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VIEWPOINT

Newsflash

A new month and the 68th issue of Viewpoint from PPi.

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Concerns over a Greek exit from the Eurozone, softer data from the US and the apparent easing of Chinese growth combined to push asset prices down in May. Global equities fell by 8.6% in US dollar terms last month, eroding year to date gains and wiping USD 2.6 trillion off the value of global stocks. Despite retreating by 6.1% over the period, the US stock market is now the best performing region year to date, comfortably ahead of its developed peers as well as emerging markets. The latter declined by 11.2% during May, as the prospect of lower external demand and foremost a slowdown in China weighed on the outlook for these economies.

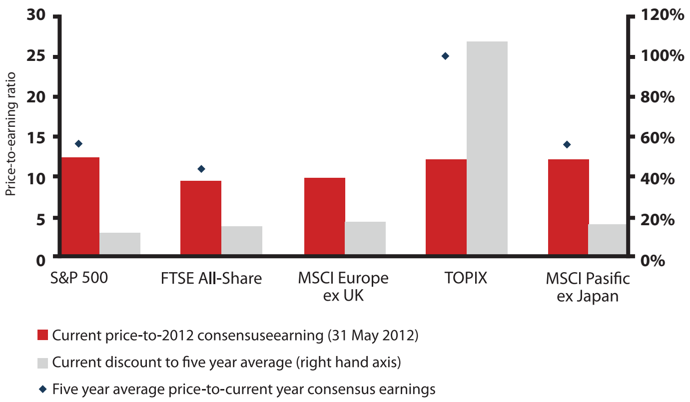
Equity volatility has increased markedly since the end of the first quarter. During the first three months of 2012, the global aggregate's average daily price movement was approximately 50 basis points (0.5%), whilst positive trading days dominated negative ones by 3-to-2. During the subsequent two months, volatility has increased to 75 basis points accompanied by a strong reversal in this underlying trend.

Yields on core developed market government bonds fell during the month, as investors sought safety in perceived high quality debt. US 10 year yields ended May at 1.56%, compared to 1.20% in Germany and 0.82% in Japan, whilst in the UK rates traded through 1.9% for the first time in the Bank of England's 318 year history. These moves are indicative of investor fears over the outlook for global growth. French OATs (Obligations Assimilables du Trésor) appear to have regained their 'safe haven' status in investors' minds, with prices rallying during May.

The spread between French and German 10 year government bond yields has fallen by 0.75% since peaking at 1.9% in November 2011.

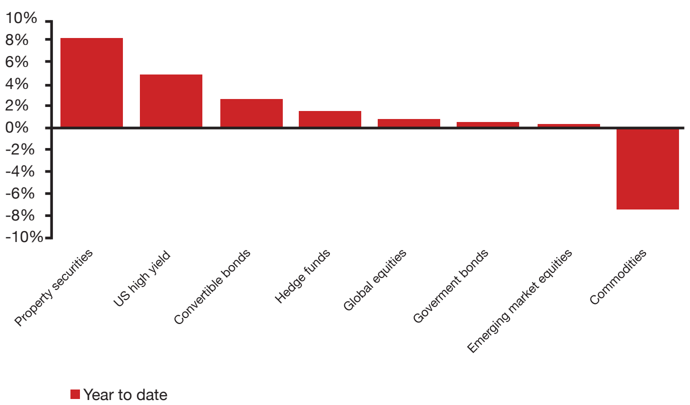
As a result of these divergent moves by equities and bonds, the 12 month trailing dividend yield on the S&P 500 index now stands above the US 10 year yield for only the second time since the 1950s. In Japan, equities are once again trading below book value, whilst price-to-earnings ratios on major stock indices are more than 10% below their five year averages:

Figure 1: Price-to-earnings multiples on major stock indices



High yield bonds in the US declined by 1.3% during May, cutting year to date returns to 5.0%. High yield is now the second strongest performing asset class in 2012, as shown in Figure 2.

Figure 2: Total returns by asset class (US dollar terms)



Political change appears to be gaining momentum in Europe, after France's Socialist party won control of the country for the first time in 17 years at the start of the month. Meanwhile in Greece, two thirds of voters rejected the main pro-bailout parties in national elections during May, as both the political Left and Right enjoyed gains at the polls. The failure of any party to form a coalition government saw Greece return to the polls on 17 June. Reports from Greece have confirmed a victory for New Democracy, with circa 30% of Sunday's vote. Syriza – with its very public opposition to the austerity measures imposed by Greece's creditors – came second. New Democracy will now try to form a 'pro-programme' government alongside Pasok and the Democratic Left, leaving Syriza to sit in opposition. Antonis Samaras, leader of New Democracy, is likely to be received tentatively by European leaders, given his reluctance to explicitly support the country's rescue plan over the last two years. History suggests that austerity requires a strong electoral mandate in order to be successful, and in this regard it is perhaps worrying to see a sizeable portion of Greek voters continue to opt for anti-bailout parties over the weekend. More integration as opposed to less still appears to be the order of the day in Europe. Policymakers have mooted using a levy on banks to raise capital for a new rescue fund, alongside a Europe-wide guarantee on bank deposits to assuage depositor fears and prevent panic withdrawals.

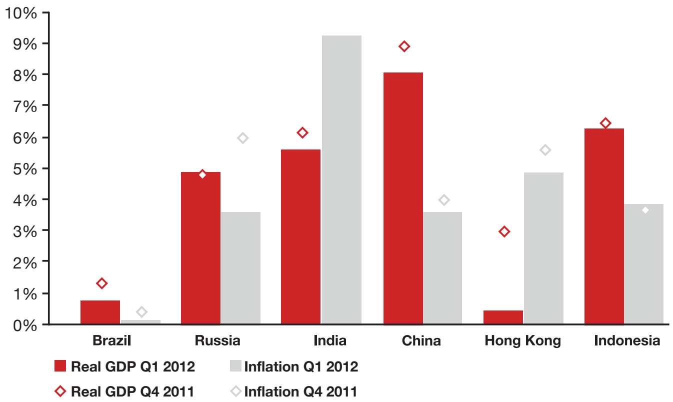
Eurozone gross domestic product was unchanged in the first quarter, surprising economists who had been expecting a contraction in the region's output. Commentators continue to focus on the capital needs of Spain's banking sector, which remains weighed down by troubled property loans. The government subsequently elected to partially nationalise Bankia – Spain's fourth largest lender – during the month, by converting EUR 4.5 billion of government preferred stock into ordinary voting shares. Symptomatic of the crisis, investors quickly concluded that the steps were insufficient, pushing the country towards a bailout from the European Union.

Source: Momentum Global Investment Management / Bloomberg/ Lipper Hindsight. May 2012

The debate over the US 'fiscal cliff' is expected to gain prominence as the year progresses. This cliff refers to the steep fall in output that is anticipated to occur when automatic spending cuts come into effect in 2013. US payroll data has consistently disappointed forecasters since March, with the private sector adding a mere 69,000 jobs in May. The ISM manufacturing index underperformed economists' forecasts last month, at 53.5 versus 53.8 expected, whilst the non-manufacturing index alternatively outperformed.

Both growth and inflation have fallen in emerging markets year to date, as summarised in Figure 3.

Figure 3: Emerging markets real GDP growth and inflation



The People's Bank of China (PBOC) cut interest rates by 25 basis points to 6.31% post the end of May, adding to expectations for a new round of easing from Beijing. Chinese authorities injected RMB 4 trillion into the economy in 2008/09 in order to aid a V-shaped recovery, including subsidies for rural consumption and spending on infrastructure. New spending in 2012 is unlikely to be on the same scale, in mind of the credit boom that resulted post 2009 and the political transition to take place at the end of this year.

Currencies displayed high volatility last month, with the euro, British pound and Australian dollar depreciating by an average of 6.2% versus the US dollar, which benefitted from a renewed flight to quality by investors. The Swiss National Bank (SNB) has managed to maintain the EURCHF floor, put in place in September 2011, with fewer resources than required in previous interventions. The SNB's balance sheet reveals that the central bank has begun diversifying away from the euro in its foreign exchange reserves. At the same time, the Norwegian sovereign wealth fund – Europe's largest equity investor – is also set to reduce its European holdings, putting further downward pressure on the euro.

The Rogers International Commodities index fell by 11.5% in US dollar terms during May, as a general supply glut alongside weakening demand pushed prices down. Gold, the perceived bear market hedge, equally fell by 5.6%, reinforcing the wisdom that valuation, and not current market conditions, offer the most reliable guide to future returns. Crude oil prices declined by 12.7% in May. Oil production in Saudi Arabia is currently running at 10 million barrels per day, a 10% increase in output compared to this time last year, whilst geopolitical tensions over Iran have eased since April.

Source: Momentum Global Investment Management / Bloomberg/ Lipper Hindsight. May 2012

Asset Class Performances

Asset Class/Region	Index	Currency	To 31 May 2012 Month	Year to date
Developed Markets Equities				
United States	S&P 500 NR	USD	-6.1%	4.9%
United Kingdom	FTSE All Share TR	GBP	-6.8%	-1.4%
Continental Europe	MSCI Europe ex UK NR	EUR	-6.6%	-1.3%
Japan	Topix TR	JPY	-10.5%	-0.2%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	USD	-11.8	-0.4%
Global	MSCI World NR	USD	-8.6%	0.8%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	-17.9%	-4.7%
Emerging Asia	MSCI EM Asia NR	USD	-9.5%	2.4%
Emerging Latin America	MSCI EM Latin America NR	USD	-13.1%	-4.2%
BRICs	MSCI BRIC NR	USD	-13.2%	-3.0%
Global Emerging Market	MSCI EM (Emerging Markets) NR	USD	-11.2%	0.1%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.8%	2.0%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.8%	4.8%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.8%	4.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-1.3%	5.0%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	4.5%	2.9%
UK Corporate (Investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.0%	4.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.1%	4.5%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.1%	6.0%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-2.3%	9.5%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.6%	1.4%
Australian Government	JP Morgan Australia GBI TR	AUD	4.1%	5.9%
Global Government Bonds	JP Morgan Global GBI	USD	-0.1%	0.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-1.0%	0.9%
Global Convertible Bonds	UBS Global Convertible Bond	USD	-4.9%	2.6%
Emerging Market Bonds	JP Morgan EMBI +	USD	-2.9%	2.9%

Source: Momentum Global Investment Management / Lipper Hindsight. May 2012

			To 31 May 2012	
Asset Class/Region	**Index**	**Currency**	**Month**	**Year to date**
Property				
US Property Securities	MSCI US REIT TR	**USD**	-4.6%	8.3%
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	**GBP**	-1.9%	8.8%
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	**EUR**	-0.8%	6.6%
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	**AUD**	-1.3%	11.9%
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	**USD**	-8.7%	9.1%
Global Property Securities	FTSE EPRA/NAREIT Developed TR	**USD**	-6.3%	8.2%
Currencies				
Euro		**USD**	-6.6%	-4.8%
UK Pound Sterling		**USD**	-5.2%	-1.0%
Japanese Yen		**USD**	1.8%	-1.9%
Australian Dollar		**USD**	-6.8%	-5.4%
South African Rand		**USD**	-9.5%	-5.7%
Commodities				
Commodities	RICI TR	**USD**	-11.5%	-7.5%
Agricultural Commodities	RICI Agriculture TR	**USD**	-8.6%	-8.2%
Oil	ICE Crude Oil CR	**USD**	-12.7%	-2.9%
Gold	Gold index	**USD**	-5.6%	1.8%
Hedge Funds	HFRX Global Hedge Fund	**USD**	-1.7%	1.5%
Interest Rates			**Current rate**	**Change at meeting**
United States	25 April 2012	**USD**	0.25%	-
United Kingdom	7 June 2012	**GBP**	0.50%	-
Eurozone	6 June 2012	**EUR**	1.00%	-
Japan	23 May 2012	**JPY**	0.10%	-
Australia	5 June 2012	**AUD**	3.50%	-0.25%
South Africa	11 June 2012	**ZAR**	5.50%	-

Source: Momentum Global Investment Management / Lipper Hindsight. May 2012

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