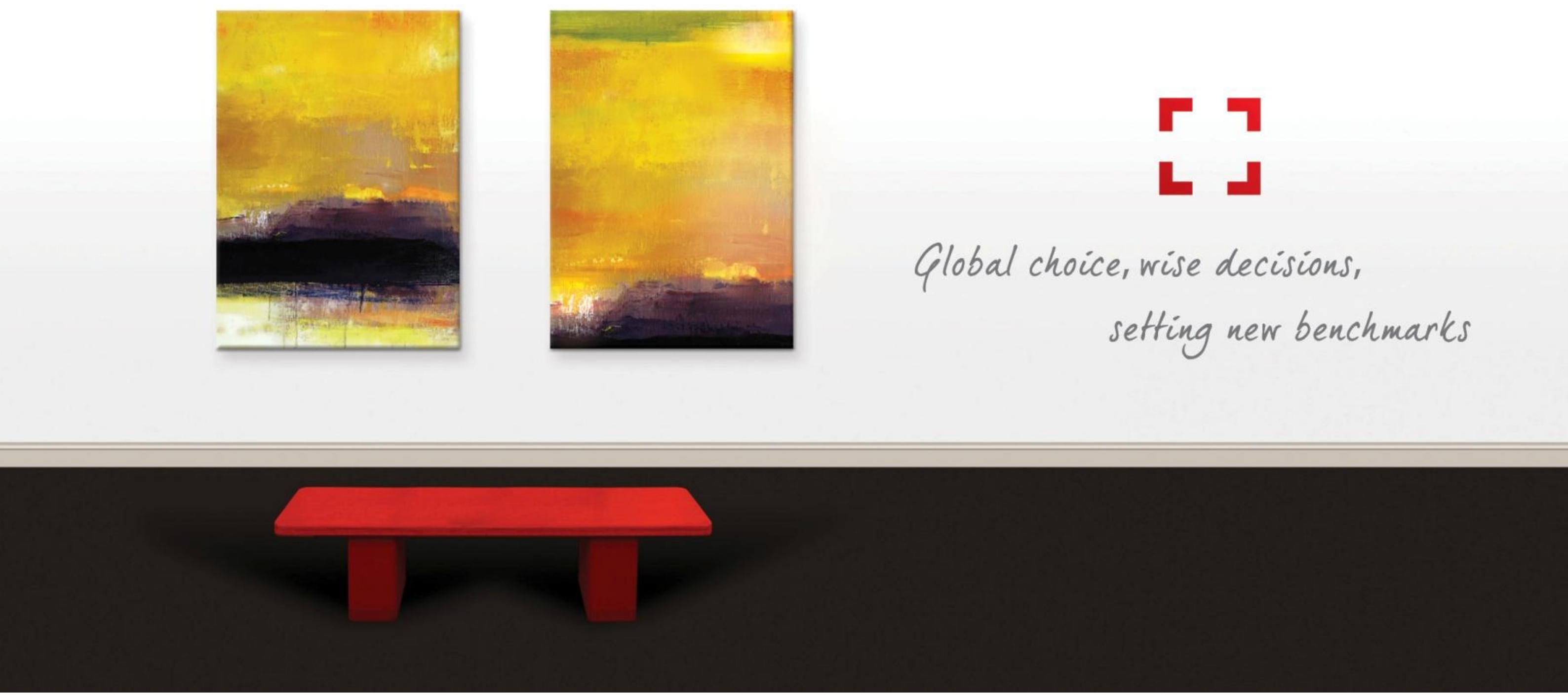
momentum

Viewpoint

Monthly market update

April 2013



global investment management

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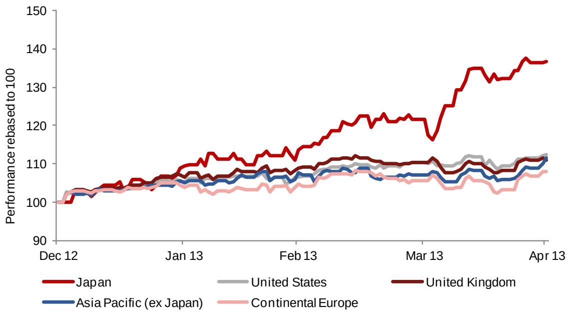
1. Market commentary

Two key forces were behind the performance of markets in April. On the one hand, economic fundamentals appeared to weaken, with forward looking indicators deteriorating in the US, Europe and China. On the other, central bank liquidity continued to provide considerable support for asset prices. On balance this latter effect appeared to outweigh the deteriorating picture with regards to global growth, with the result that markets continued to push ahead over the month. However, as with March, there was a marked difference in performance both between and within asset classes.

Developed market equities continued to rally strongly, with the MSCI World index adding 3.1% in April. Most markets posted gains, but it was Japan who once again set the pace, with the Topix index rallying sharply (plus 12.6% in yen terms) to bring its year to date return to over 36%. Peripheral Europe rebounded following a weak end to the first quarter, with Spain, Italy, Portugal and Greece adding between 7% and 12%. In contrast, China's stock market fell for the third month in a row, down by 2.6%, whilst the broader emerging markets index added a modest 0.8% to take its year to date return to -0.9% compared to 11.1% for developed markets. Japan continues to benefit from new ultra-loose monetary policy from the Bank of Japan, while moves in peripheral Europe can be seen (to an extent) as a rebound post the sharp selloff triggered by events in Cyprus during March.

Figure 1: Performance of developed markets in 2013 (local currency terms)



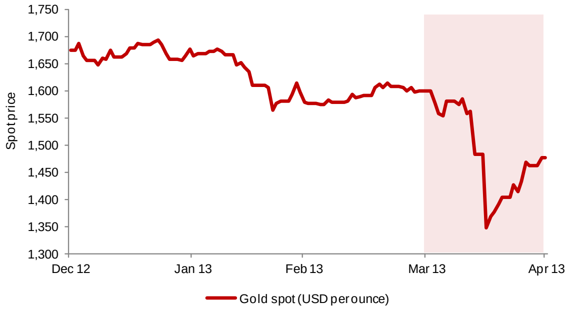
Bond markets also moved higher, after government bond yields in peripheral Europe reversed the rises seen in March. With 10 year yields falling by close to 1% in Italy and Spain, investors enjoyed gains of around 5% on their bond investments over the month. The traditional safe haven government bond markets of the US, the UK and Germany also saw yields fall, albeit less dramatically, with returns of around 1% for the month. In all three of these markets 10 year yields are now approaching the all time lows of mid 2012. Talk of the 'great rotation' from bonds to equities (a thesis we do not subscribe to) has taken a back seat for the time being. Intriguingly, despite massive monetary easing, Japanese bond yields rose slightly during April (although 10 year yields remain at a paltry 0.5%), and investors suffered losses of around 0.5%. Elsewhere in fixed income markets, in what remains a good environment for corporate borrowers, credit performed well (1.8%) alongside gains for high yield (1.8%) and convertibles (2.2%).

Commodity markets experienced large moves in April. Growing evidence of a global slowdown including mounting concerns over Chinese growth, put pressure on industrial metals, with copper prices falling by 6.3% for the month (now -13% year to date) in a pattern that was repeated across the majority of other metals. Having remained stubbornly above USD 115 per barrel, the oil price fell back sharply in April to below USD 100. Precious metals found themselves in bear market territory as prices fell sharply during the middle of the month. Gold peaked at USD 1,900 an ounce in August 2011 and has been gradually drifting lower since that time, but the decline accelerated sharply in mid April with prices falling by 14% in just two days. Gold has now fallen by 30% from its peak, with prices down to USD 1,347 per ounce, a level last seen in 2010. The fall was attributed to a combination of factors: a loss of confidence in the gold bull market of the past decade; profit taking by investors, with the price of gold having already risen from around USD 200 in the 1970s; a strengthening US dollar, which has historically proven a negative factor for gold prices, and easing concerns over inflation, with price-growth seemingly contained around the globe. The catalyst for the slide in April appears to have been the decision by the European Commission to ask Cyprus to sell a portion of its gold reserves to help fund its bailout. Although the amount involved was fairly small (around 10 tonnes, equivalent to circa EUR 400 million) the market has begun to discount the possibility that this decision sets a precedent for other

Source: Bloomberg. Returns in US dollars unless otherwise stated. April 2013.

European countries, which could make central banks sizeable sellers of gold going forwards. Despite rallying by around USD 100 into the month end, gold nonetheless returned -7.6% in April, to bring its year to date return to -11.9%. The size and pace of the fall has unnerved investors, although there is anecdotal evidence that retail buyers of gold took the weakness as an opportunity to re-enter the market.

Figure 2: Performance of gold in 2013



The most significant development during April was the decision by the Bank of Japan to engage in full scale quantitative easing. Although the move had been well flagged, there remained room for disappointment. In the event, the market was surprised on the upside by the scale of the action; the Bank of Japan has now moved ahead of other central banks in embarking on the largest easing programme seen to date. It will increase the value of its asset purchases to JPY 7 trillion per month (USD 72 billion), equivalent to 15% of GDP in a year (compared to USD 85 billion per month and 6.8% of GDP in a year in the case of the Federal Reserve). Further, the Bank of Japan has pledged to extend the average maturity of its bond holdings from three to seven years; to double the country's monetary base by March 2015 to JPY 270 trillion (from 29% to 55% of GDP), and to achieve inflation of 2% within two years. This unprecedented programme will involve the Bank of Japan expanding its balance sheet by 1% of GDP each month this year and next, double the rate of expansion of the Federal Reserve's balance sheet currently. In addition, the Bank of Japan will be financing about one third of the government's net debt both this year and in 2014. Although most of the asset purchases will be of Japanese government bonds, the Bank will also be buying ETFs (Exchange Traded Funds) and JREITs (Japanese Real Estate Investment Trusts). It was perhaps of little surprise then that the equity market continued to surge higher immediately after the announcement, with the stock market producing its best monthly gain since December 2009.

This new and additional source of liquidity helped to push asset prices higher around the globe, as investors factored in the effects of this new money seeking a home. All four of the world's major central banks are now engaged in ultra loose monetary policy. With growing signs of a slowdown in most countries, investors concluded that such policy will continue for longer, with the result that this wall of money will be driving markets for some considerable time to come. This view was strengthened by the falls in commodity prices, especially energy, which helped to push inflation rates down, giving central banks more room to continue easing without the immediate concern of higher inflation. Any longer term concerns about the implications of this unprecedented policy action (e.g. the misallocation of capital and resources; the creation of 'zombie' companies being kept alive by artificially low interest rates; reduced creative destruction keeping trend growth lower, etc.) appear to have been sidelined for now, given more immediate concerns over slower global growth and high unemployment.

Evidence of slowing activity was apparent in most economies. The US remains the best performing of the major economies by some margin, but it appears that fiscal tightening measures introduced at the start of this year – in particular, the end of the payroll tax cuts and the sequestration cuts which came into effect on 1 March and are expected to knock USD 85 billion off Federal spending this year, equivalent to 0.6% of GDP – are beginning to have an effect on the real economy. First quarter growth registered 2.5% annualised, within which the contribution from government spending was negative at -0.6%, with the biggest single drag coming from defence which is set to bear about half of the sequestration cuts. Payrolls were somewhat disappointing in April and although housing continued its recovery with housing starts at over one million, their highest level since mid 2008, retail sales and durable goods orders were both weak, as were regional PMIs (Purchasing Managers' Indices) and the ISM index. It seems likely that US growth will level out at around 2% this year, supported by housing, business investment and the positive spur of falling energy prices, but held back by the cuts to government spending.

Markets have enjoyed a strong run in the past nine months and increasingly appear due a period of

Source: Bloomberg. Returns in US dollars unless otherwise stated. April 2013.

consolidation (especially in markets such as Japan, which has risen by over 50% in the past five months). Massive liquidity continues to underpin asset prices, but ultimately the underlying fundamentals will need to improve to sustain today's bull market. The big tail risks of 2012 have been reduced substantially, but signs of softer global growth in the past month and the real risk of a more serious recession developing in Europe are creating a mismatch between deteriorating fundamentals and rising market prices. We remain positive about the outlook for markets on a medium term view, and with weaker economic activity and falling inflation the long period of ultra loose monetary policy is set to extend even further, but a period of consolidation in the short term is now appears likely.

Source: Bloomberg. Returns in US dollars unless otherwise stated. April 2013.

2. Market performance

Asset class/region	Index	To 30 April 2013 Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	1.9%	12.5%
United Kingdom	FTSE All Share TR	GBP	0.6%	11.0%
Continental Europe	MSCI Europe ex UK NR	EUR	2.3%	8.0%
Japan	Topix TR	JPY	12.6%	36.8% e
Asia Pacific (ex Japan)	MSCI Pacific ex Japan TR	USD	4.1%	11.4%
Global	MSCI World NR	USD	3.1%	11.1%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-0.6%	-3.2%
Emerging Asia	MSCI EM Asia NR	USD	1.5%	0.1%
Emerging Latin America	MSCI EM Latin America NR	USD	-0.3%	0.6%
BRICs	MSCI BRIC NR	USD	1.3%	-1.7%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	0.8%	-0.9%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.0%	0.8%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.0%	0.5%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.8%	1.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.8%	4.8%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	1.1%	1.9%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.7%	4.4%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.5%	2.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.4%	1.9%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	5.3%	4.1%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.5%	2.0%
Australian Government	JP Morgan Australia GBI TR	AUD	1.7%	1.6%
Global Government Bonds	JP Morgan Global GBI	USD	1.0%	-1.9%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.5%	-0.6%
Global Convertible Bonds	UBS Global Convertible Bond	USD	2.2%	5.8%
Emerging Market Bonds	JP Morgan EMBI+	USD	3.4%	0.0%

Source: Bloomberg. April 2013.

Asset class/region	Index	Currency	Month	Year to date
		To 30 April 2013		
Property				
US Property Securities	MSCI US REIT NR	USD	6.6%	14.9%
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	6.7%	10.1%
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	EUR	5.6%	6.4%
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	AUD	8.3%	13.7%
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	USD	7.7%	16.8%
Global Property Securities	FTSE EPRA/NAREIT Developed TR	USD	7.3%	14.0%
Currencies				
Euro		USD	2.7%	-0.2%
UK Pound Sterling		USD	2.2%	-4.4%
Japanese Yen		USD	-3.3%	-11.0%
Australian Dollar		USD	-0.5%	-0.2%
South African Rand		USD	3.0%	-5.5%
Commodities & Alternatives				
Commodities	RICI TR	USD	-3.6%	-3.5%
Agricultural Commodities	RICI Agriculture TR	USD	-0.4%	-1.9%
Oil	ICE Crude Oil CR	USD	-5.5%	-6.5%
Gold	Gold Spot	USD	-7.6%	-11.9%
Hedge funds	HFRX Global Hedge Fund	USD	0.6%	3.8%
Interest rates			**Current rate**	**Change at meeting**
United States	1 May 2013	USD	0.25%	-
United Kingdom	9 May 2013	GBP	0.50%	-
Eurozone	2 May 2013	EUR	0.50%	-0.25%
Japan	4 April 2013	JPY	0.10%	-
Australia	7 May 2013	AUD	2.75%	-0.25%
South Africa	20 March 2013	ZAR	5.00%	-

[e] Estimate

Source: Bloomberg. April 2013.

3. Asset allocation dashboard

🟢 Positive	🟡 Neutral	🔴 Negative

Asset class	View
Equities	
Developed equities	🟡
UK equities (relative to developed)	🟢
European equities (relative to developed)	🟡
US equities (relative to developed)	🔴
Japan equities (relative to developed)	🟡
Emerging market equities	🟢
Fixed Income	
Government	🔴
Index-linked (relative to government)	🔴
Investment grade (relative to government)	🟢
High yield	🟡
Loans	🟢
Emerging market debt	🟡
Convertible bonds	🟡
Alternatives	
Commodities	🟡
Hedge funds	🟡
Property (UK)	🟡
Currencies	
Dollar	🟡
Euro	🔴
Yen	🔴
Emerging market currencies	🟡

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