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HKM Private Wealth

HKM PRIVATE WEALTH MONTHLY UPDATE

JULY 2014

DISAPPOINTING MONTH FOR EQUITY MARKETS & COMMODITIES; BONDS OUTPERFORM BOTH

July Highlights

Most global equity markets pulled back in July with the exception being emerging markets. As a result bond prices rallied driving yields down. All major commodity groups except base mteals were down.

Global Markets

Equity market growth stalled in July. For the majority of the month markets traded sideways before melting down the last few days. This trend has carried over into August. Global conflict (Russia/Ukraine), geo-political unrest (Middle East) as well as financial uncertainty (Argentina debt default, major Portugal bank default) seem to be the culprits. We aren`t overlooking the fact that equities have shot straight up for a year. This pull-back hasn`t been too harmful and we view it as a buying opportunity. China has been the best performing market recently and erased YTD losses in July.

Commodities and especially WTI were down in July. WTI wiped out its YTD gains. Higher than expected US supply is likely behind the move. Surprisingly, commodity dependent equity markets (Canada, Australia, Brazil) performed well in July.

Capital flight in July was into longer term bonds. Most developed nations` 10 year government bonds saw prices increase during the month – driving down yields to their lowest levels of the year.

Table 1 – Select Markets Performance

	July	YTD
TSX	+1.2%	+12.5%
S&P 500	-2.0%	+4.5%
Nasdaq	+1.9%	+4.6%
China	+10.3%	+2.5%
WTI	-6.8%	-0.0%
Copper	+0.8%	-5.7%
Gold	-3.3%	+6.7%
U.S. 10 Year Treasury Yield	2.58%	2.67% (Jan)

Source: Thomson One

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ECONOMIC OUTLOOK

Higher than expected US Q2 GDP & higher Chinese economy expectations offset by the end of QE

United States

The first print of US Q2 GDP was released on July 30 and was a remarkable contrast to the Q1 number. Annualized growth of 4.0% was much higher than expected and erased any recession talk the Q1 number fueled (Q1 annualized growth was -2.9%).

We expect growth will return to a more moderate rate in Q3. If growth exceeds our expectations it will likely be on inventory building – which we will take as a positive sign of companies` expecting higher demand in the future.

The biggest and most direct economic threat to markets over the next three months is the impending end of QE in October. The US Federal Reserve will stop pumping liquidity into markets at that time. Uncertainty around whether market-based interest rates will rise and if so by how much will likely cause more equity and bond market volatility.

We think the US economy is doing well and will continue to do so. In the current economic environment we expect to increase US exposure during periods of volatility for the appropriate clients over the next few months.

China

Expectations for higher Chinese economic growth have finally set in. Chinese and Pacific equity markets (excluding Japan) and supporting markets (Australia & Brazil) bucked the global downtrend in July. We expect this trend will continue. We initiated exposure to China for appropriate clients mid-month.

MARKET OUTLOOK

The current pull-back should provide us with an excellent entry point for mostly North American equities

Equities

The TSX met our expectations and continued to grow in July. Financials lead as we expected. Materials were up until the broad global market sell off at the end of the month, again as we thought. After an excellent, almost straight up, run from 12,000 to 15,000 we expect the TSX pull-back to continue. A market rally off 14,900 would be a good entry point for the next move up.

Broad US markets were sharply down in July in contrast to our expectation. We expect these markets to continue to pull-back but we think they are very near the lows for this swing. For appropriate clients, we will add to our US positions with a focus on US listed companies with higher exposure to Asia and US economies.

Commodities

Oil prices have retreated to just below the bottom end of our expected trading range of $98-$112. This was contrary to our thoughts last month and surprised us given intensifying conflict in Iraq and Israel/Palestine. We expect WTI is oversold and that oil will rebound. If prices remain below our trading range for an extended period our view for the commodity will change. We predicted a downward move for natural gas in July and it did come to fruition. The move is likely over and we expect a sideways consolidation. However, the heart of hurricane season is upon us so there will likely be volatility in natural gas price as is common this time of year. We reduced exposure to the energy sector for appropriate clients in June and July.

Precious metals contrary to our view in July and headed down. If global conflicts subside – which is our thinking – these commodities should continue to slide.

Copper appears to be consolidating. A move up would give us confidence to increase our positions in the materials sector for appropriate clients.

Fixed Income

No change to our view that the risk/reward trade-off in bonds is unappealing. We continue to hold cash in money market funds as an alternative to fixed income.