MARKET BULLETIN

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World capital

Washington will be the focus for investors and financial markets this week as the International Monetary Fund (IMF) and World Bank hold their spring meetings in the US capital to assess the state and health of the global economy. Although the US, UK and European economies are healing, the IMF managing director Christine Lagarde has warned that projected global growth at 3.7% this year is "too weak for comfort". The head of the IMF last week raised the spectre of low inflation in the eurozone, geopolitical tensions from the crisis in Ukraine, and financial volatility in the emerging markets. But, despite the caution from global policy makers, the outset of the second quarter is marked by optimism among global investors and business.

In Asia, growth in China has slowed further in response to policies designed to dampen the risk of a credit bubble and address slowing growth. China's official government Purchasing Managers' Index (PMI) for March came in only a fraction above the 50 level that separates expansion from contraction, while Markit's gauge is now at the 48 level. China last week announced measures to boost growth, including a huge 18% increase in funding for state railway lines, backed by the sale of 150 billion yuan in government bonds. Although the measures are largely a policy-led infrastructure initiative, Beijing continues to aim to move the economy towards more market- and consumer-driven growth. Fund manager BlackRock's chief executive Larry Fink last week stressed that a slowdown by China to 7% growth was not a negative and reflected the difficulty of this transition.

Meanwhile, in Japan, concerns linger that the government's monetary stimulus scheme is failing to lift the nation out of decades of stagnation. The increase last week in the sales tax to help pay down the national debt is seen by many as a threat to consumer spending that could derail Prime Minister Shinzo Abe's version of quantitative easing (QE). Average forecasts for Japanese economic growth are at around 0.8%, which is well off the official 2.5% estimate for 2014. However, with hopes that the Bank of Japan might adopt further stimulus measures this Tuesday, the Nikkei 225 Stock Average closed last week up 3.5% over the five-day period to 15,064 points, but fell on Monday to 14,809 points. The Tokyo index is down 9% this year.

Slack stimulus

US Federal Reserve chair Janet Yellen last week said there was still considerable slack in the US economy and labour market, and implied the Fed would continue its stimulative monetary policy for the foreseeable future. Yellen, in a speech in Chicago, said the economy was "not back to normal health". Last month markets construed comments at her Federal Open Market Committee debut as a hint of an earlier-than-expected interest rise in 2015. Yellen last week challenged the analysis that the US economy has started to run out of spare capacity and that accommodative policy could start to push up wages and inflation. Yellen said the economy has growth potential with companies still not hiring enough and wage increases weak.

However, US economic data last week looked more solid than the recent figures after the unusually harsh American winter. Latest employment figures showed 192,000 new jobs were added to the US economy in March, although the overall unemployment level remains at 6.7%. The data is in line with US Federal Reserve's forecasts and is likely to support its plans to taper asset purchases in increments this year and hold back from a raise of interest rates until 2015. Fund manager Bill Gross of PIMCO told Bloomberg that, at the current level of tapering, QE is set to end by the end of October, and the Fed is likely to begin to talk about higher interest rates six months later.

Investors have continued to look for signals from the US economy that an underlying recovery is firmly in place, after an uneven start to the year with the S&P 500 index up by only 1.3% over the first quarter in the wake of a 30% rally during 2013. However, the S&P 500 remains at a near-record high, and last week reached 1,897 during intraday trading. Further signs of a strengthening US economy over the rest of the month will counterbalance a disappointing first-quarter corporate earnings season and concerns about US equity valuations amid continued bullishness on Wall Street. However, the forecast strengthening of the economy is expected to drive company profits growth sharply higher in the coming quarters.

Technology cash

Last week, the S&P 500 gained 1.2%, in part on the more positive US data. The US equity index rose in early trading on Friday to just below the 1,900 level, but closed down 0.3% to 1,883 points as investors continued to sell off US technology stock. On Friday, Facebook lost 4.6%, Yahoo dipped 4.2% to its lowest level since November, Amazon fell 4.5% and Google shares were down 3.8%. Wall Street has begun to show nervousness about the high multiples displayed by technology stocks, as well as the biotech area, which made large gains in 2013 as investors were pulled into momentum-driven enthusiasm for the broad sector.

The US technology sector has amassed large cash piles amid strong profits in recent years and caution over the strength of the US recovery. American corporates have regained their confidence following the collapse in capital spending in 2009, and started to invest in business expansion. Although US companies increased capital spending in 2013, many continue to amass significant levels of cash. US rating agency Moody's reports that American businesses have more than doubled their cash reserves since 2007 to $1.6 trillion last year, which was also a 12% increase on 2012. Meanwhile, capital spending rose from $862 billion in 2012 to $869 billion last year. Investment in the technology sector has not kept up with rising profits, according to Moody's.

US technology giants hold 39% of US cash reserves, followed by healthcare and pharmaceuticals with 15%. Apple alone had $159 billion in cash on its balance sheet in 2013, trailed by Microsoft ($84 billion), Google ($59 billion) and Verizon ($54 billion). US multinationals also kept $947 billion of cash overseas rather than invest in business at home – and face tax – or pay dividends or make stock buybacks. Although more investment in recent years could have helped speed up the US and global recovery, corporate America is widely expected to start to spend more cash as confidence strengthens in 2014.

'The British are coming!'

Chancellor George Osborne will travel to Washington this week for the IMF's spring meeting, which is expected to upgrade its forecast for UK economic growth. This follows the Organisation for Economic Co-operation and Development's 3.3% estimate for UK annual growth. Britain's recovery has broadened with UK corporate spending in the fourth quarter up 9% from a year earlier, contributing to almost a third of the economy's 0.7% growth from the third quarter. Evidence of increased business investment suggests that the recovery has moved beyond consumer spending and a policy-driven housing market boom.

In London, the FTSE 100 index advanced 1.2% over the week to reach 6,696 points, after it gained 0.7% on Friday. The optimism around the prospects for the UK and global economy at the start of the second quarter helped push the index to its highest level in three weeks. UK banks and international mining stock continue to perform strongly, reflecting this confidence in the domestic economy – and for the global economy amid the more positive US data and Beijing's announcement that it would take stimulus measures to support flagging economic growth that will hold up demand for raw materials.

Life insurers also staged a rally at the end of last week after the disclosure of a market-sensitive Financial Conduct Authority investigation into the treatment of 30 million long-term policyholders sparked a sell-off earlier in the week that wiped an estimated £7 billion off the sector's share value. Some of the City's largest institutional investors are taking legal advice to pursue the financial regulator for compensation for the share price losses after the leak of the FCA probe. Life insurance shares had already dropped sharply last month after Osborne's Budget unveiled its radical overhaul of the pensions and annuity market.

To QE or not to QE?

European stocks are also enjoying a strong rally with the FTSEurofirst 300 index continuing a two-week climb that took it to its highest level in more than five years during trading on Friday to 1,353 points. The pan-European index gained 0.6% on Friday and closed the week up 1.5% at 1,346 points, boosted by the prospect of asset gains if the European Central Bank loosens its monetary policy stance. European corporate confidence remains high with first-quarter merger and acquisition (M&A) activity up 60% from a year earlier to $149 billion-worth of deals, outpacing activity in the US and Asia.

However, inflation in the eurozone lingers at its lowest levels since the end of 2009 at 0.5%, and has triggered calls for action in the shape of QE. Although the ECB last week left interest rates on hold, its president, Mario Draghi, raised the possibility of an introduction of QE measures to counter the risk of deflation. Data last week showed that consumer prices in the region rose at the slowest pace in more than four years, while PMIs confirmed that the eurozone's recovery remained sluggish. The ECB has given itself plenty of room to decide on the exact conditions that could bring an introduction of QE, but last week's hints indicated it is prepared to pursue a policy route it would not countenance only last year.

Draghi is yet to detail the monetary policy instruments under consideration to lift inflation back to its target of just below 2%. But internal ECB models leaked by respected economic think tank FAZ to the German press suggest that the ECB would need to buy assets worth €1 trillion to add 0.2–0.8% to inflation. One obstacle for European central bankers as they look to loosen monetary policy is deep-seated German public opposition, although the Bundesbank president and long-standing critic Jens Weidman has been won over to the use of unconventional measures against deflation. The ECB is thought to be looking at the private debt market in Europe – although there are questions over whether this can support QE.

Beyond petroleum

Questions of ethics are no longer a side issue for global investors. Norway, for example, is divided over plans to reform the country's $850 billion oil fund, including reviewing its ethical guidelines and how its reports emerging market and environmental investments. Oslo wants its central bank to take over from an independent council the responsibility for corporate governance and the mechanism to exclude companies that break its investment mandate. The government wants to balance its ethical mandate with increased returns. The fund, which was set up in 1998 to invest in Norway's oil revenues, is increasing investments in renewable energy to up to $8.3 billion; while an expert group is looking at whether it should stop investing in fossil fuels.

Fund manager Cindy Rose of Aberdeen Asset Management uses 15 negative screens to ensure the companies within her ethical fund adhere to criteria that cover categories from alcohol to weapons. Her investment team has 30 days to disinvest any businesses that fails the criteria for the fund. But, beyond the ethical criteria, the process is bottom up and looks for good companies with long-term qualities at reasonable prices. "We apply the same analysis as we would for a business in any sector," she adds.

Rose is upbeat about how corporate social responsibility has moved to the centre of business in emerging markets. "The Ethical fund approach offers a great opportunity for investors who understand Aberdeen's investment process of building a portfolio of quality businesses at reasonable valuations and holding them for the long term," adds Rose. The socially responsible investing functions in the fund allow investors who do not want to participate in certain activities in the marketplace to invest "without worry or loss of sleep".

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