Market Insights: Monthly Market Newsletter

May 2014 (covering April 2014)

Global overview

Global equity markets were marginally positive over the month, remaining resilient in the face of weaker than expected economic growth figures for the US and UK; renewed concerns over a Chinese hard landing and ongoing tensions in Ukraine. UK and European equity markets were among the strongest performers, with the former helped by an improving trend of economic news.

UK data showed business optimism at a 41-year high, and that growth in UK average earnings has finally risen above the rate of consumer price index (CPI) inflation. In continental Europe, country divergence was less marked than has been the case in the past few months. The gradual economic recovery in the region remains on track as consumer and business confidence indicators continue to move higher. Speculation has strengthened that the European Central Bank (ECB) will act to address near deflationary conditions and support the regional recovery through some further form of monetary accommodation.

US and emerging equity markets ended April broadly where they started it. In the US, investors seemingly took profits in strong performing household names in the technology sector, rotating into some of the less volatile areas of the market. While first quarter economic growth was much weaker than expected, the detail showed that this weakness was concentrated in areas affected by the adverse weather conditions experienced earlier in the year. Data for the employment market and retail sales was more positive, with the outlook for the US economy sufficiently strong for the US Federal Reserve (Fed) to continue tapering its bond-purchasing programme at its April meeting.

Emerging equity markets slightly underperformed their developed markets peers. At a regional level, Latin America was the best performing equity market, while the threat of stiffer sanctions on selected Russian individuals and companies had a negative impact on stock prices in Russia. In Asia, there was once again dispersion between equity markets, with positive performance in ASEAN (the Association of Southeast Asian Nations) and Australian markets and negative performance in Japan and China. The Japanese equity market was the biggest underperformer. Japanese equities sold off sharply, following the Bank of Japan's statement that "no additional monetary easing was required at this time".

Bonds achieved broadly positive returns in April as the market continued to be supported by evidence of growth in the major developed economies and relatively benign inflation data. Higher levels of yield and some spread tightening meant that lower credit quality bonds saw some outperformance. Inflation is relatively low across the developed economies. The headline rate in the US picked up in March from the 1.1% level of February, but only to 1.5%. eurozone inflation was 0.7% in April, up from 0.5% in March. Against this backdrop, core government bond yields fell. While bond yields have fallen in recent months, they remain higher than a year ago, just before the Fed indicated its possible intention to wind down its bond-purchasing programme.

- Investors switched into the more defensive areas of the market
- Dow Jones Industrial Average ended April at a new high
- Q1 2014 economic growth was weaker than expected

US

US equity markets ended April broadly where they started it, having returned a modest total return of 0.74% in US dollar terms for the month. The period began strongly, as the S&P 500 Index reached a new all-time high early in the month. However, the market experienced weakness as investors took profits in strong-performing technology stocks, switching into some of the less volatile areas of the market, i.e. into stocks that tend to provide a constant dividend and stable earnings regardless of the state of the overall stock market. As the month progressed, equity markets were helped by better-than-expected first quarter US earnings reports. A combination of the rotation into defensive areas, and positive earnings announcements, helped the Dow Jones Industrial Average to end April at a new all-time high too.

In sector terms, the energy and utilities sectors were notably positive. Indeed, April's strong performance has led them to outperform their peers on a year-to-date (YTD) basis. Financials, consumer discretionary and healthcare stocks were weakest, all ending in negative territory for the month. The consumer discretionary sector was also weakest on a YTD basis, the only sector in negative territory over that period. This is perhaps reflective of investor's increasingly nervous outlook for US equity markets.

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In economic news, US gross domestic product growth figures announced for the first quarter of the year were weaker than expected. This was partly the result of the adverse weather experienced earlier in the year. More positively, private consumption grew. The employment market also proved to be relatively resilient. Payroll growth for March was in line with expectations while figures for January and February were revised upwards. Elsewhere, the release of minutes from March's meeting of the Federal Open Market Committee (FOMC) appeared to suggest that monetary policy was likely to remain loose for some time to come.

In corporate news, the first quarter earnings season results were better-than expected. Approximately three quarters of the companies that had reported earnings, had exceeded expectations. Much of the improvement in earnings was broadly attributed to improving profit margins rather than to increased revenues.

- Notable increase in mergers and acquisitions activity
- Bank Lending Survey also supportive for European economy
- ECB limbering up for action

Europe

European equity markets moved higher in April as the first quarter earnings season got under way and there was a notable return in mergers and acquisitions (M&A) activity across sectors including telecoms, industrials and pharmaceuticals. Macroeconomic data continued to be supportive while the latest European Central Bank (ECB) lending survey was also positive. In performance terms, country divergence was not as marked as has been the case in the past few months but on a sector basis, the clear leader was the oil and gas sector. The telecoms and consumer goods sectors also performed well while technology was the laggard. There was a marked pick-up in large company deal-making during April in a broad range of sectors in telephony, industrials, and pharmaceuticals.

As Europe's economy is typically bank-funded, seeing an improving trend in credit demand is in our view a helpful development for the economy and for corporates generally. The most recent ECB bank lending survey showed that credit demand had picked up for all loan categories in the first quarter of 2014. The detail is interesting: the pick-up in demand for credit saw positive contributions from credit for M&A and inventory financing, whilst the survey also showed an improving trend in funding for capital expenditure.

Elsewhere, it looks suspiciously like the ECB and other central banks might just be limbering up for action. Recent comments from a number of sources suggest that the likelihood of more monetary policy accommodation coming in the eurozone is rising. It feels as though the rhetoric from the ECB about the euro exchange rate is subtly changing.

- UK gross domestic product (GDP) accelerated in Q1 2014
- CBI quarterly business optimism rose to a 41-year high
- Industrial production rose 0.9% in February

UK

A total return over the month of 2.2% by the FTSE All-Share Index confirmed the trading pattern of the stock market over the last few months as positive, albeit with a continuation, generally, of alternate "up" and "down" months. The trend of economic news has continued to improve: the initial report for Q1 GDP showing an acceleration to 0.8% from 0.7% in Q4; a CBI (Confederation of British Industry) business survey which registered business optimism at a 41-year high; a rise in industrial of 0.9% in February and a rise in the annual growth in average earnings in February that has finally risen above the rate of CPI inflation. Such news helped sterling to maintain its strength, which has now risen by about 7.5% against its trade weighted index over the last 12 months and encouraged some comments in the press to suggest that an official UK interest rate rise may not be that far away. In this context, Ian McCafferty from the Bank of England made this comment in a speech in early in April. "I am sure that as the recovery develops, we will see some lively debate within the Committee as to the implications, but so far there has been general agreement that there is room for further slack to be absorbed as the recovery progresses, implying that there is no need for an immediate rise in Bank Rate[1]." An analysis of the month's larger sector price movements from within the equity market shows that the industrial metals and mining sectors were amongst the better performers while technology hardware sector was amongst the worst.

[1]Source. The Bank of England 1 April 2014.

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- Dispersion in Asian equity market performance
- No additional monetary easing caused underperformance of the Japanese equity market
- Positive economic backdrop encouraged further foreign investment in the Philippines

Asia Pacific

There was dispersion in the performance of Asian equity markets with positive performance in the ASEAN and Australian markets and negative performance in Japan and China. Overall the MSCI ex-Japan Index delivered a 1.0% return, total return in US dollar terms (USD total return terms) while the TOPIX fell 3.4%, total return in local currency terms. The Philippines was the best performing market in the region. The Philippine Composite Index delivered 4.3% in local currency total return terms over the month. The Bangko Sentral ng Pilipinas decision to keep interest rates on hold at the end of March provided a boost to the market. This positive sentiment was maintained for much of April as the country's positive economic backdrop encouraged further foreign investment.

Indian and Indonesian equity markets have in recent months enjoyed support from foreign investors. Support has been driven by improving macro-economic fundamentals and optimism that the leading candidates in both elections will be able to deliver much needed economic reforms. The market was therefore disappointed that Joko Widodo, the current governor of Jakarta, was unable to secure the predicted landslide victory in the Indonesian legislative election and will instead need to form a coalition for the presidential elections. The increased uncertainty caused both the rupiah and Indonesian stocks to decline; however, the Jakarta Index has since recovered some of its losses and is slightly up on the month. Meanwhile, with the results of the Indian election not due until mid-May and the Sensex Index reaching all-time highs investors have chosen to take some profits coming into month-end. The Sensex Index finished the month marginally up.

In China economic data remained soft. Year-on-year economic growth of 7.4% was reported in April. Meanwhile, activity data was marginally higher; the HSBC manufacturing Purchasing Managers Index (PMI) increased to 48.3 from 48 in March (a level that still indicates contraction). The official manufacturing PMI index also showed a similar small uptick with a reading of 50.4 for April indicating expansion. As part of its economic stimulus package, the Chinese government increased its budget for railway construction and also announced a decrease in the reserve requirement for agricultural banks.

The Japanese equity market was the biggest underperformer. Japanese equities sold off following the Bank of Japan's statement that "no additional monetary easing was required at this time". The impact of the 1 April tax rise continues to distort economic data. For example, retail sales data for March spiked higher with a reading of 6.3% month-on-month (compared to 0.3% in February) and market expectations are that consumption will now fall sharply in Q2. Elsewhere, the Australian equity market also delivered positive returns. The ASX 200 Index is dominated by the financial sector, which although trading on a historically high price to earnings multiple continues to benefit from investors' search for yield.

- Tensions between the West and Russia over Ukraine continued
- Slowing economic growth in China
- General elections in India proceeded with record turnout

Emerging markets

Global emerging equity markets had a relatively quiet month, slightly underperforming developed markets. At a regional level, Latin America was the best performing equity market, followed by emerging Asia. Performance in Europe, Middle East & Africa was more varied with equity gains in Egypt and Turkey being offset by losses in Russia and Greece. Brazil energy, Brazil financials and Turkey financials were the top three country sectors. Russia financials, South Africa consumer discretionary and China information technology (IT) were the bottom three.

Equity gains in Latin America were led by Peru and Brazil. Investor confidence in Peru was lifted by strong economic data. Economic releases in Brazil were also generally positive with a healthy retail sales report showing better-than-expected momentum for consumption on the back of real income growth. March's labour report showed a surprising decrease in the unemployment rate to 5.0% from 5.1% in February. April's monthly inflation rate marginally fell due to lower food prices although on a yearly basis the inflation rate remains stubbornly high. Interest rates in Brazil were raised by 25 basis points from 10.75% to 11.0%. Economic data in Mexico was also encouraging, providing support for a recovery in Q2 2014. The manufacturing Purchasing Managers Index (PMI) rose to 52.7 in March while the services PMI edged down to 51.2 from 52.2 in February. Inflation continued to drift lower in April, falling to 3.5% year-on-year from 3.8% the prior month.

The threat of stiffer sanctions on selected Russian individuals and companies from the US and Europe had a negative impact on stock prices in Russia as tensions in Ukraine showed little sign of improvement. However, some of the losses were pared after the new sanctions that were actually imposed bypassed major banks and companies. Standard & Poor's cut its long-term sovereign bond rating for Russia from BBB to BBB-, citing the worsening geopolitical situation with Ukraine. Interest rates in Russia were raised 50 basis points from 7.0% to 7.5% due to inflationary concerns. A narrowing current account deficit and the Adalet ve Kalkınma Partisi's (Justice and Development Party) victory (the ruling party) at the local elections in Turkey drove local equity prices higher. As widely expected, Poland's central bank maintained its reference interest rate at 2.50%.

Performance in emerging Asian equity markets was mixed with weakness in Chinese stock prices reflecting concerns over slowing economic growth. China's Q1 2014 GDP grew by 7.4% year-on-year, lower than the previous quarter's 7.7% rate. The 2014 Indian general elections began on 7 April, with record voter turnout being recorded in the major constituencies. The final results will not be announced until 16 May.

Fixed Interest

- Growth and low inflation drove positive returns in the bond market
- Economic data was positive for the major developed economies
- Speculation has grown that the ECB will ease monetary conditions further

Bonds achieved broadly positive returns in April as the market continued to be supported by evidence of growth in the major developed economies and relatively benign inflation data. Higher levels of yield and some spread tightening meant that lower credit quality bonds saw some outperformance.

The US economy grew in the first quarter of 2014 at an annualised rate of just 0.1%, according to initial data, well below expectations. However, more detailed data shows that weakness was concentrated in areas such as business investment and exports, which were more affected by the severe winter weather. Consumption grew at a much healthier 3% rate. More forward-looking data released in recent weeks have also been positive. Employment grew by close to 200,000, according to March's Non-Farm Payrolls report and retail sales grew 3.8% in the year to March. The outlook was for the US economy was sufficiently strong for the US Federal Reserve (Fed) to continue tapering, cutting its asset purchasing programme to a monthly rate of US$45bn at its April meeting.

Economic performance is improving gradually in the eurozone, according to the latest data. April's Ifo survey indicated that the German economy is recovering steadily while the eurozone-wide ZEW report also showed improvement from March levels. The rate of unemployment in the single currency area fell to 11.9% in February from 12% the month before. In the UK unemployment fell to 6.9% in the three months to the end of February. February data showed earnings growth above the rate of inflation, with annual earnings up 1.9%, compared to a headline consumer price index of 1.7%.

Inflation is relatively low across the developed economies. The headline rate in the US picked up in March from the 1.1% level of February, but only to 1.5%. Eurozone inflation was 0.7% in April, up from 0.5% in March. Speculation has strengthened that the European Central Bank (ECB) will eventually act to address these near-deflationary conditions through some further form of monetary accommodation.

Against this backdrop, core government bond yields fell. The 10-year Gilt yield closed April at 2.66%, down 8 basis points (bps) for the month. This move was echoed by the corresponding German Bund and US Treasury yields. According to data from Merrill Lynch, Gilts had a total return for the month of 0.7%. Sterling investment grade corporate bonds returned 1.3%, with little variation across sectors but with BBB rated bonds slightly stronger. While bond yields have rallied lower in recent months, they remain higher than a year ago, just before the Fed indicated its possible intention to wind down quantitative easing.

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Invesco

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Global equity and commodity index performance – figures to 30 April 2014

	1 Month	3 Months	6 Months	YTD	2013
Global US & Canada					
MSCI World (US$)	1.1%	6.4%	6.6%	2.5%	24.7%
MSCI World Small Cap (US$)	-1.6%	3.1%	5.6%	1.3%	32.9%
MSCI Emerging Markets (US$)	0.4%	6.9%	-2.9%	0.0%	-2.3%
FTSE World (US$)	1.1%	6.6%	6.0%	2.5%	24.7%
Dow Jones Industrials	0.9%	6.2%	7.9%	0.7%	29.7%
S&P 500	0.7%	6.2%	8.4%	2.6%	32.4%
NASDAQ	-2.0%	0.6%	5.6%	-1.2%	40.1%
S&P/ TSX Composite	2.4%	7.8%	11.3%	8.6%	13.0%
Europe					
FTSE World Europe ex-UK (£)	0.4%	6.6%	3.4%	3.5%	25.2%
MSCI Europe	2.0%	6.1%	6.4%	4.2%	20.5%
CAC 40	2.6%	8.3%	5.4%	5.0%	22.2%
DAX	0.5%	3.2%	6.3%	0.5%	25.5%
Ibex 35	1.5%	6.4%	8.7%	6.8%	30.0%
FTSEMIB	0.5%	12.3%	12.9%	15.0%	20.5%
Swiss Market Index (capital returns)	0.3%	3.5%	2.9%	3.3%	20.2%
Amsterdam Exchanges	-0.2%	4.3%	3.3%	0.5%	20.7%
HSBC European Smaller Cos ex-UK	-0.4%	7.0%	11.8%	8.8%	34.0%
MSCI Russia (US$)	-6.4%	-10.9%	-22.8%	-19.9%	1.4%
MSCI EM Europe, Middle East and Africa (US$)	-2.8%	-0.1%	-14.8%	-9.2%	-3.9%
FTSE/JSE Africa All-Share (SA)	2.7%	9.6%	9.0%	7.1%	21.4%
UK					
FTSE All-Share	2.2%	4.7%	2.7%	1.5%	20.8%
FTSE Small Cap ex Investment Trusts	0.3%	-0.9%	6.2%	2.4%	43.9%
Asia Pacific & Japan					
Hong Kong Hang Seng	0.0%	1.0%	-4.1%	-4.5%	6.6%
China SE Shanghai Composite (capital returns)	-0.3%	-0.3%	-5.4%	-4.2%	-6.7%
Singapore Times	3.2%	9.0%	3.2%	4.2%	3.0%
Taiwan Weighted (capital returns)	-0.7%	3.9%	4.0%	2.1%	11.9%
Korean Composite (capital returns)	-1.2%	1.1%	-3.4%	-2.5%	0.7%
Jakarta Composite (capital returns)	1.5%	9.5%	7.3%	13.2%	-1.0%
Philippines Composite (capital returns)	4.3%	11.0%	1.9%	13.9%	1.3%
Thai Stock Exchange	3.7%	13.1%	0.1%	11.0%	-3.6%
Mumbai Sensex 30	0.3%	9.8%	6.9%	6.6%	10.9%
Hang Seng China Enterprises index	-2.9%	-0.4%	-8.0%	-9.6%	-1.5%
ASX 200	1.8%	7.1%	3.4%	3.9%	20.2%
Topix	-3.4%	-3.9%	-1.6%	-9.9%	54.4%
MSCI Asia Pac ex Japan (US$)	1.0%	7.5%	-0.2%	2.1%	3.7%
Latin America					
MSCI EM Latin America (US$)	2.8%	13.9%	-3.8%	3.2%	-13.2%
MSCI Mexico (US$)	0.3%	2.0%	-0.9%	-4.7%	0.2%
MSCI Brazil (US$)	3.9%	19.5%	-4.8%	6.9%	-15.8%
MSCI Argentina (US$)	2.1%	42.0%	19.8%	8.1%	66.2%
MSCI Chile (US$)	1.5%	13.4%	-8.2%	-0.7%	-21.4%
Commodities					
Oil - Brent Crude Spot (US$/BBL)	2.3%	0.0%	0.7%	-1.7%	0.2%
Oil - West Texas Intermediate (US$/BBL)	-1.5%	2.6%	3.9%	1.9%	6.9%
Reuters CRB index	1.6%	9.3%	11.4%	10.5%	-5.0%
Gold Bullion LBM (US$/Troy Ounce)	0.3%	4.1%	-2.3%	7.1%	-27.3%
Baltic Dry index	-30.8%	-15.0%	-37.3%	-58.6%	225.8%

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

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