# MARKET BULLETIN

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ST. JAMES'S PLACE WEALTH MANAGEMENT

## Lows, highs and storms

As the rancour of an industrial dispute hung over one of Britain's largest refineries at Grangemouth and national opinion remained divided over the Royal Mail's privatisation, there was something of the early 1980s about the news swirling around British shores last week. Amid these political squalls and the huff and puff around a meteorological rather than metaphorical storm named after the patron saint of lost causes, St. Jude, there is plenty to encourage investors as October comes to a close. Whether or not further signs of economic recovery, a resurgent property market and the continued buoyancy of the London Stock Exchange and global equity markets herald 1980s-style boom years, they are positive developments as households and government grapple with the challenges of austerity, debt and rising living costs.

The air of economic and financial optimism was captured by the Bank of England's Canadian import Mark Carney last week, whose speech in the City was widely received as drawing a line under his predecessor's combative stance towards bankers and the financial sector. He announced a dramatic easing of the central bank's attitude towards financial companies with funding difficulties in contrast to the previous governor Lord King. "The Bank of England today is the friend of the resilient bank, continuous markets and good collateral," said Carney. "We are the enemy of taxpayer bail-outs, fragile markets and financial instability."

Moreover, Carney recognised the central role that the City plays in the UK economy – and that Britain stands to benefit from London's central role in global finance. Carney estimated that the banking sector's assets could grow to nine times the UK's gross domestic product (GDP) by 2050, and this growth was good for both savers and investors. "Properly structured, this creates investment opportunities for British savers, reinforces trading ties for UK firms and improves access to credit for the real economy across the country," said Carney.

## Live cat bounce?

As the Bank's governor held out an olive branch to encourage the banking sector to support industrial growth – and not just to regulate punitively its reach – official data indicated that the British economy underwent the fastest rate of growth since 2010 with a 0.8% expansion for the three months to September that exceeded 0.7% in the second quarter. Public finances are also beginning to reap the rewards of a stronger economy, with receipts rising faster than spending. The CBI Industrial Trends Survey for October showed that the manufacturing recovery is on course despite a recent appreciation of sterling. And UK unemployment appears to be falling faster than forecast with the current 7.7% rate down from 7.8% in the previous quarter. "Britain's hard work is paying off and the country is on the path to prosperity," said the UK chancellor George Osborne.

The Office for National Statistics figures showed a quarterly expansion across production (0.5%), the dominant services sector (0.7%) and construction (2.5%), with a much sought-after increase in manufacturing (0.9%). The economy's output is still 2.5% smaller than before the recession and the manufacturing sector is 9% smaller than before the crisis (while construction needs to make up 12.5% of lost output). But the overall recovery of the UK economy is strong and powered crucially by the private sector – and has grown more in the first three quarters than the Bank thought likely for the year. Analysts are expecting the good growth to continue, unlike the 'dead cat bounce' of 2010 when growth was not sustained.

With the economy expanding, the Monetary Policy Committee's (MPC) October minutes also revealed unanimous support to hold monetary stimulus at present levels. Since the Bank announced forward guidance in August, gilt yields have fallen back from recent peaks and expectations for the timing of a rate rise have moved further into the future. Although these conditions continue to support markets, savers are facing news lows, with Halifax, Lloyds and Bank of Scotland last week further reducing interest rates on deposit accounts. For example, Halifax has reduced the rate on its instant-access cash ISA to just 1%. Meanwhile, with the unemployment rate falling faster than expected, the MPC is due to revise down its forecast for unemployment in next month's inflation report (with the 7% rate the threshold point at which it will think about raising rates).

**Atlantic highs**

Further speculation over the direction of monetary policy on the other side of the Atlantic continued last week to swirl around global markets, with the S&P 500 index closing on Friday at another all-time high of 1,755 points. Markets expect the US Federal Reserve to continue its $85 billion-a-month bond-purchase scheme into 2014 with the continued flow of easy money into the global financial system supporting the equity rally. The S&P 500 gained 0.55% over the week and added 0.4% on Friday.

Strong corporate earnings also helped lift the S&P 500. US online retailer Amazon's shares were up 9.6% at the end of the week following better-than-expected quarterly earnings, while software giant Microsoft also gained 5.9% on strong results. A strong third-quarter reporting season will address concerns that the bullish momentum of US equities and rising valuations need to be matched by growth in sales and profit from corporate America. "The majority of this year's gains have come through higher multiples, not a boom in corporate earnings," said Russ Koesterich, chief investment strategist at BlackRock. "Gains need to be more driven by earnings growth; otherwise US stocks will start to climb into overvalued territory."

Disappointing US jobs data last week, which had been delayed by the US government shutdown and debt-ceiling crisis, further entrenched the market view that the Fed will push its quantitative easing (QE) tapering date further into the future. US job figures for September showed a slowing down of new employment over the period to 148,000 compared to more than 200,000 earlier in spring (although the overall unemployment rate is down to 7.2%). Chris Iggo, chief investment officer of fixed income at AXA Framlington, commented that, if QE was appropriate when job growth was running at over 200,000 per month, then it is also appropriate as job growth slows. "For many at the Fed, QE needs to continue to support the economy through the mechanism of rising asset prices generating enough confidence to provide investment and employment growth," says Iggo. Market expectation that Fed policy will for now remain unchanged pushed down yields on US Treasury bonds by 9 basis points (bp) last week to a three-month low of 2.5%.

European equity markets also booked gains over the week with the FTSEurofirst 300 index also up 0.55% over the five-day period. Reports that Telecom Italia was looking at cutting its dividend back added to a 0.1% drop on Friday, but the index was up over the five-day period for the third week as investors continue to move into European equities. Fund manager Stuart Mitchell of S. W. Mitchell Capital believes Europe is at the start of a multi-year growth phase despite a lingering negative view of the region among some investors. "I have never seen such a wide gap between the perception of businesses in Europe and the reality on the ground," added Mitchell.

However, the Nikkei 225 index proved an exception in the main equity markets, losing 3.25% over the week and sustaining a 2.8% drop on Friday, its largest one-day decline for two months. Japanese equity investors are showing some concern over the strengthening of the yen, which could hamper Prime Minister Shinzo Abe's attempts to make exports more competitive. The yen has risen 3.3% over the past five weeks against the dollar as concerns over the US debt ceiling crisis have driven investors to other currencies, including Japan's, as a haven. The dollar fell 0.6% last week against a basket of currencies to its lowest in nearly nine months.

**Lifting London**

As Wall Street enjoyed another record week, the mix of positive economic news and confidence that the Fed's monetary policy remains in place also helped lift UK equities. The FTSE 100 index ended the week up to just a few points below its 13-year high reached last May of 6,840 points (its highest was in December 1999 when it reached 6,930 prior to the dot-com crash). At the end of June this year it had fallen back to 6,000 points.

The City has wanted signs of economic recovery and corporate earnings to give ballast to the UK equity rally. From the International Monetary Fund's change of stance on UK growth prospects to the steady stream of upbeat official data, there has been plenty on display in recent months. Rising equity prices are in tandem with meaningful recovery and the loose monetary policy that has sustained asset prices as the economy strengthens. Fund manager Schroders chief economist Keith Wade continues to favour UK as well as US equities with both well-supported by the economic recovery. "We have also kept our positive assessment on UK equities as corporates stand to benefit from a loose monetary setting and a positive growth backdrop," said Wade.

The FTSE 100 gained 1.49% over the week to 6,721 points, with banks making strong gains after Carney pledged back-up to liquidity-stricken lenders. The Royal Bank of Scotland climbed 3.3% to 369p on Friday; although it was down 1.2% over the five-day period after losing 5.3% earlier in the week on indications that the UK government would decide in mid-November on whether or not to break up the bank and spin off its toxic assets. Lloyds inched 0.3% to 80.4p on Friday, after a steady 5.1% rise during the week after fund manager Aberdeen Asset Management announced it was in talks to purchase its Scottish Widows Investment Partnership for an estimated £440–£500 million in shares. Fund managers such as Mitchell believe UK and European banks offer good value. Lloyds' stock value has doubled this year and is yielding 14–15% based on current earnings with scope for further improvement, said Mitchell. "Politicians know that if you want the economy to recover you have to cut the retail banks some slack," he added.

## Flotation spell

The privatisation of Royal Mail continues to cause political furore amid accusations that the coalition underpriced the privatisation and news that the hedge fund The Children's Investment Fund has taken a 5% stake (despite business secretary Vince Cable's express wish for Royal Mail to remain in the hands of long-term investors and pension funds). A strike ballot this Wednesday threatens industrial action next week, but amid the fallout from the sale there's no doubt the Royal Mail float caught the imagination of investors.

With shares ending last week at 555p, up 67% from its launch and valuing the company at £5.5 billion, interest is stirring in further initial public offerings (IPOs) lined up in London. The UK government has indicated that it wants to give retail investors priority in any further sell-offs ahead of the general election of 2015, and views the uptake of the Royal Mail sale as evidence that there is an appetite for Thatcher-style "popular capitalism". The UK government, with a 32% stake in Lloyds and 81% in RBS, is lining the banks up for privatization. More than half of the shares of the remaining £17 billion public stake in Lloyds could go to retail investors, with a two-stage government plan proposing the sale of £7 billion next February and £10 billion late in 2014. A sale of RBS is unlikely before 2015.

In the meantime, Merlin Entertainments last week unveiled plans to float in London in a deal that is expected to value the owner of the Madame Tussauds waxworks and the LEGOLAND theme parks at around $3 billion, plus $1 billion of debt. Merlin wants to raise around $200 million to reduce debts, and is hoping 10–15% of its offering will go to retail investors. Russian credit card company TCS last week also raised $1.1 billion. The UK's 59 IPOs this year have raised $12.6 billion, compared with $2.8 billion from 35 issues a year ago, according to Dealogic. In 2009, there were just six deals that raised $702 million.

The UK economic recovery is underpinning this revival of interest, with cyclical stock such as the house-builder Crest Nicholson and estate agents Countrywide and Foxtons among this year's offerings. David Vaughan, IPO leader for Ernst & Young, says activity is underway for further UK launches. US institutional investors are also building up their exposure across Europe as the UK recovery continues and concerns ease over the eurozone. Craig Coben, head of equity capital markets at Bank of America Merrill Lynch, says: "We have seen inflows of funds and macroeconomic recovery – that is a powerful combination."

*Aberdeen, AXA Framlington, BlackRock, Schroders and S. W. Mitchell Capital are fund managers for St. James's Place.*