
Market Insights: Monthly Market Newsletter

Global financial markets dominated once again by central bank activity

July 2014 (covering June 2014)

Global overview

The combination of a stable macro-economic backdrop, well-behaved inflation and supportive central banks ushered in a month of positive returns for global financial markets. Despite geopolitical uncertainties, emerging equity markets outperformed developed equity markets. Emerging markets benefited from stabilisation in Chinese economic data, a further de-escalation of tensions between Russia and Ukraine and a reduction in current account deficit funding concerns. While the European Central Bank may have attracted global headlines by reducing the deposit rate to -0.1%, interest rates were also lowered in Mexico and Turkey. Latin America was the best performing regional equity market, followed by emerging Asia. The top three individual markets were Thailand, Brazil and Taiwan, while Qatar and United Arab Emirates (UAE) suffered the biggest losses. Contributing towards equity weakness were concerns of the UAE property market overheating and fresh uncertainties over the 2022 FIFA World Cup and whether it will still be held in Qatar.

Within Asia ex-Japan the best performing market was once again India with the Sensex reaching new highs as foreign investors provided further support to the market. The market took encouragement from the early policy decisions announced by the new Modi government. In Japan the TOPIX index enjoyed its strongest month so far this year. Investors have been encouraged by data that appears to show the impact of April's consumption tax hike has not been as severe as some had previously feared.

The UK equity market showed a lacklustre performance last month despite economic news continuing to improve. The figures for employment for the three months ending April were released and this showed a rise of 345,000 which was the biggest increase in any three-month period since records began in 1971. The latest unemployment rate subsequently fell to 6.6% from 6.8% previously. It was in this context that the Governor of the Bank of England made his annual speech at The Mansion House. During this speech, when considering the outlook for interest rates, Mark Carney said that the exact timing of the first rate hike was becoming more balanced and that 'it could happen sooner than markets currently expect.'

European equities were little changed in June, as geo-political uncertainties and a 'shy' global economic recovery still weighed on investors. Meanwhile, the European Central Bank (ECB) announced a robust package of monetary policy measures and more to come if needed to help stave off deflation and support the Eurozone's fragile economic recovery. Among the moves announced were interest rate cuts, including a negative interest rate on excess deposits that banks hold with the ECB to -0.1% from zero, and new facilities to support bank lending to small businesses.

The US equity market continued to reach new highs. Sector leadership for June was from the typically less economically sensitive, defensive utilities and energy stocks.

Bond market returns were mixed, driven primarily by changes in core government yields. Corporate bonds outperformed modestly. Many of the key economic and policy developments of the month were reflected in the relative performance of the Bund market compared to Gilts and US Treasuries. While Bund yields fell in response to weaker eurozone economic data and further easing by the European Central Bank (ECB), Gilt and Treasury yields were pushed higher amidst rising anticipation of future rate hikes.

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- US equity markets rose for the fifth successive month
- First quarter economic growth revised downwards
- Housing data was mixed

US

US equity markets ended higher for the fifth month in succession, with the S&P index having returned 2.25% (in US\$ total return terms) for June. The index continued its trend of reaching new highs.

Sector leadership for June, and indeed the year thus far, has been from the typically less economically sensitive, defensive utilities and energy stocks. However, the more economically sensitive, 'cyclical' financials and technology sectors also outperformed the broader market in June. Telecoms fared worst, the only sector to deliver negative returns (in US\$, total return terms), in contrast to their strong performance in May.

In economic news, data releases showed weak first quarter gross domestic product (GDP) growth. The Bureau of Economic Analysis' third estimate, released at the end of June, showed that real GDP decreased at an annual rate of 2.9%. This was in marked contrast to the initial estimate which showed an increase of 0.1%, and also to the US economy's performance in the fourth quarter of 2013, when it increased by an annual rate of 2.6%.

Data released for US consumer spending, while weaker than expected, showed an increase for May versus the previous month. A critical component of the US economy, consumer spending represents more than two thirds of GDP. Inflation rose during May to its highest level for more than 18 months. However, at its June meeting the US Federal Reserve expressed no obvious concerns, demonstrating that it is content to keep interest rates at low levels in order to aid the economy.

Housing data was more mixed and broadly indicated that sales had increased but that price acceleration had slowed. While sales of new single-family homes and existing homes rose significantly, prices rose at their lowest rate for more than a year, despite tight housing inventories in many areas. There was also a sharp fall in mortgage applications during the month. However, consumer confidence survey results painted a more positive picture. The Conference Board Consumer Confidence index and the University of Michigan 'Survey of Consumer Confidence Sentiment' index both rose.

- European equity markets were flat in June
- ECB took measures to boost lending and growth
- Macro data showed recovery remained slow

Europe

European equities were little changed in June, as geo-political uncertainties and a 'shy' global economic recovery still weighed on investors. After four months of consecutive gains, the FTSE World Europe ex UK Index (in EUR) ended the month relatively flat, slipping by 0.9% in the month of June, but posting a total return of +3.14 % in the second quarter of 2014.

In terms of markets, the oil & gas sector was the best performer in June, benefiting from a hike in energy prices following uncertainties in Eastern Europe and the Middle East. This was complemented by a positive performance for the healthcare and utilities sectors, indicating a temporary return to defensive stocks by investors. Financials posted the worse performance during the month of June, especially pulled down by a Portuguese bank which dropped by 37.55% this month alone, on governance concerns, and triggering a management reshuffle.

Expectations of Mario Draghi, President of the European Central Bank (ECB), acting in the face of a very low inflation rate in the Eurozone, materialised on 5 June, with the ECB introducing an unprecedented set of measures to tackle deflationary risks and spark demand: the Main Financing Rate set by the ECB was decreased from 0.25% to 0.15%, and the Deposit Facility Rate was placed into negative territory at (-0.1%), compelling banks to make loans or pay charges on any additional capital placed at the central bank on top of their minimum requirements. New facilities made available through the 'Targeted Longer-Term Refinancing Operations' or TLTROs provided banks with new attractive borrowing terms, and even further incentive to lend.

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While ECB measures were widely seen as positive stimuli and a step in the right direction, they were relatively outweighed by June macroeconomic data coming out of Europe and the US, which still showed mixed economic signals. The Eurozone economic confidence indicator dropped to 102 from 102.7 in the previous month, missing the expected 103 level. There was also a drop in the consumer and industrial confidence indicators compared to the May levels, impacted by the on-going crisis in Ukraine, developments in Iraq, and the US quarterly GDP numbers, which shrank more than forecast and posted the worse reading since Q1 2009.

Other indicators were encouraging however, with unemployment in Spain continuing to fall, Eurozone manufacturing Purchasing Managers Index (PMI) figures remaining in expansion territory (above the 50 threshold), and credit demand by the euro area private sector still showing significant improvement in the level of new borrowings, suggesting a slow but steady return to growth.

- Large increase in UK employment
- CPI inflation in May fell to 1.5%
- Mark Carney said interest rates might rise sooner than expected

UK

A total return over the month of -1.3% by the FTSE All-Share index has continued to reflect the general lack of volatility of share prices. Despite this lacklustre trend the economic news in the UK has continued to improve and perhaps reflecting this steady improvement there have been some consequent comments from the Bank of England.

In June the figures for employment for the three months ending April were released and this showed a very large rise of 345,000 which was the biggest increase in any three-month period since records began in 1971. This rise in employment took the latest unemployment rate to 6.6% from 6.8% previously. The figure for CPI inflation for May was then released which showed a fall to 1.5% from 1.8% in April. Such positive data may have helped to keep the volume of retail sales at an elevated level, as despite falling by 0.5% in May, total sales were still recorded at 3.9% above the level of May last year. It was in the context of such economic reports that the Governor of the Bank of England made his annual speech at The Mansion House. In this speech, when considering the outlook for interest rates, Mark Carney said that the exact timing of the first rate hike was becoming more balanced and that 'it could happen sooner than markets currently expect.'

An analysis of the month's larger sector price movements from within the UK equity market shows that pharmaceutical & biotech and leisure goods were amongst the better performers whereas industrial metals & miners and chemicals lagged.

- Indian Sensex index continued to reach new highs
- Some signs of stabilisation in China's economy
- Military coup brushed aside in Thailand with Stock Exchange of Thailand rallying strongly
- Topix had best month of the year so far

Asia

During June the MSCI Asia Pacific ex-Japan index was up 1.7% while the TOPIX index was up 5.3%. Outside of Japan the best performing market was once again India with the Sensex reaching new highs. At the other end of the spectrum Australia was the worst performing market with the ASX 200 down -1.5%.

In India the Sensex index delivered 5.1% over the month as foreign investors provided further support to the market. The market took encouragement from the early policy decisions announced by the new Modi government and the onset of the southwest monsoon, which it is hoped will help alleviate food price inflation thereby helping the Reserve Bank of India achieve its inflation target.

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In China the Purchasing Managers Index (PMI) manufacturing data showed further improvement with the end of June HSBC number edging slightly above 50 to 50.8. Meanwhile, M2 Money supply rose in May to 13.4% year-on-year with new yuan loans increasing to 870.8 billion yuan. Aggregate financing however eased to 1.4 billion in line with estimates. The People's Bank of China sought to increase credit growth further through a targeted cut in the reserve requirement for banks that mainly lend to small businesses and rural borrowers. This follows on from the April cut in reserve requirements for rural banks. Meanwhile, house prices in China continued to come under pressure with 50% of the cities in the National Bureau of Statistics 70 city house price index showing a month-on-month decrease.

There was dispersion in the performance of Association of Southeast Asian Nations (ASEAN) equity markets; the Indonesian market was down slightly on the month as investors weighed up whether or not the markets favoured candidate Jokowi would win July's election. Meanwhile, last month's military coup in Thailand has been brushed aside by domestic retail and institutional investors who welcomed the political stability that the coup has brought. Elsewhere in the region international investors have continued to push the Philippine stock market higher with the PSEI composite up 3% on the month.

In Japan the TOPIX index enjoyed its strongest month so far this year. Investors have been encouraged by data that appears to show the impact of April's consumption tax hike has not been as severe as some had previously feared. PMI data rebounded with the final manufacturing PMI reading for June above 50 - indicating expansion. Retail sales data released toward the end of the month also showed an improvement with month-on-month sales increasing 4.6%. This increase follows on from the 13.6% fall in sales during April immediately post tax rise.

- Emerging market equity gains supported by stabilisation in Chinese economic data
- Russian stocks aided by de-escalation of tensions with Ukraine and higher oil prices
- Interest rates cut in Mexico and Turkey

Emerging

Emerging equity markets gained further ground during June, drawing benefit from stabilisation in Chinese economic data, a further de-escalation of tensions between Russia and Ukraine and a reduction in current account deficit funding concerns. While the European Central Bank may have attracted global headlines by reducing the deposit rate to -0.1%, interest rates were also lowered in Mexico and Turkey. Latin America was the best performing regional equity market, followed by emerging Asia. The top three individual markets were Thailand, Brazil and Taiwan, while Qatar and United Arab Emirates suffered the biggest losses. All ten sectors of the MSCI Emerging Markets Index recorded gains, with healthcare and energy leading the pack. Higher geopolitical risk in Iraq pushed Brent oil prices to a nine month high of US\$115 per barrel.

Brazil's central bank signalled it will keep interest rates unchanged as it weighs the delayed impact of a year-long tightening cycle and a slowing economy. The number of formal net jobs created in May fell to 58,000, much lower than the 105,000 that were registered in April. On 20 June, the Brazilian government announced another round of stimulus measures to boost the manufacturing industry. Economic data in Mexico was generally upbeat with industrial production figures showing construction activity picking up. With no inflationary concerns, the country's central bank cut its benchmark interest rate by 50 basis points to a record low of 3%. Investor confidence in Colombia was boosted by healthy economic activity with GDP growing by 6.4% (above expectations) in the first quarter period of this year. President Santos won the presidential run-off over Oscar Ivan Zuluaga, winning his second four-year term. Chile's central bank kept the policy rate at 4% and emphasised that inflation expectations for the next two years remain well anchored.

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Russian equities were boosted on news that President Putin had asked the upper parliament to cancel a mandate to send troops into Ukraine and to extend the temporary ceasefire. In economic news, industrial production accelerated for the third month to 2.8% year-on-year and the annual inflation rate ticked up to 7.6%. Russia's central bank maintained its key interest rate at 7.5% but warned it would tighten monetary policy if its medium-term inflation target is threatened by a decline in the rouble's exchange rate or higher food prices. A cut in interest rates in Turkey was welcomed by financial markets although fears of violence in Iraq spreading in the region tempered demand for Turkish equities. UAE and Qatar had a tough beginning as new entrants to the MSCI Emerging Markets Index. Contributing towards equity weakness were concerns of the UAE property market overheating and fresh uncertainties over the 2022 FIFA World Cup and whether it will still be held in Qatar.

- European Central Bank (ECB) monetary policy easing and weaker economic data pushed down Eurozone bond yields
- Anticipation of tighter monetary conditions in the US and UK grew
- Government bond yields and income the chief drivers of return

Fixed Interest

Bond market returns were mixed in June, driven primarily by changes in core government yields. Corporate bonds outperformed modestly. Many of the key economic and policy developments of the month were reflected in the relative performance of the Bund market compared to Gilts and US Treasuries. While Bund yields fell in response to weaker eurozone economic data and further monetary policy easing by the European Central Bank (ECB), Gilt and Treasury yields were pushed higher amidst rising anticipation of future rate hikes.

The most recent data on Eurozone GDP growth shows consumption rising by just 0.1% in the first quarter. More forward-looking data reflects this picture of very modest growth. June's ZEW and Ifo surveys reported a decline in expectations for economic activity in Germany while provisional data on Eurozone-wide activity in June showed a second successive fall. Responding to this weakness and low levels of inflation, the ECB cut its main refinancing and deposit rates by 0.1%, bringing the deposit rate below zero for the first time. The bank also announced a number of new measures aimed at stimulating lending to the business and consumer sectors and made clear its preparedness to initiate a programme of outright asset purchases.

Data on US growth in the first quarter has also disappointed; however, indicators for the second quarter and beyond are much more positive. In May, industrial production grew at an annual rate of 4.3% while the economy added 217,000 jobs (Non-Farm Payrolls), the fourth successive 200,000+ rise. The Conference Board measure of US consumer confidence hit a six-year high in June. US inflation has shown signs of rising from recent low levels. Core inflation rose to 2.0% in May from 1.8% the month before. Given this, it surprised few that the Federal Reserve (Fed) continued to wind down its asset purchase programme at its June meeting. There has been some evidence in recent comments of increased support within the Fed for the initiation of interest rate increases. Bank of England rhetoric has also been more hawkish in recent weeks, raising the possibility that the bank's interest rate will rise sooner than previously thought. While inflation remains relatively low in the UK economy, positive business sentiment, rising employment and growing retail sales all indicate that the recovery is continuing.

The 10 year Bund yield ended the month at 1.25%, down 11 basis points (bps). Corresponding Treasury and Gilt yields closed up 6bps and 10bps respectively. According to data from Merrill Lynch, Bunds had a total return of 0.6%, with Treasuries and Gilts both returning -0.2% and -0.6% respectively. Peripheral Eurozone government bonds were boosted by the ECB's support, with Spanish sovereigns returning 1.3% and Italians 1.5%. The yield spread of corporates over governments was little changed. Corporates outperformed modestly due to their higher levels of yield. Sterling investment grade corporate bonds returned -0.2%. The prospect of higher UK interest rates extended the recent strength of sterling, with the pound rising against the euro and the US dollar.

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Global equity and commodity index performance - figures to 30 June 2014

	1 Month	3 Months	6 Months	YTD	2013
Global, US & Canada					
MSCI World (US\$)	1.8%	5.1%	6.5%	6.5%	24.7%
MSCI World Small Cap (US\$)	4.0%	3.5%	6.5%	6.5%	32.9%
MSCI Emerging Markets (US\$)	2.7%	6.7%	6.3%	6.3%	-2.3%
FTSE World (US\$)	1.9%	5.2%	6.6%	6.6%	24.7%
Dow Jones Industrials	0.8%	2.8%	2.7%	2.7%	29.7%
S&P 500	2.1%	5.2%	7.1%	7.1%	32.4%
NASDAQ	4.0%	5.3%	6.2%	6.2%	40.1%
S&P/ TSX Composite	4.1%	6.4%	12.9%	12.9%	13.0%
Europe					
FTSE World Europe ex-UK (£)	-2.3%	0.1%	3.1%	3.1%	25.2%
MSCI Europe	-0.4%	4.3%	6.6%	6.6%	20.5%
CAC 40	-1.7%	3.2%	5.7%	5.7%	22.2%
DAX	-1.1%	2.9%	2.9%	2.9%	25.5%
Ibex 35	1.5%	6.7%	12.3%	12.3%	30.0%
FTSEMIB	-1.2%	0.1%	14.5%	14.5%	20.5%
Swiss Market Index (capital returns)	-1.4%	1.2%	4.3%	4.3%	20.2%
Amsterdam Exchanges	1.5%	4.1%	4.8%	4.8%	20.7%
HSBC European Smaller Cos ex-UK	-0.6%	1.3%	10.7%	10.7%	34.0%
MSCI Russia (US\$)	5.5%	10.8%	-5.2%	-5.2%	1.4%
MSCI EM Europe, Middle East and Africa (US\$)	-0.5%	4.8%	-2.1%	-2.1%	-3.9%
UK					
FTSE All-Share	-1.3%	2.2%	1.6%	1.6%	20.8%
FTSE Small Cap ex Investment Trusts	-1.3%	-1.6%	0.4%	0.4%	43.9%
Asia Pacific & Japan					
Hong Kong Hang Seng	1.3%	6.9%	2.0%	2.0%	6.6%
China SE Shanghai Composite (capital returns)	0.4%	0.7%	-3.2%	-3.2%	-6.7%
Singapore Times	-1.2%	3.4%	4.4%	4.4%	3.0%
Taiwan Weighted (capital returns)	3.5%	6.2%	9.1%	9.1%	11.9%
Korean Composite (capital returns)	0.4%	0.8%	-0.5%	-0.5%	0.7%
Jakarta Composite (capital returns)	-0.3%	2.3%	14.1%	14.1%	-1.0%
Philippines Composite (capital returns)	3.0%	6.5%	16.2%	16.2%	1.3%
Thai Stock Exchange	5.0%	9.2%	16.9%	16.9%	-3.6%
Mumbai Sensex 30	5.1%	14.1%	21.2%	21.2%	10.9%
Hang Seng China Enterprises index	2.9%	5.3%	-1.9%	-1.9%	-1.5%
ASX 200	-1.5%	0.9%	3.0%	3.0%	20.2%
Topix	5.3%	5.1%	-1.9%	-1.9%	54.4%
MSCI Asia Pac ex Japan (US\$)	1.7%	6.1%	7.2%	7.2%	3.7%
Latin America					
MSCI EM Latin America (US\$)	4.2%	7.0%	7.4%	7.4%	-13.2%
MSCI Mexico (US\$)	3.1%	6.6%	1.3%	1.3%	0.2%
MSCI Brazil (US\$)	5.4%	7.7%	10.7%	10.7%	-15.8%
MSCI Argentina (US\$)	11.8%	18.7%	25.6%	25.6%	66.2%
MSCI Chile (US\$)	-1.0%	2.7%	0.4%	0.4%	-21.4%
Commodities					
Oil - Brent Crude Spot (US\$/BBL)	1.5%	4.7%	0.6%	0.6%	0.2%
Oil - West Texas Intermediate (US\$/BBL)	2.6%	4.4%	8.1%	8.1%	6.9%
Reuters CRB index	0.9%	1.2%	10.0%	10.0%	-5.0%
Gold Bullion LBM (US\$/Troy Ounce)	5.8%	2.1%	9.0%	9.0%	-27.3%
Baltic Dry index	-9.0%	-37.6%	-62.7%	-62.7%	225.8%

Source: Thomson Reuters Datastream, total returns in local currency unless otherwise stated.
Data as at 30 June 2014.