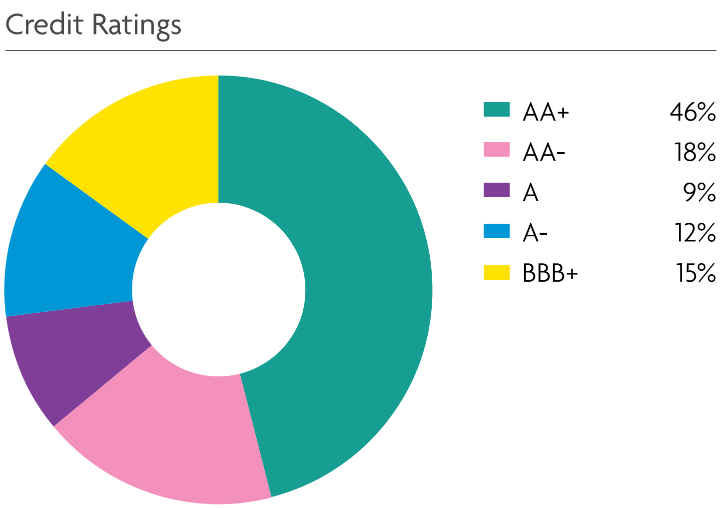

Sector Allocation



## BONDS

- Opportunistically add Treasuries maturing in four-to-five years for roll-down along the yield curve.
- Hold shorter-dated investment grade corporate bonds for their relative yield advantage over Treasuries.
- Hold floating-rate notes for when the Fed starts raising interest rates.




*BIAS structures portfolios according to the needs and risk profile of a specific investor. Some systematic risks should be acknowledged over which BIAS and other asset managers have no control including: trading on exchanges not regulated by any US Government agency, the Bermuda Monetary Authority, or the Cayman Islands Monetary Authority; possible failure of brokerage firms or clearing exchanges; illiquid markets which may make liquidating a position at a given price more difficult. For more details on these and other risk factors, please refer to BIAS' Form ADV as files with the US Securities and Exchange Commission.*

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