

# Market & Economic Update

## Overview of the last month



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**Global equity markets retraced some of this year's gains in April.** European equities were amongst the biggest casualties, whilst 'safe haven' government bond yields moved to lows seen last year, **German 10 year Bunds hitting 1.65%.**

Worries about Spain's fiscal position resurfaced as they missed their targets for deficit reduction; the **economy slipped back into recession and unemployment hit 25%.** The ECB's recent refinancing operations were supposed to buy time for peripheral nations but the impact appears to have faded already. With elections due across core and peripheral European countries over the summer and austerity fatigue increasingly evident, **political risk is likely to remain to the fore.** The IMF also topped up its funds by \$430bn to act as a crisis firewall in the event of further deterioration.

**Europe is in recession,** whilst the UK registered its first double dip since the 1970s. In the US, the overall trend seems to be one of a slow, albeit sub-par recovery, evidenced by the gradual turnaround in the housing market and manufacturing activity. **US corporate earnings have been supportive.** However corporate expectations were guarded by management statements warning on increasing costs whilst the price of oil and certain commodities remain stubbornly high. The developed world is likely to experience positive, albeit weak, economic growth for some years.

We believe the most attractive risk / return opportunities are currently available through **higher yielding corporate bonds and equities** but further volatility is expected as sentiment shifts.



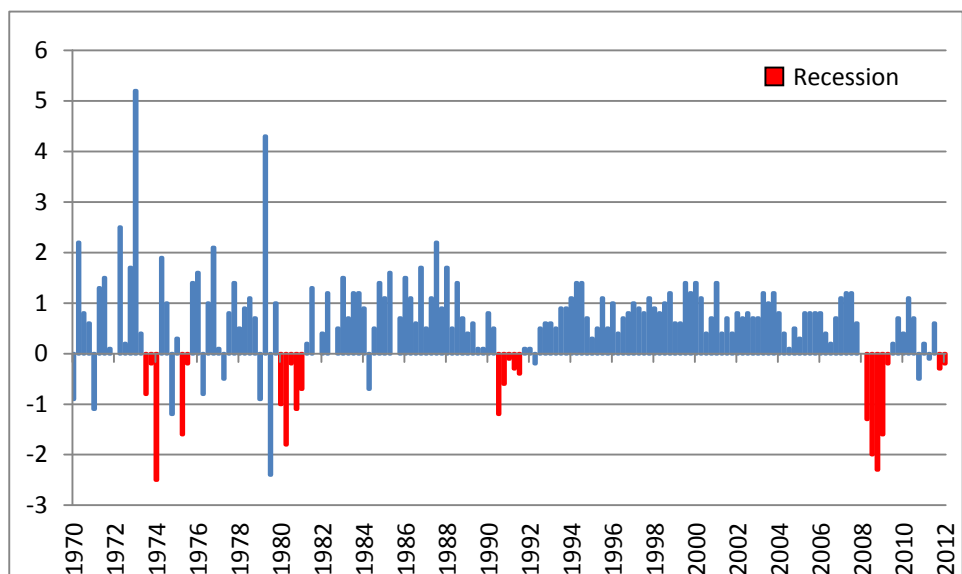
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### Explanation of Chart of the Month:

Preliminary data has indicated UK GDP shrank by 0.2% between January and March after a 0.3% contraction in Q4 of last year, sinking Britain into a technical recession. The UK economy contracted by 7.1% during the 2008-09 recession and since then the recovery has been slow. Most economists had expected modest growth but the biggest fall in construction output in three years, a meager 0.1% increase in the service sector and a fall in industrial output upset predictions. It is unlikely that the Bank of England will respond with another bout of QE as inflation is surprising on the upside. However, industry appears somewhat unfazed by the announcement as other leading economic indicators continue to be positive. Of course, GDP numbers are often revised later.

Chart of the month: UK GDP Growth (quarter-on-quarter %)



**Asset Allocation Summary - from the CIO's desk**

	House view	Direction of Asset Allocation moves
<b>General Summary</b>	<ul style="list-style-type: none"> <li>• Consensus economic growth forecasts in the medium term look too high as austerity programs become synchronised</li> <li>• The ECB Long Term Refinancing Operation has eased fears and supported asset prices generally. A sustained rally will require a permanent solution</li> <li>• Western and Japanese short term interest rates are likely to remain close to zero for some time</li> <li>• Looking to add to Japanese and Emerging market equity on weakness and lighten property</li> </ul>	➔
<b>Equities</b>	<ul style="list-style-type: none"> <li>• Consensus earnings forecasts are likely to be marked down</li> <li>• Negative real cash rates for the foreseeable future increase equities' attraction although continue to favour defensive, larger-sized businesses.</li> <li>• Europe looks cheap relative to history but economic and political issues remain</li> <li>• The US market remains relatively dear while Asia looks fair value compared to history</li> <li>• Japanese equities continue to look cheap relative to their history and emerging market valuations look reasonable therefore looking to add to both of these</li> </ul>	➔
<b>Fixed Income - Quality Bonds</b>	<ul style="list-style-type: none"> <li>• Perceived "safe haven" government bonds are unattractive as they continue to provide exceptionally low yields</li> <li>• Prefer investment grade corporate debt over government bonds and cash</li> </ul>	➔
<b>Fixed Income - High Yield Bonds</b>	<ul style="list-style-type: none"> <li>• A low default outlook makes high yield bonds relatively attractive although spreads have come down</li> <li>• A lack of liquidity, especially in times of distress, does increase their correlation to equities therefore we continue to suggest short duration to mitigate risk</li> </ul>	➔
<b>Property</b>	<ul style="list-style-type: none"> <li>• Total return on IPD has peaked and property returns have faded, rental income becomes the main focus</li> <li>• Preference for liquidity leads us to reducing exposure in favour of Japanese and Emerging market equities</li> <li>• Favour property securities over Bricks and Mortar</li> </ul>	➔
<b>Commodities</b>	<ul style="list-style-type: none"> <li>• Supply / Demand characteristics continue to be mildly supportive</li> <li>• Long term commodity outlook remains favourable</li> </ul>	➔
<b>Hedge</b>	<ul style="list-style-type: none"> <li>• The majority of hedge fund strategies have performed well until recently as correlation between sectors and within sectors weakened</li> <li>• Outlook remains challenging as risk-off environment returns</li> </ul>	➔
<b>Cash</b>	<ul style="list-style-type: none"> <li>• This asset class continues to produce negative real returns as cash rates remain close to 0%</li> </ul>	➔

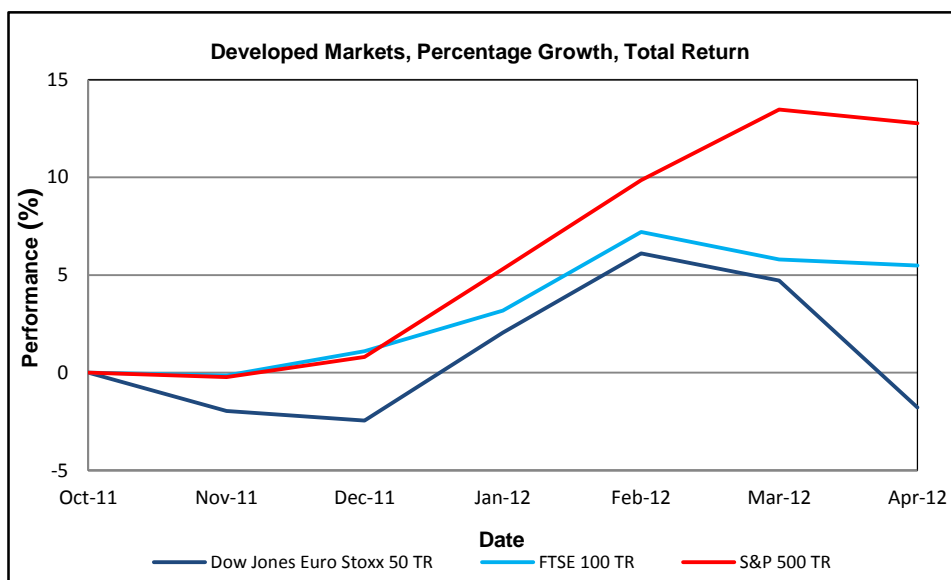
## North America, UK and Western Europe

- The April IMF World economic outlook has forecast that the Eurozone will contract by 0.3% in 2012. Spain and Italy will contract by 1.8% and 1.9% respectively and Germany's GDP will expand by 0.6%.
- Spain's economy slipped into a recession in Q1 as GDP shrank 0.3% from the previous quarter. Unemployment in Spain increased to 24.4% in Q1, increasing from 22.9% in Q4 of last year.
- French unemployment is now at its highest level since September 1999 after the number of jobless people in France rose for the eleventh month in a row. Jobless claims hit 2.88 million in March ahead of the French elections.
- According to preliminary data German inflation slowed to 2% year on year in April.
- UK manufacturing PMI fell more than forecasted in April, dropping to 50.5 as an economic slowdown in the euro zone curbed demand for goods made in Britain.
- Euro zone inflation was 2.6% year-on-year in April fuelled by high oil prices and tax policies. Exceeding expectations of 2.5% this gives the ECB little room to lower interest rates in an attempt to boost growth

### Major Developed Countries' equity markets

Returns over last six months denominated in local currencies

Source: Lipper as at 30 April 2012



**S&P 500:** PE= 14.35, Yield= 1.97% (ex loss makers)  
**FTSE All Share:** PE= 12.44, Yield= 3.71% (ex loss makers)  
**German Dax** PE= 14.16, Yield= 4.43% (ex loss makers)

Sources: Thompson Reuters, Financial Times as at 30 April 2012

(Country yields and PEs relate to a sample of stocks that cover at least 75% of each market's capitalisation and are denominated in local currency)

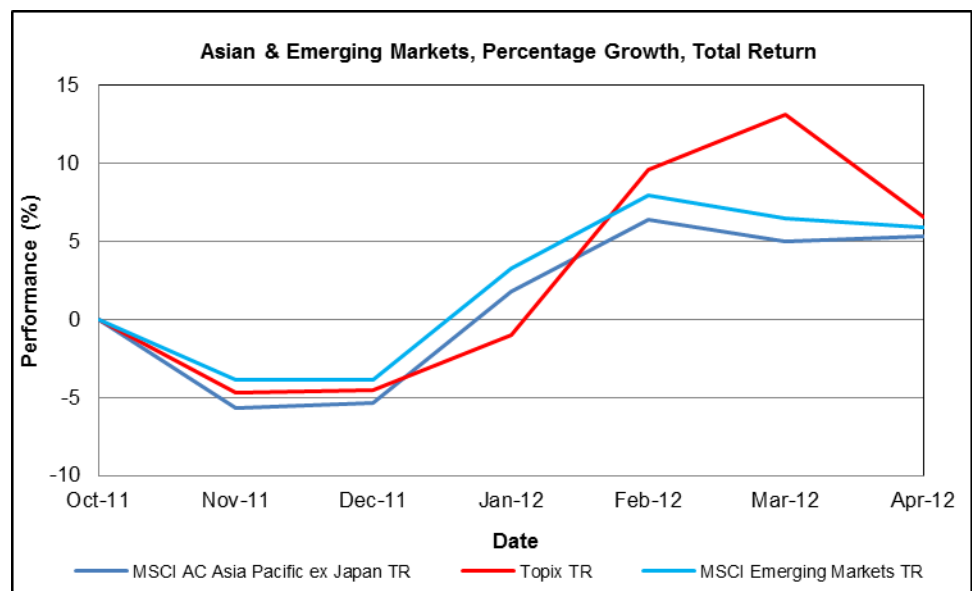
## Japan, Asia and the Emerging Markets

- India's central bank cut interest rates by 0.5% to 8% due to concerns of the country's slowing economy. This is the first cut in three years after 13 increases between March 2010 and October 2011 as it battled inflation.
- Inflation in Indonesia and Sri Lanka accelerated to a seventh month high in April, to 4.5% year-on-year and 6.1% year-on-year respectively. The central bank in Indonesia kept rates at a record low of 5.75% for a second month.
- Thailand's inflation fell to 2.47% in April from 3.45% in March, below the 2.9% forecasts.
- GDP growth was positive in Taiwan, at 0.26% Q-on-Q after two quarters of contraction, edging the economy out of recession.
- Brazil cut interest rates by 0.75% as the country adjusts to a slower rate of growth.
- Official PMI figures in China rose to 53.3 in April, up from 53.1 in March

### Asian and Emerging Markets equity markets

Returns over last six months  
denominated in local currencies

Source: Lipper as at  
30 April 2012



**Topix:** PE= 28.55, Yield= 2.32%

Sources: Thompson  
Reuters, Financial Times  
as at 30 April 2012

(Country yields and PEs relate to a sample of stocks that cover at least 75% of each market's capitalisation and are denominated in local currency)

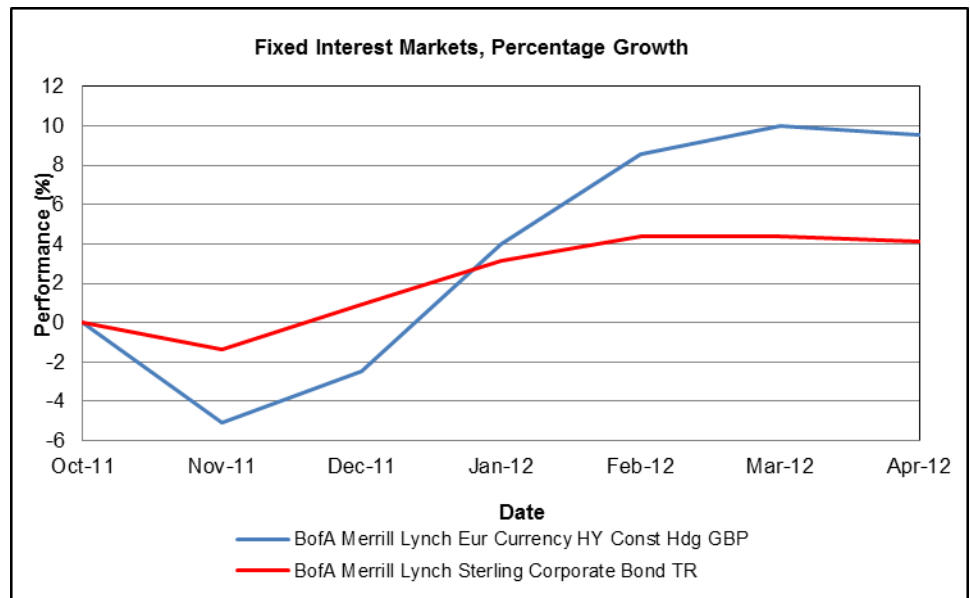
### Fixed Income

- S&P ratings agency downgraded Spain’s credit rating to BBB+ which puts it on par with Italy’s current rating. The reasons for the two notch downgrade included downward revisions for Spanish growth forecasts and expectations that the banking system will require additional fiscal aid.
- After a strong rally starting at the beginning of 2012, it seems that capital gains on high yield bonds have now peaked
- “Safe haven” government bond yields lowered again, US and German 10 year government bonds continue to yield under 2% while the UK is yielding just over 2%

### Fixed Income Performance

Returns over last six months

Sources: Thompson Reuters, Financial Times as at 30 April 2012



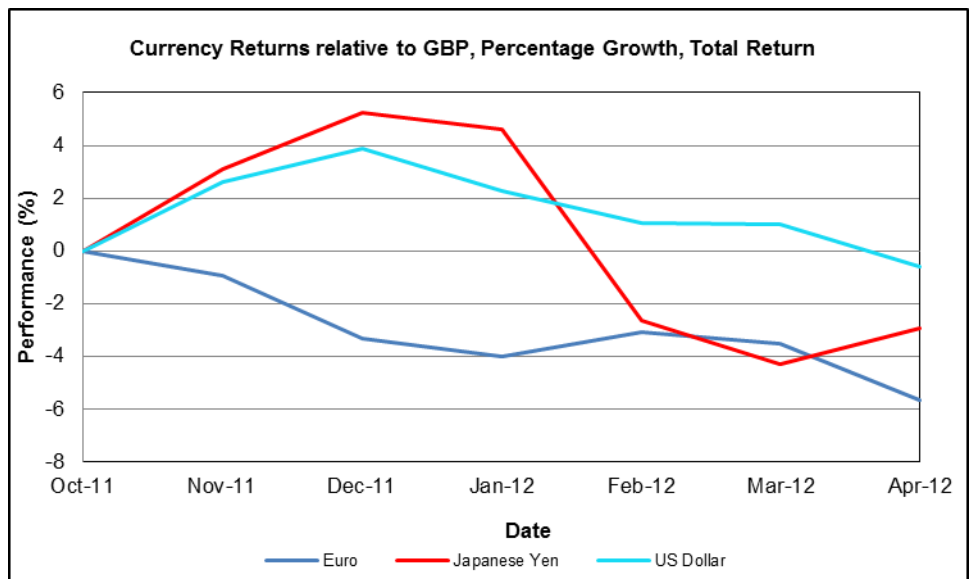
### FX

- The Japanese Yen strengthened slightly in April after weakening against the Sterling throughout Q1 of 2012
- Both the Euro and the US Dollar weakened against the Sterling during April after a relatively flat performance in March.

### Currency Performance

Returns over last six months

Sources: Thompson Reuters, Financial Times as at 30 April 2012



## Commodities

- WTI Nymex crude oil increased by 1.28% while Brent oil decreased by 1.78% during April.
- The divergence between the two oil benchmarks continues
- Natural gas continued to fall, down by 3.23% over the month
- Equities in the commodity sector fell approximately 4% during March, reversing early year gains as concerns of China's falling growth rate remained
- Soybeans increased by 6.91% during April and are now up 22.70% year to date. Reason for this is drought in South America

### Commodities' performance

\*indicates a spot index value

Price six months ago in brackets

Market Price/Index	As at 30 April 2012	% change over 6m
Nymex Crude Future USD	104.87 (92.58)	12.29
Dated Brent Spot USD	119.47 (106.69)	11.98
Gold USD (Mid)	1663.81 (1724.48)	-3.52
S&P GSCI*	684.88 (647.96)	5.70
S&P GSCI Non-Energy Index*	432.74 (440.13)	-1.68
S&P GSCI Agriculture*	435.32 (443.79)	-1.91

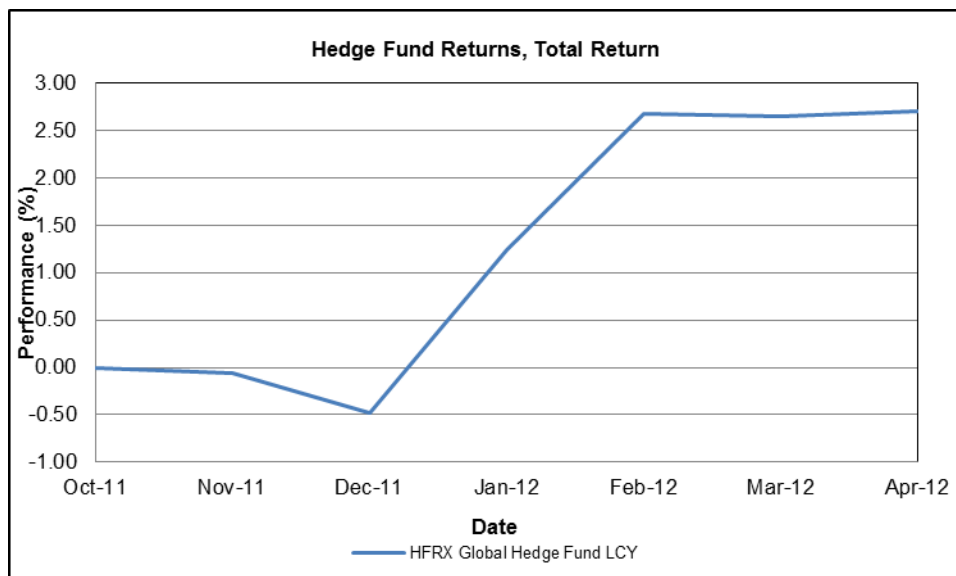
*GCSI – Goldman Sachs Commodity Index*  
*\*Spot index value. Price 6 months ago in brackets.*  
*S&P GSCI is heavily skewed to energy at roughly 70% to 75%*

Sources: Thompson  
Reuters, Financial Times  
as at 30 April 2012

### Hedge Funds

- All hedge fund strategies produced negative returns in April
- HFRX Global Hedge fund was the best performing sub index over the month returning -0.18%. It is also the best performing hedge fund strategy year to date at 3.22%.
- HFRX Equity market neutral was the worst performing over the month returning -2.69%
- The worst performing strategies year to date have been the HFRX Equity market neutral and the HFRX Macro, returning -7.29% and -5.13% respectively.

Hedge Fund Returns chart over six months

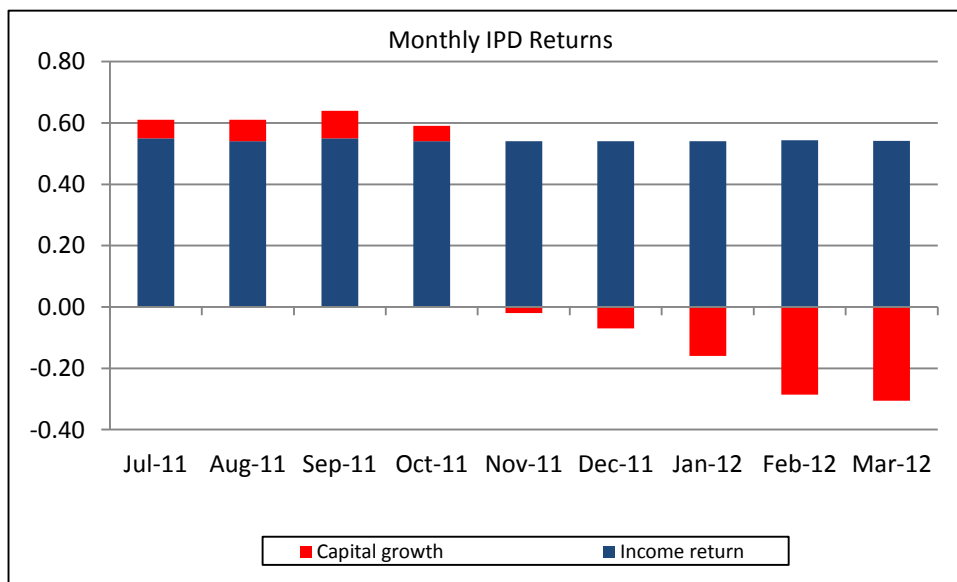


Source: Lipper as at 30<sup>th</sup> April 2012

### Property

- IPD capital growth was -0.3% in March, negative for the fifth consecutive month
- Total return is now decreasing as income returns remain constant at 0.54%
- Total return on property has fallen from 3.6% at its peak in December 2009 to 0.24% in March 2012

Monthly IPD Property Index returns



Sources: Investment Property Databank TR (to 31 March 2012)\*

\*Index data is released mid-month and therefore figures are only available with a one month lag

**Datasheet - Latest Market Returns to the 30 April 2012**

Market	1m	3m	6m	2011-12*	2010-11*	2009-10*	2009-08*	2007-08*	3 Years	5 Years
<b>S&amp;P 500 TR</b>	-2.22	4.06	12.10	7.60	7.57	34.41	-13.54	-3.75	55.58	29.47
<b>FTSE All Share (ex IT) TR</b>	-0.28	2.97	6.31	-1.89	13.62	36.65	-26.87	-4.39	52.33	6.51
<b>FTSE 100 TR</b>	-0.28	2.26	5.50	-1.95	12.91	35.85	-27.21	-2.06	50.39	7.22
<b>FTSE Europe ex UK TR GBP</b>	-5.49	-0.44	-0.91	-19.80	16.94	28.00	-26.27	1.52	20.05	-10.14
<b>FTSE EuroTop 100 TR</b>	-3.78	-0.58	-0.14	-13.97	14.08	27.37	-24.91	3.27	25.01	-3.06
<b>Topix TR</b>	-4.53	-0.09	3.42	0.88	-6.23	21.20	-10.47	-6.26	14.65	-3.79
<b>MSCI AC Asia Pac ex Japan TR</b>	-1.10	-0.29	3.63	-7.67	11.84	50.89	-20.30	19.10	55.82	47.91
<b>MSCI Emerging Markets TR</b>	-2.76	-1.57	3.40	-9.96	11.04	52.52	-23.43	26.93	52.50	48.21
<b>Numis Small Cap (ex IT) TR</b>	-0.81	7.72	13.00	0.05	22.03	43.82	-21.83	-19.28	75.58	10.79
<b>HSBC Global Mining TR</b>	-1.96	-10.91	-8.46	-24.24	19.92	69.42	-37.63	46.60	53.92	40.73
<b>BofA Merrill Lynch Eur Currency HY Const Hdg GBP</b>	-0.41	5.34	9.53	3.01	10.50	71.08	-19.49	-4.21	94.74	50.19
<b>Markit iBoxx Sterling Corporates TR</b>	-0.38	0.92	3.92	5.13	6.94	29.71	-12.99	-2.43	45.84	23.80
<b>FTSE APCIMS/Balanced TR</b>	-0.80	1.37	4.89	0.97	10.02	25.26	-16.52	-1.08	39.15	14.90
<b>FTSE APCIMS/Growth TR</b>	-1.10	1.88	5.40	-1.03	10.58	29.55	-20.14	-1.95	41.79	11.03
<b>FTSE APCIMS/Income TR</b>	-0.43	0.84	4.41	3.30	9.78	20.50	-12.03	-0.11	36.66	20.09
<b>US Dollar</b>	-1.61	-2.82	-0.60	2.72	-8.23	-3.19	33.66	0.97	-8.75	23.15
<b>Euro</b>	-2.21	-1.74	-5.68	-8.37	2.39	-2.86	13.76	15.19	-8.86	19.44
<b>Japanese Yen</b>	1.41	-7.20	-2.93	4.38	6.32	1.31	41.98	15.46	12.44	84.33
<b>LIBOR GBP 3 Month</b>	0.08	0.26	0.52	0.96	0.75	0.81	4.55	6.20	2.54	13.86
<b>Gold GBP</b>	-2.27	-7.99	-4.68	9.85	20.14	29.23	35.54	29.88	70.54	200.21

\*1 Year ending 30 April

Percentage returns for major asset class indices.

Source: Lipper (to 30 April 2012 in GBP. Currency movements are vs. Sterling.)

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