BACK TO BUSINESS

THE VIEW
RICHARD HARRIS

Gainers vs losers

More excitement in store after volatile dollar and oil send shock waves through markets in 2014

When I was a young intern at Royal Dutch Shell 30 years ago, I worked in the department where scenario planning was invented. I calculated, to two decimal points, the impact on the markets for the major petroleum products for oil price scenarios between US$20 and US$40 a barrel.

Within six months, the price of Brent crude hit US$10! So I am unsurprised that, when the oil price was at US$110 in January last year, the world's most seasoned and highly paid oil analysts missed the looming fall to US$57.

However, it was not the black gold that produced the biggest shock wave of the year, but the greenback. The US dollar has had its best year in the past 17, rising against all of its 31 major peers save one – the Hong Kong dollar.

This means that every time Hong Kong investors invested a dollar overseas last year, the currency was always against us. Non-US dollar investors in dollar assets, however, received a tailwind from the charging buck.

The euro fell about 12 per cent against the dollar last year, meaning that while the European Stoxx Index was up 1 per cent locally, a dollar-based investor lost 11 per cent. However, a European investor in long-dated US bonds happily troused a 37 per cent return from the biggest US Treasury rally in three years, which took bond yields down 28 per cent, making 2014 yet another good year for bond investors.

One mantra in investment is currency is the canvas on which investment is painted

The depreciation of the pound took a 6 per cent bite out of the minus 3 per cent local equity return. The fall of more than 8 per cent in the aussie caused a loss of more than 7 per cent for US dollar holders of the Sydney stock exchange. The Nikkei-225 Index added 7 per cent in the year but lost 6 per cent in US dollars as the yen tumbled. Argentina was up 59 per cent locally and just 24 per cent in US dollars.
strong, losing only 2.5 per cent, and that allowed the 52 per cent jump in A shares on the Shanghai Composite Index to come through. India's Nifty index was a good place to be as it rose 32 per cent, with the rupee losing just 3 per cent.

In contrast, the Hang Seng Index took a year to break into positive territory by a small margin. While this may seem pathetic, it is the same lesson, one-oh-one. Our market did not have to go up for a euro investor to feel pleased. They made 12 per cent just by parking their money in Hong Kong.

The Russian rouble sank 39 per cent, holed by oil and sanctions, but not as badly as the Ukrainian hryvnia, which collapsed nearly 46 per cent. The biggest so-called currency meltdown was from bitcoin, down 57 per cent. Rats and sinking ships come to mind.

One of the biggest mantras in investment is to remember that currency is the canvas on which investment is painted. It takes a year like 2014 to show that often what you gain on the stock market you can lose on the currency.

The exception is the US markets, which behaved contrary to the mantra, being driven largely by domestic investors. The Dow Jones Industrial Average broke 18,000 for the first time, breaking all-time highs a record 38 times. The S&P 500 Index bust 53 highs while climbing 13 per cent. The Russell 2000 Index crept up just 4 per cent, but broke through its own record high. The Nasdaq Composite Index rose 15 per cent despite poor returns from Amazon (minus 22 per cent) and Google (down 5 per cent).
an asset denominated in dollars and behaved like a proxy of dollar cash all year.

Successful trades are highlighted at year-ends, especially if one shorted iron ore (down 46 per cent) and went long the Shanghai stock market, doubling your money.

But there will be some who took profits from a booming US equity market in late 2013 to invest in oil and are now sitting on a 61 per cent loss. And if that trade was made with borrowed dollars, it would be much worse.

52%
The rise in A shares on the Shanghai Composite Index in 2014

Extraordinary price moves will always catch somebody out. It may be companies that borrowed dollars and now have to repay using depreciated local currency. It may be the oil-producing countries in Africa, the Americas, Europe and the Middle East that are unable to balance their books in the near term.

We are likely to be only months – perhaps days – away from news of a big corporate, or country, or bank default due to the dramatic volatility in the dollar and oil, with 2015 already shaping up to be an exciting year.

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