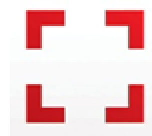
momentum

Viewpoint

Monthly market update

May 2015



global investment management

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1. Market commentary

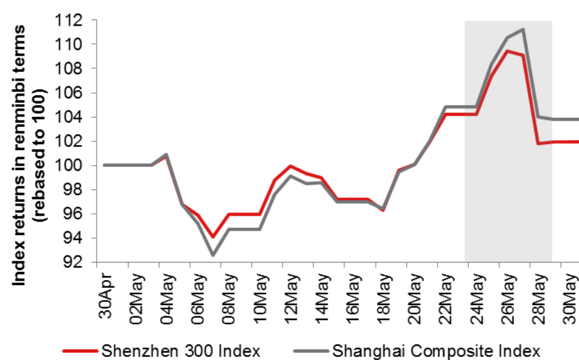
Equity markets have generally performed well year-to-date, and a period of consolidation may now be due. We continue to maintain that growth will be relatively modest, however, and believe that the US Federal Reserve (Fed) will be slow to raise rates and then only very carefully. At the same time the European Central Bank and the Bank of Japan are set to maintain their huge Quantitative Easing (QE) programmes, underpinning global liquidity and supporting modest growth in those regions. As such, the world remains awash with liquidity, keeping bond yields at unattractive levels, and providing support for equities. While there are clear risks, none of these appear to be potentially damaging enough to result in a renewed bear market; there will be periods of consolidation but there are sound reasons for believing that this very long bull market and cycle has further still to run.

In Europe, the economy has been on an improving trend, with Q1 GDP growth of 0.4% quarter-on-quarter (1.6% annualised), with peripheral Europe at long last picking up. Spain grew by 0.9% quarter-on-quarter, the strongest economy in the euro area in Q1 and well ahead of the German growth rate of 0.3%. And in Japan there was good growth of 3.9% annualised in Q1, helped by the currency weakness of the past 18 months and the much improved competitiveness in the corporate sector. A pick-up in wages has also helped the Japanese consumer. Generally, however, global growth remains well below pre-crisis levels. In particular, high debt levels, structural rigidities (especially in Europe), and low productivity growth all remain impactful.

Central bank watching has arguably been the key concern for investors in the past several years, and none more so than now, with the Fed intent on starting the process of normalising policy. Earlier expectations of a June rise have been pushed back due to the weak performance of the economy in Q1, and the noises from the Fed have tended to err on the dovish side, emphasising the data dependency of the decision, the impact of a strong dollar and risks to global growth outside the US, notably from Greece and the slowdown in China. The first rise will now most likely be in December. This prospect has caused US Treasuries to weaken in recent weeks, and much will now depend on whether the data confirms the economic recovery.

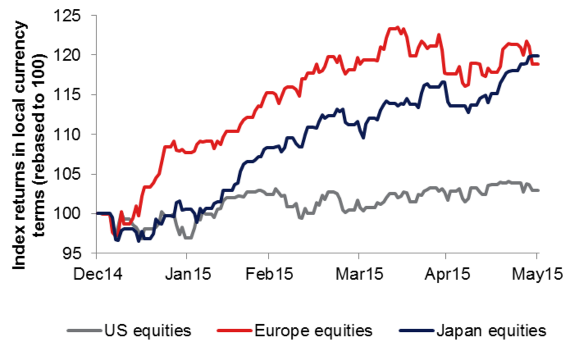
In China, extraordinary market moves have continued in the past month, with very sharp rises (more than 100% over the past nine months) followed by a sharp correction at the end of May. This comes despite a clear slowdown in the Chinese economy and pressure on corporate profitability. A raft of data, including weak housing and construction, falling exports, and price deflation have all pointed to a structural slowdown in growth. In turn, China's authorities have reacted by loosening monetary policy, with a further quarter point cut to interest rates following an easing of reserve requirements. So, as we have seen in other markets through this cycle, bad news on the economy is good news for markets as governments pump-prime in an attempt to stimulate activity. Relaxed regulations on the stocks that Chinese domestic investors can buy and a surge of retail buying appears to be behind recent gains. This can only be described as a speculative frenzy, driving share prices up to levels far ahead of fundamentals and inevitably giving rise to fears of a major correction to come. This is clearly a time for great caution towards China.

Figure 1: China equity market sees sharp correction



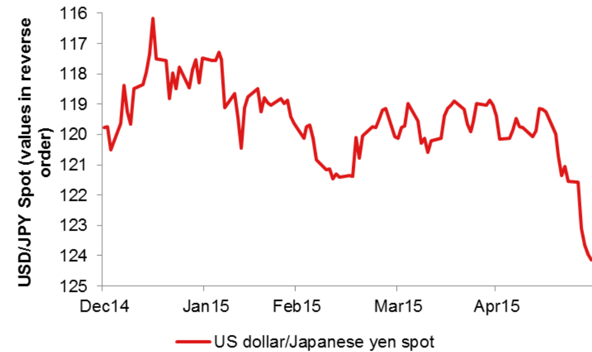
The outright Conservative party win in the UK general election confounded all the pollsters. The outlook for the UK and sterling is now very encouraging, with a business friendly, reform minded, free enterprise, low tax, low public spending government now in power with a clear mandate. Although the prospect of a referendum on the UK's continuing membership of the EU, which will take place in 2017 at the latest, is likely to cause some nervousness as the poll approaches, the strong likelihood is that the Prime Minister will be able to secure sufficient EU-reforms to persuade the electorate to maintain the status quo.

Figure 2: European and Japanese equities outperform the US



Against this background, and with the exception of China, markets were quieter than in April. The US added 1.2%, Europe returned 1.1% and Japan outperformed with gains of 5.1% in local currency terms. Both Europe and Japan have now risen by circa 20% so far this year in local currency terms while the US is up a mere 3.0%. The MSCI World was up by 0.3% in the month, held back in dollar terms by a recovery in the US dollar after the weakness in April. The yen in particular was weak, down by around 3.8% against the US dollar, after holding up well earlier in the year. In contrast emerging markets in aggregate were down by 4.0%, with big falls in Brazil and Russia as commodity prices came under renewed pressure and the oil price gave up part of its rise in April. Brent crude fell by 1.8% in May.

Figure 3: Japanese yen declines in value against the US dollar



Equities again outperformed bonds as government bond yields rose sharply between mid-April and early May, but then settled back as the European Central Bank reaffirmed its commitment to its huge bond buying programme and the economic news continued to point to relatively subdued growth. US treasuries were down by 0.2%, European government bonds fell by 1.5% in euro terms, and the JP Morgan Global Government Bond Index was down by 2.1% in the month. In contrast, corporate bonds continued to outperform, with modest positive returns in May.

Source: Bloomberg. Returns in US dollars unless otherwise stated. May 2015.

2. Market performance

Asset class/region	Index	Currency	Month	Year to date
		To 29 May 2015		
Developed markets equities				
United States	S&P 500 NR	USD	1.2%	3.0%
United Kingdom	MSCI UK NR	GBP	0.6%	8.1%
Continental Europe	MSCI Europe ex UK NR	EUR	1.1%	18.9%
Japan	Topix TR	JPY	5.1%	19.9%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-2.7%	7.6%
Global	MSCI World NR	USD	0.3%	5.1%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-4.7%	9.0%
Emerging Asia	MSCI EM Asia NR	USD	-2.7%	9.5%
Emerging Latin America	MSCI EM Latin America NR	USD	-7.1%	-7.3%
BRICs	MSCI BRIC NR	USD	-4.4%	11.5%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-4.0%	5.7%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.2%	0.9%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-0.9%	1.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.7%	0.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.3%	4.1%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	0.5%	1.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	0.4%	1.8%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-1.5%	1.3%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.5%	0.4%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	-0.1%	3.3%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.6%	-0.7%
Australian Government	JP Morgan Australia GBI TR	AUD	-0.1%	1.6%
Global Government Bonds	JP Morgan Global GBI	USD	-2.1%	-3.1%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-1.7%	-2.9%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-0.8%	3.1%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-0.5%	2.9%

Source: Bloomberg. e denotes estimate

		To 29 May 2015		
Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	-0.3%	-2.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	2.9%	10.4%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-0.1%	13.2%
Global Property Securities	S&P Global Property USD TR	USD	-1.6%	3.3%
Currencies				
Euro		USD	-2.1%	-9.2%
UK Pound Sterling		USD	-0.4%	-1.8%
Japanese Yen		USD	-3.8%	-3.6%
Australian Dollar		USD	-3.3%	-6.5%
South African Rand		USD	-1.9%	-4.8%
Commodities & Alternatives				
Commodities	RICI TR	USD	-2.4%	-2.5%
Agricultural Commodities	RICI Agriculture TR	USD	-1.9%	-10.3%
Oil	Brent Crude	USD	-1.8%	14.4%
Gold	Gold Spot	USD	0.5%	0.5%
Hedge funds	HFRX Global Hedge Fund	USD	0.3%	2.6%
Interest rate		**Current rate**		
United States		0.25%		
United Kingdom		0.50%		
Eurozone		0.05%		
Japan		0.10%		
Australia		2.00%		
South Africa		5.75%		

Source: Bloomberg. e denotes estimate

3. Asset allocation dashboard

Positive | Neutral | Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Positive
European equities (relative to developed)	Neutral
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Neutral
Emerging market equities	Positive
Fixed Income	
Government	Neutral
Index-linked (relative to government)	Neutral
Investment grade (relative to government)	Neutral
High yield	Neutral
Loans	Positive
Emerging market debt	Positive
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
GBP	Neutral
Euro	Neutral
Yen	Neutral

For more information, please contact:

Russell Andrews
Head of Distribution Services
E: Russell.andrews@momentumgim.com
T: +44 (0)207 618 1803

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