Invesco 景順

Market Insights: Global Monthly Market Review

August 2014 (covering July 2014)

Global overview

Global equity markets in the developed world rose steadily until the last day of July when investor confidence, positive for most of this year, was punctuated by a broad based market retreat.

The US economy roared ahead in the second quarter with annualised growth of 4%, confirming that weakness earlier this year may have been an aberration and that the recovery was back on track. However, the late retreat in the US equity market was primarily impacted by continued geo-political uncertainties in the Middle East and Ukraine together with Argentina's latest debt default. Nervousness surrounding the general valuation of US equity markets relative to historic levels also encouraged profit taking.

Asian equity markets, in particular Hong Kong and China, produced positive gains across the board in local currency terms due to the announcement of further strong economic data and confidence in the political situations in both Indonesia and India. Two exceptions to the generally positive Asian tone were the equity markets in Taiwan and Malaysia.

The UK equity markets maintained their recent low levels of volatility and remained broadly unchanged in local currency terms. Economic news remained broadly encouraging with the economy continuing to expand with a still relatively low level of inflation. To this end, Mark Carney, Governor of the Bank of England, indicated that the timing of any increase in interest rates would be determined solely by the economic data.

European equity markets were impacted by mixed corporate earnings results, and the shadow of a renewed debt crisis in the region. In addition, a new set of economic sanctions against Russia was announced by European and US leaders amid increased tensions in Ukraine. Despite prevailing regional and global challenges, however, the macroeconomic environment in Europe is still showing a slow but steady positive momentum, especially in some periphery markets.

Emerging equity markets in general continued their positive momentum, aided by optimism over China's monetary stimulus and upbeat news on its economy. However, the deteriorating geo-political environment between Russia and the West took its toll on equity markets in Russia, Hungary, Poland and Czech Republic. In a surprise move, Russia's central bank raised its key interest rate by 50 basis points (bps) to 8% on concerns about inflation and the effect of geopolitical tensions on the rouble.

Bond markets also produced broadly positive returns. The persistence of relatively weak price pressure in the major developed economies, combined with rising geo-political uncertainty, supported core government bonds, such as Gilts. The problems of a Portuguese bank, however, increased volatility in the high yield debt market although aggregate yields changed relatively little. The euro fell 2.2% against the US dollar and 0.9% against sterling.

US

- Second quarter economic growth roared ahead
- US labour market gained momentum
- Investor confidence was in retreat on last day of trading

US equity markets rose steadily until the last day of July when investor confidence, positive for most of this year, was punctuated by a broad based market retreat. The S&P index fell 1.4% (in US$ total return terms) in July, as geopolitical concerns in the Middle East and Ukraine together with Argentina's latest debt default abruptly spooked the market. Nervousness surrounding the general valuation of US equity markets relative to historic levels also encouraged profit taking.

Sector leadership was mixed. The telecoms, technology and healthcare sectors rose during the month as well as year-to-date. Telecoms stocks were the clear leaders, in contrast to the previous month in which they fared the worst. Conversely, the utilities sector was the weakest sector in July, falling 6.8% (in US$ total return terms).

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Despite the US equity market late setback, the US economy roared ahead in the second quarter with annualised growth of 4%, confirming that weakness earlier this year may have been an aberration and that the recovery was back on track.

This has been supported by other US economic data. June's Purchasing Manager's Index rose compared to levels seen in May with new orders centred nearly entirely on domestic demand. Lagging behind were export orders which barely showed any monthly growth. Manufacturing continued on a recent uptrend, retaining its status as a key engine of US growth. Durables orders have been up in four of the last five months. US factory orders fell 0.5% in May but, when excluding defence, orders rose 0.2%. One significant positive was a 0.7% order gain for non-defence capital goods excluding aircraft, which is an important core reading for business investment. Retail sales disappointed for June but again there were upward revisions to the prior month.

The US labour market also appears to be gaining momentum. The unemployment rate surprisingly fell to 6.1% in June from 6.3% in May. Total non-farm payroll jobs increased 288,000 in June after a 224,000 gain in May and a 304,000 rise in April.

Against this background, the majority of US companies that have announced earnings thus far have reported better-than-expected sales and profits. In addition, company managements have provided broadly positive outlooks, which perhaps suggests rising optimism for earnings growth as the year progresses and as the US and global economies continue to improve.

- European equity markets retreated in July
- Corporate earnings have produced a mixed picture so far
- Macro data progress slow but steady

Europe

European equity markets were impacted in July by continued geo-political uncertainties, mixed corporate earnings results, and the shadow of a renewed debt crisis. Most of continental Europe's stock indices retreated, led by Portugal's PSI All- Share Index which registered the worst performance in the region, dropping 10.5% (in EUR total return terms) in one month. The FTSE World Europe excluding UK Index (in EUR total return terms) fell by 2.7% in July.

A new set of economic sanctions against Russia were announced by European and American leaders amid increased tensions in Ukraine. These recent coordinated sanctions went beyond previous moves against banking and defence industries, targeting Russia's energy sector and its access to western technology, limiting its capabilities to tap into reserves. The effect of these announcements was felt particularly by the oil & gas sector, which witnessed the most severe drop in value due to its significant links to the Russian market. Among the 10 industry segments of the ICB classification, only technology and healthcare gained ground in July, while all the remaining sectors regressed.

Meanwhile, European corporate earnings continue to show a mixed picture. On the one hand, encouraging results are stemming from areas most affected by the euro crisis such as financials; Spanish mid-size banks, for example, reported very positive Q2 earnings powered by margin expansions and falling bad debt. On the other hand, concerns remain over global business activity, with a number of international companies lowering their guidance and profit forecasts for 2014.

景順 Invesco

Market Insights: Global Monthly Market Review

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Despite prevailing regional and global challenges, the macroeconomic environment in Europe is still showing a slow but steady positive momentum, especially in some periphery markets. Latest European jobless data showed figures decreasing (albeit modestly) and beating estimates, with very strong employment numbers from Spain. Preliminary July eurozone data for both Composite and Services Purchasing Managers' Indices (PMIs) beat estimates and pointed to strong expansion: Composite PMI stood at 54 while the Services PMI increased from 52.7 to 54.4, a 3 years-high figure. While France and Germany lagged, PMI outputs for the rest of Europe recorded the largest monthly increase in business activity since August 2007. A further encouraging note came out of the European Central Bank (ECB) lending survey, pointing to a continued rise in the rate of net new lending and further improvements in private demand. Notwithstanding the still low level of inflation, the combination of these factors in our view should set a good stage for an accelerating growth in Europe.

- Unemployment fell to 6.5%
- Q2 GDP rose on first estimate
- Trade deficit widened in May

UK

A total return over the month of -0.3% by the FTSE All-Share index (in total GBP terms) has meant that the low level of volatility and modest monthly changes in the level of the UK equity market has been maintained. Notwithstanding this, the economic news remains encouraging with the economy continuing to expand with a still relatively low level of inflation.

In July the preliminary estimate of the UK's GDP was released, which showed a quarterly rise of 0.8%. This rise in economic activity had a particular significance as it meant that GDP had risen to a level just above where it was before the recession started in 2008. In addition, the latest unemployment figures were released, which showed a further fall to 6.5%. This rate was the lowest since December 2008. Commentaries suggested that there is still, however, slack in the labour market and this was evidenced by the latest growth rate for average pay, including bonuses, which fell from 0.8% in April to 0.3% in May. The figure for CPI inflation was then released, which showed a rise from 1.5% in May to 1.9% in June. Just as this was a disappointing figure, so was the data for trade. In May the overall deficit grew to £2.4bn from £2.1bn in April. This growing deficit was probably in part attributable to the strength of sterling. Taking his opportunity of making a speech at the opening of the Commonwealth Games, Governor of the Bank of England, Mark Carney gave an update on the outlook for interest rates saying that the timing of any increase in interest rates will be determined solely by the economic data.

An analysis of the month's larger sector price movements from within the equity market shows that the mining and banks sectors were amongst the better performers whereas industrial transport and food & drug retailers were amongst the worst.

- Economic data strengthened in China
- Joko Widodo declared winner of the Indonesian presidential election
- Package of measures announced in Korea to stimulate the economy.

Asia

There were broad based gains across Asian equity markets through July. The strongest performing market was China where stock markets benefitted from further announcements of a strengthening of economic data.

The preliminary HSBC Manufacturing Purchasing Managers Index (PMI) data for China released on 24 July showed a reading of 52.0; well above expectations and an increase on the June number of 50.7. The number indicates further expansion of the manufacturing sector. GDP data released during the month for Q2 2014 was slightly above expectations at 7.5% year on year. Meanwhile, there were further signs of credit growth: aggregate financing increased to 1.97 trillion yuan and M2 Money supply grew 14.7% year-on-year. All sectors of the market, except Utilities, were higher with Telecoms leading the way.

In Korea, the newly appointed finance minister announced a package of measures to stimulate the economy. The measures included a 41 trillion won stimulus package; tax measures to better transfer the growing wealth savings of Korean corporates to households and deregulation of the housing market with loan to value and debt to income ratios relaxed. These measures were well received by the market with the KOSPI returning 3.7% for the month (in local currency total return terms).

Joko Widido was declared the winner of the Indonesian presidential election. The stock market welcomed the result with the Jakarta Stock Exchange rallying 4.3% over the month (in local currency total return terms).

The new Modi led Indian government held its first budget. Announcements included a commitment to reduce India's fiscal deficit to 4.1% of GDP in the current year as well as Foreign Direct Investment reform and measures to boost infrastructure investment. By the end of the month the Sensex index was up 2.1% (in local currency total return terms).

The two exceptions to the positive tone were Taiwan and Malaysia where the stock market fell over the month. In Taiwan equity markets were dragged lower by poor performance in the semiconductor sector where earnings expectations had gotten ahead of fundamentals. Meanwhile, in Malaysia as widely anticipated Bank Negara Malaysia hiked rates 25 basis points. The equity market ended lower on the month (in local currency total return terms).

In Japan, the Topix recorded its third consecutive monthly gain (in local currency total return terms). Economic data was, however, weaker over the month of July with preliminary Industrial production figures for June for example, falling 3.3%, well below the markets expectations. Meanwhile, companies that have so far reported earnings have beaten expectations. Speculation that the Government Pension Investment Fund will begin buying domestic equities provided positive support to sentiment.

- Positive momentum maintained in emerging equity markets in July
- Optimism boosted by Chinese reforms and upbeat economic data
- New EU and US sanctions imposed on Russia

Emerging Markets

Emerging equity markets continued their positive momentum in July, aided by optimism over China's monetary stimulus and upbeat news on the economy, which expanded by 7.5% in Q2 2014, and the Peoples' Bank of China providing a three-year one trillion Yuan Pledged Supplementary Loan to China Development Bank. The size of the loan was above expectations. Improved sentiment was in evidence elsewhere in the emerging Asian region with equity gains in Indonesia being boosted on hopes that Joko Widodo, the new president, will bring major reforms to promote growth. Indian stocks took a breather after their strong rally so far this year.

United Arab Emirates and Qatar were the top country performers in emerging equity markets while the worst ones were concentrated in emerging Europe, adversely impacted by the imposition of further sanctions on Russia from the EU and the US that could damage trade in the region. In a surprise move, Russia's central bank raised its key interest rate by 50 basis points (bps) to 8% on concerns about inflation and the effect of geopolitical tensions on the rouble. The central bank also warned that further monetary tightening could follow if political shocks prevent inflation from coming down. Hungary's central bank trimmed 20 basis points off their benchmark interest rate and said it planned to keep the rate at 2.1% until the end of next year. Although the deteriorating geopolitical environment between Russia and the West took its toll on equity markets in Hungary, Poland and Czech Republic, by contrast Turkish equities gained ground drawing support from the country's narrowing current account deficit and a further fall in interest rates. The benchmark interest rate was reduced from 8.75% to 8.25% with the central bank signalling that more "measured" reductions may still be a possibility.

Market Insights: Global Monthly Market Review

August 2014 (covering July 2014)

A weakening macroeconomic environment in Latin America failed to dent investor confidence with equity gains being registered in Brazil and Mexico. Materials, energy and financials were the best performing sectors in Brazil, while the laggards were information technology and telecom. Economic data releases from Brazil were relatively disappointing, leading many analysts to downgrade the country's 2014 GDP forecast. The central bank kept interest rates unchanged at 11% but indicated they may need to remain at this level to allow for inflation to converge to its target. Economic data from Mexico was more mixed, with consumer-related indicators continuing to improve amid stronger labour market conditions. However, the latest trade data showed deceleration in export activity. On the political front, the most important event in Mexico was the approval of the four packages of the Energy Secondary Laws sent to the Senate by the government. Weaker-than-expected economic data in Chile and Peru prompted both central banks to similarly cut interest rates from 4.25% to 3.75%.

- Bunds were relatively strong on lower eurozone growth outlook
- Anticipation of rising interest rates boosted dollar
- High yield negatively affected by the weakness in a Portuguese bank

Fixed Interest

July saw broadly positive returns in the bond markets. The persistence of relatively weak price pressure in the major developed economies, combined with rising geo-political uncertainty, supported core government bonds, such as Gilts. The problems of a Portuguese bank increased volatility in the high yield debt market although aggregate yields changed relatively little.

Economic data for the eurozone was mixed over the month. News from the European Central Bank's Q2 Bank Lending Survey was positive, showing increased demand for credit and a loosening of lending conditions. However, business confidence in Germany has continued to weaken, with both the Ifo and ZEW indicators down again in July. Eurozone industrial production grew just 0.5% in the year to May while retail sales were similarly weak at 0.7%.

Initial data on US GDP showed the economy growing at an annualised rate of 4.0% in the second quarter, bouncing back strongly from the weather-affected rate of -2.1% (revised up from -2.9%) recorded for Q1. More recent evidence suggests that this strength is likely to be sustained into the second half of the year. A strong June employment report showed 288,000 additional payrolls. Retail sales grew 4.3% in the year to June while in July the Conference Board's consumer confidence measure rose to its highest level since 2007. Headline inflation remained relatively low at 2.1%. However, comments after the Federal Reserve's (Fed's) latest meeting suggest a rise in concern about the erosion of slack in the labour market. The Fed's programme of asset purchases was reduced by a further US$10 bn per month in July, in line with expectations. Anticipation of rising UK interest rates has also grown. The UK economy grew 0.8% in the second quarter, finally surpassing the pre-recession peak. Activity data suggests that the recovery in growth is being maintained into the second half of the year.

The 10 year Bund yield fell 9bps in July to 1.16%, extending this year's strong rally. Reflecting, the growth divergence between the US and the eurozone, the 10 year Treasury yield rose, albeit by just 3bps to 2.56%. According to data from Merrill Lynch, Treasuries had a total return of -0.2% (all in local currency terms), compared to 0.6% for Bunds. Gilts rebounded from June weakness with a 1.1% return in July. Sterling investment grade corporate bonds returned 0.5%. Lower credit quality bonds underperformed, with European high yield bonds returning -0.3%. Peripheral eurozone sovereign bonds continued to outperform, with Portuguese bonds returning 0.8% for the month. The euro fell 2.2% against the dollar and 0.9% against sterling.

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Global equity and commodity index performance – figures to 31 July 2014

	1 Month	3 Months	6 Months	YTD	2013
Global, US & Canada					
MSCI World (US$)	-1.6%	2.3%	8.9%	4.8%	24.7%
MSCI World Small Cap (US$)	-4.0%	1.0%	4.1%	2.2%	32.9%
MSCI Emerging Markets (US$)	2.0%	8.5%	16.0%	8.5%	-2.3%
FTSE World (US$)	-1.4%	2.6%	9.4%	5.1%	24.7%
Dow Jones Industrials	-1.4%	0.5%	6.7%	1.2%	29.7%
S&P 500	-1.4%	3.0%	9.4%	5.7%	32.4%
NASDAQ	-0.8%	6.5%	7.1%	5.3%	40.1%
S&P/ TSX Composite	1.4%	5.4%	13.5%	14.5%	13.0%
Europe					
FTSE World Europe ex-UK (£)	-3.7%	-4.0%	2.4%	-0.7%	25.2%
MSCI Europe	-1.5%	0.7%	6.9%	5.0%	20.5%
CAC 40	-4.0%	-3.4%	4.6%	1.5%	22.2%
DAX	-4.3%	-2.0%	1.1%	-1.5%	25.5%
Ibex 35	-1.6%	3.4%	10.1%	10.5%	30.0%
FTSEMIB	-3.4%	-3.7%	8.1%	10.7%	20.5%
Swiss Market Index (capital returns)	-1.7%	-0.8%	2.7%	2.5%	20.2%
Amsterdam Exchanges	-2.1%	2.1%	6.5%	2.6%	20.7%
HSBC European Smaller Cos ex-UK	-3.7%	-1.9%	4.9%	6.7%	34.0%
MSCI Russia (US$)	-8.4%	8.4%	-3.4%	-13.2%	1.4%
MSCI EM Europe, Middle East and Africa (US$)	-4.1%	3.4%	3.3%	-6.1%	-3.9%
UK					
FTSE All-Share	-0.3%	-0.2%	4.5%	1.3%	20.8%
FTSE Small Cap ex Investment Trusts	-0.8%	-2.7%	-3.6%	-0.4%	43.9%
Asia Pacific & Japan					
Hong Kong Hang Seng	7.5%	14.8%	15.9%	9.6%	6.6%
China SE Shanghai Composite (capital returns)	7.5%	8.6%	8.3%	4.0%	-6.7%
Singapore Times	3.8%	4.0%	13.4%	8.4%	3.0%
Taiwan Weighted (capital returns)	-0.8%	6.0%	10.1%	8.2%	11.9%
Korean Composite (capital returns)	3.7%	5.8%	7.0%	3.2%	0.7%
Jakarta Composite (capital returns)	4.3%	5.1%	15.2%	19.1%	-1.0%
Philippines Composite (capital returns)	0.3%	2.3%	13.6%	16.6%	1.3%
Thai Stock Exchange	1.2%	6.6%	20.5%	18.3%	-3.6%
Mumbai Sensex 30	2.1%	16.1%	27.4%	23.7%	10.9%
Hang Seng China Enterprises index	9.0%	18.3%	17.8%	7.0%	-1.5%
ASX 200	4.4%	3.5%	10.9%	7.6%	20.2%
Topix	2.1%	11.1%	6.8%	0.2%	54.4%
MSCI Asia Pac ex Japan (US$)	3.6%	8.8%	17.0%	11.0%	3.7%
Latin America					
MSCI EM Latin America (US$)	1.1%	5.2%	19.9%	8.5%	-13.2%
MSCI Mexico (US$)	1.4%	7.7%	9.9%	2.7%	0.2%
MSCI Brazil (US$)	1.9%	5.6%	26.2%	12.8%	-15.8%
MSCI Argentina (US$)	6.3%	23.5%	75.4%	33.6%	66.2%
MSCI Chile (US$)	-4.9%	-3.8%	9.1%	-4.4%	-21.4%
Commodities					
Oil - Brent Crude Spot (US$/BBL)	-5.5%	-3.3%	-3.3%	-4.9%	0.2%
Oil - West Texas Intermediate (US$/BBL)	-7.4%	-1.8%	0.7%	0.1%	6.9%
Reuters CRB index	-4.5%	-4.9%	3.9%	5.1%	-5.0%
Gold Bullion LBM (US$/Troy Ounce)	-2.3%	-0.6%	3.5%	6.5%	-27.3%
Baltic Dry index	-11.2%	-19.9%	-32.0%	-66.8%	225.8%

Source: Thomson Reuters Datastream, total returns in local currency unless otherwise stated.
Data as at 31 July 2014.