

Viewpoint

Monthly market update

April 2014



*Global choice, wise decisions,
setting new benchmarks*



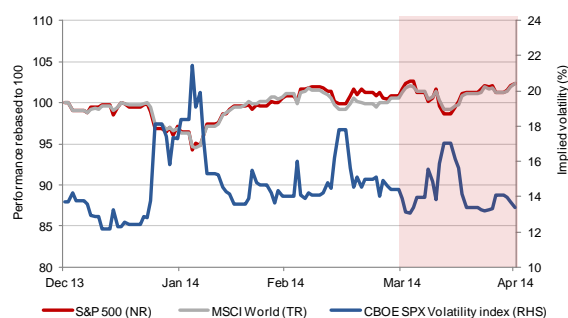
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1. Market commentary

In a relatively quiet month for news flow, markets failed to establish a clear trend while volatility continued to fall. Over the month both the MSCI World index (developed equities) and the MSCI Emerging Markets index were flat to moderately up, while bond yields generally drifted down slightly, leading to gains of 1.1% for global government bonds. Credit outperformed sovereign debt as yields compressed and investors continued their search for spread, duration and yield. Notably, however, investment grade credit outperformed high yield, with a return of 1.2% compared to 0.6% for lower quality paper. Emerging market (EM) bonds continued their recovery post 2013's sell-off, returning 1.9% in April to make them one of the best performing asset classes to date in 2014 with a return of 5.4%.

Figure 1: Volatility trending downwards as markets remain range bound

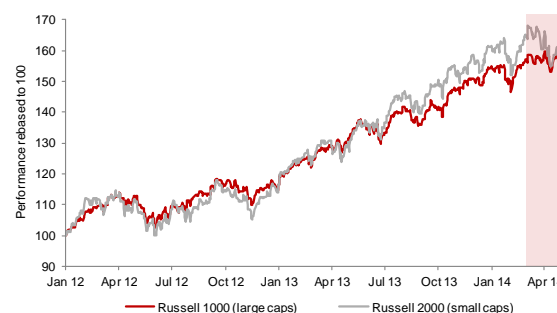


The most significant moves in equity markets were between regions. UK equities returned 3.2% in sterling terms, buoyed by a stream of positive news from the economy and the corporate sector, while Japan was down again (-3.4% in yen terms) to bring its year to date decline to close to 10%. In EM, Russia was weak, down by 5.9% over the month and 19.6% year to date, as international sanctions began to undermine confidence in the economy.

As with the previous month, sector moves were a key feature in markets during April. Previously high flying growth / momentum stocks, especially those in the biotech and technology sectors, peaked in late February before falling, including declines of around 3% in April for biotech (Nasdaq Biotech index) and 7% for internet stocks (Nasdaq Internet index). From their peaks this year these indices have now fallen by around 16%, unwinding what appeared to be rich valuations.

Small cap stocks have also underperformed so far this year, especially in the US and UK, with signs of profit taking by investors following their sharp outperformance in recent years and with valuations approaching parity with large cap stocks (whereas small caps usually trade at a discount reflecting their greater risk). So far this year small cap stocks in the US are down by 2.8% while large cap stocks are up by 2.5%.

Figure 2: Small cap stocks enter a period of underperformance

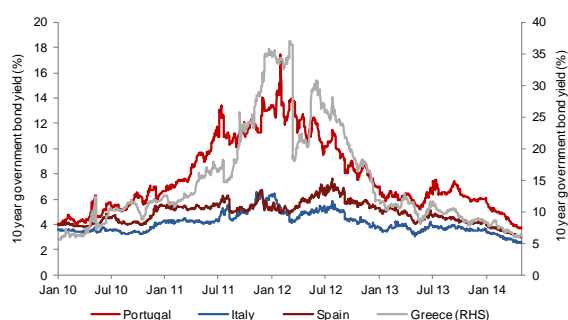


In the US, economic data remains difficult to interpret given the impact on activity of the severe winter weather. First quarter growth registered 0.1%, well below the previous quarter's 2.6%, but forward indicators are currently consistent with a rebound in Q2. The UK grew by 0.8% in the first quarter and forecasts for the year are rapidly being revised up to over 3%, a big surprise to most economists but reflecting the strength in both manufacturing and the important services sector, together with the recovery in the housing market. Less encouraging was data from China, where first quarter GDP fell to 7.4% year-on-year, below the government's 7.5% target for 2014. Trade figures and leading indicators from China also disappointed and point to a continuing slowdown in growth this year. Although Beijing reacted with some small stimulative measures, credit growth continues to be reined in and this is likely to be the dominant force during 2014.

The most encouraging data came from the euro area, where most indicators are pointing towards an improved economy in 2014, with growth potentially as high as 2%. The euro area composite PMI (Purchasing Managers' Index) rose to 54 in April, financial conditions have eased substantially as reflected in further falls in peripheral European government bond yields, and confidence indicators

have been rising, especially in the periphery which has suffered severe austerity in the past four years. This drop in peripheral European government bonds yields has been a notable feature of the past 12 months. So far this year yields on 10 year Spanish and Italian bonds have fallen by around 1%, taking them to their lowest levels since the euro was launched in 1999, while in Greece and Portugal yields have fallen by over 2% to 6.2% and 3.6% respectively.

Figure 3: Government bonds yields imply a return to health for peripheral Europe



Despite generally encouraging data from the US and Europe, inflation remains remarkably subdued. In the US, consumer price inflation registered 1.5% year-on-year in March; in the euro area inflation was steady at 0.7% in April, well below the European Central Bank's (ECB's) reference rate of close to 2%. In response to concerns over deflation in Europe, and given the continued strength of the euro, ECB President Mario Draghi indicated that further monetary stimulus might be necessary, specifically referring to the appropriateness of "a broad based asset purchase programme" (quantitative easing) for the first time.

The return of confidence to the boardroom has led to a resurgence in mergers and acquisitions (M&A). In the first four months of the year global M&A deal flow reached USD 1.2 trillion, 42% up from the same

period last year and not far short of the record of USD 1.4 trillion in 2007. While this is often seen as a warning sign of excess in markets as the corporate sector takes on increasing debt and risk, there is evidence that this is a more sustainable and well grounded cycle than in 2007. This time, for example, much more of the deals are being financed with equity or equity plus cash, with over half the deals so far this year financed on this basis compared with less than a quarter in 2007, when 76% of the deals were cash (debt) financed.

The Ukraine / Russia crisis rumbled on in April, with Russian separatists ignoring the Geneva accord between the Russia and the West. An extension of sanctions on key Russian individuals coincided with further capital flight from the country, while rising inflation forced the central bank to hike interest rates by a further 50 basis points (0.5%) following the 150 basis points rise in March. The dangers of an escalating conflict are clear, but diplomacy remains the most likely solution.

The prospect of a steady pickup in the key US economy and in Europe through the remainder of 2014 should bolster investor confidence following the wobbles seen in Q1. Improved sentiment towards EM assets and lately the euro area are also encouraging signs, and it appears clear that while the Federal Reserve gradually removes its ultra loose monetary policy, both the ECB and the Bank of Japan will continue to ease. Although there are clear risks on the horizon, notably the impact of tapering in the US and the potential for a policy misstep in China, the underlying economic and corporate news and the continuation of zero interest rate policy are all positives for markets.

Source: Bloomberg. Returns in US dollars unless otherwise stated. April 2014.

2. Market performance

		To 30 April 2014		
Asset class/region	Index	Currency	Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	0.7%	2.4%
United Kingdom	MSCI UK NR	GBP	3.2%	1.7%
Continental Europe	MSCI Europe ex UK NR	EUR	1.0%	4.5%
Japan	Topix TR	JPY	-3.4%	-9.9% ^e
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	1.0%	2.0%
Global	MSCI World NR	USD	1.0%	2.3%
Emerging markets equities				
Emerging Europe	MSCI EM Europe NR	USD	-2.9%	-9.2%
Emerging Asia	MSCI EM Asia NR	USD	0.2%	-0.1%
Emerging Latin America	MSCI EM Latin America NR	USD	2.7%	3.0%
BRICs	MSCI BRIC NR	USD	-1.0%	-3.9%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	0.3%	-0.1%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	0.6%	2.3%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.5%	3.7%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.2%	4.2%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.6%	3.6%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	0.7%	3.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.1%	3.6%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.0%	4.8%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.9%	3.3%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	1.5%	4.6%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.2%	1.0%
Australian Government	JP Morgan Australia GBI TR	AUD	1.1%	2.3%
Global Government Bonds	JP Morgan Global GBI	USD	1.1%	3.8%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.1%	3.6%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	0.4%	4.1%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	1.9%	5.4%

Source: Bloomberg

To 30 April 2014

Asset class/region	Index	Currency	Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	3.3%	13.3%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	5.7%	7.9%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	1.1%	-5.1%
Global Property Securities	S&P Global Property USD TR	USD	2.5%	6.2%
Currencies				
Euro		USD	0.7%	0.9%
UK Pound Sterling		USD	1.3%	1.9%
Japanese Yen		USD	1.0%	3.0%
Australian Dollar		USD	0.3%	4.1%
South African Rand		USD	0.1%	-0.1%
Commodities & Alternatives				
Commodities	RICI TR	USD	1.2%	6.2%
Agricultural Commodities	RICI Agriculture TR	USD	1.6%	14.2%
Oil	ICE Crude Oil CR	USD	0.9%	-2.3%
Gold	Gold Spot	USD	0.6%	7.1%
Hedge funds	HFRX Global Hedge Fund	USD	-0.7%	0.4%
Interest rates			Current rate	Change at meeting
United States	30 April 2014	USD	0.25%	-
United Kingdom	8 May 2014	GBP	0.50%	-
Eurozone	8 May 2014	EUR	0.25%	-
Japan	30 April 2014	JPY	0.10%	-
Australia	6 May 2014	AUD	2.50%	-
South Africa	27 March 2014	ZAR	5.50%	-

^e Estimate

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		
Property (UK)		
Currencies		
GBP		
Euro		
Yen		



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