ST. JAMES'S PLACE
WEALTH MANAGEMENT

Monday 31 March 2014

Spring rebound?

Global stock markets enter the second quarter this week after a mixed start to the year. The developed world's major stock exchanges have been unable to sustain the advances of 2013 over the first quarter of the year, with the S&P 500 in New York up only 0.5%, London's FTSE 100 index down 2% and, in Tokyo, the Nikkei 225 Stock Average losing 9.3% over the first three months of the year. However, there's a confidence in financial markets and boardrooms that April and the second quarter will bring further news of recovery for Western economies and equity markets. Despite market concerns over Russia and Ukraine, the mood is upbeat for the US economy and the pace of its central bankers' retreat from loose monetary policy. And China's Premier Li Keqiang has reassured global investors that Beijing is ready to support its cooling economy.

Optimism for the US economy and Chinese policy helped lift the Nikkei over the week by 3.3% to 14,696 points, with the index up 0.5% on Friday. The Tokyo index made gains last week after losing ground since the start of the year, amid concerns that Prime Minister Shinzo Abe's stimulus package has lost momentum. There is uncertainty over the effect that the 1 April sales tax increases will have on consumer spending and corporate earnings, and whether this policy to tackle the national debt could derail the economic recovery. Fund manager Schroders believes any effect the tax change has will be short term, and remains positive on Japan's ability to distance itself from its decade of deflation and keep to its 2% inflation target.

Meanwhile, the value of worldwide merger and acquisition (M&A) activity rose 54% to $710 billion over the first quarter from a year earlier as boardroom confidence grows globally. Thomson Reuters' data includes bids for US media giant Time Warner Cable and French telecoms group SFR, as well as Ireland-based pharmaceutical manufacturer Actavis's $23.8 billion move on US group Forest Laboratories and Facebook's $19.4 billion purchase of mobile services firm WhatsApp. Alongside the increase in mega-M&A deals, activity in the $1–5 billion region – which is considered a good indicator of M&A vitality – is up 17.5% this year. Europe and Asia-Pacific were behind with 24% and 16% of deals, but America continues to lead with 51% of deals.

American confidence

In the US, the S&P 500 rallied at the end of the week with a 0.5% rise on Friday and was down 0.2% over a volatile five-day period to 1,858 points. Earlier in the week, financials were hit after the Federal Reserve's announcement that it had rejected Citigroup's plan to buy back $6.4 billion of shares and increase dividends. The deepening crisis over Ukraine also weighed on the New York index. Wall Street will be looking to the round of second-quarter company results to assess whether the strengthening US economy has begun to power a growth in corporate earnings (although the recent extreme winter weather will blur this quarter's picture).

Technology and biotechnology stocks on Wall Street also came under pressure last week; while investors in some of the past year's more popular stocks that offer 'momentum trading' opportunities were dealt a sharp jolt over the five-day period. Credit Suisse has identified a group of 24 popular or 'hot' stocks that have lost $63 billion in market value, or almost 19%, mostly in the biotech and IT sectors. Meanwhile, the initial public offering of London-based King Digital Entertainment, the maker of the popular Candy Crush online game, raised more than $500 million in New York – but shares lost 18% over the first three days of trading. Investors are rotating into better-value sectors, such as telecoms, utilities, energy and financials, while the S&P 500 lingers only just below record levels.

US data continues to suggest a rebound over the next few months as employment, retail sales and industrial production figures improve. The bond markets have remained circumspect over whether this winter's big freeze explains fully some of the poor recent economic data. But higher consumer spending and business investment before the bad weather struck would suggest a healthy picture for the US economy. The 10-year US Treasury yield was up 5 basis points on Friday and over the week was down by 2 basis points to 2.72%.

Eurozone easing?

There was speculation across markets last week that the European Central Bank (ECB) will opt to ease its monetary policy on Thursday to tackle growing fears of deflation, which would give a further fillip to equities across Europe. The talk helped the pan-European FTSEurofirst 300 index gain 1.9% over the five-day period, which was its second consecutive weekly advance, to rest at 1,332 points. However, similar rumours about a change in tack preceded the February and March ECB meetings, which did not lead to a shift in policy. Economist Maxime Alimi of AXA Investment Managers anticipates that inflation will return to between 1% and 1.5% in 2015 and, although a risk in some countries, deflation is a "remote possibility" for the region.

However, consumer prices in Spain fell unexpectedly in March, while German inflation is below 1%. And one of the arch-critics of quantitative easing, Jens Weidmann, president of the Bundesbank, last week suggested that the ECB might need to consider looser monetary policy to tackle deflation. However, the eurozone can boast a current account surplus with exports exceeding imports in the final quarter of 2013 at 3% of gross domestic product. And the surpluses have boosted global confidence in the bloc's stability.

Moreover, the uncertainty over Russia's further ambitions in former Soviet territories has increased already-strong inflows into European equities and the debt markets of the crisis-hit countries in Europe's periphery. Yields on 10-year Portuguese government debt are below 4% for the first time since early 2010, and are near a decade low for Spanish 10-year bonds. Despite slow economic growth, deflation fears and the recent currency crisis, the eurozone is seen as a relatively attractive investment destination compared to higher-valued US equities or struggling emerging markets. AXA suggests valuations are cheap and longer-term investors need to keep a perspective over the short-term effects of inflation levels below 1% over the coming months.

Retreat from Moscow

Russia's annexation of Crimea has spurred investors to move out of eastern European and Russian equity funds. Investors pulled $3.2 billion from Russian equity funds in 2013 and a further $400 million has been withdrawn so far this year, according to EPFR. However, contrarian investors have shown interest in Russian equities, with positive inflows on some trading days since the start of the crisis in the Ukraine. Emerging Europe equity funds sustained outflows of $2.4 billion last year, with withdrawals of $1 billion so far this year.

Although the Moscow stock market MICEX has fallen 10.6% since the start of 2014, it enjoyed a 0.9% gain on Friday and was up over the week by 2.8%. The US and EU's sanctions on Russia have also increased international investor wariness about exposures to Russian business interests. Russ Koesterich, chief investment strategist of fund manager BlackRock, conceded that the crisis was an "unknown" for markets that raises longer-term issues if it does not significantly resolve itself in the next two to three months.

Russia's economy minister Alexei Ulyukayev last week conceded that capital outflows could reach up to $70 billion in the first quarter and previous growth estimates of 2.5% could slow to 0.6%. The World Bank said Russia's economy could contract markedly and see record capital outflows of $150 billion. Finance minister Anton Siluanov said he was ready to offer companies the same emergency measures adopted during the 2008–2009 financial crisis when the government spent about 8% of GDP to bail out Russian banks and companies.

Miners and insurance

The expectation of government action in Beijing rather than Moscow was one of the main international factors to move the London market last week. London's global mining stocks enjoyed another week of improved

performance on the back of hopes that the Chinese government had stimulus measures ready to tackle a slowdown of the economy. The reassurance from China's premier that policy tools were in place to ward off a 'hard landing' for the world's second-largest economy held out the prospect of continued demand for global resources. The FTSE 100 index closed the week up 0.89% to 6,616 points, after a 0.41% gain on Friday, which is 3.78% off its 52-week high back in May last year.

However, it was domestic news that brought the sharpest correction in London last week as markets digested the implication for the life insurance sector of the UK financial regulator's plans to look into the fairness of 30 million policies sold between the 1970s and 2000. Reports on Friday that revealed the Financial Conduct Authority (FCA) planned to investigate insurers' use of returns from closed funds caused a major sell-off among life insurers. Financial services companies, smarting from the sharp losses, have accused the FCA of creating a false and disorderly market in the sector's shares. Life insurers have already taken a knock from George Osborne's Budget plans to lift restrictions on pensioners' access to their retirement pots and opt for alternatives to annuities.

Meanwhile, savers have their last opportunity to make use of and invest this year's annual ISA allowance of £11,520 over the coming days before the 5 April deadline. Hopes among savers for an early rise in the Bank rate, however, took another dent last week, after the Office for National Statistics revealed that the Consumer Prices Index (CPI) of inflation dropped from 1.9% in January to 1.7% in February. The level is the lowest since October 2009 in the aftermath of the UK recession. Although the falling inflation rate holds out good news for incomes, households, consumers and the wider economy, it will give the Bank of England further room to argue to hold interest rates at their historic low into 2015.

The Scottish question

Meanwhile, in Scotland the debate about the cost of a yes vote for independence has continued to rumble with the referendum now only six months away. Scotland's financial services and banking industry last week found itself drawn into the fray over the cost and length of disruption if Scotland were to choose to break away. The former Royal Bank of Scotland (RBS) chief executive, Sir George Mathewson, claimed independence would benefit the financial sector; while the trade body, Scottish Financial Enterprise (SFE), has highlighted the uncertainty that a yes vote would stir for the nation's currency and the prospect of higher regulatory costs. Sir George also has the support of Angus Tulloch of fund managers First State. Both claim that independence would offer opportunities to attract more jobs and investment to Scotland and its financial services industry. However, RBS, Lloyds and other institutions have identified risks to their businesses in the event of a yes vote, while Standard Life has warned that a vote to leave the union could lead to it moving operations out of Scotland.

However, fund manager BlackRock has highlighted the "major uncertainties, costs and risks" for Scotland and the UK from a breakup of the 307-year-old union. BlackRock said that currency union was unfeasible, and Scotland adopting its own currency was the best of the few choices open to Edinburgh in the event of breakup. The fund manager also warned that Scotland's cost of borrowing could rise, with its credit rating likely to be several notches below the UK's rating. The fund manager also cited concerns over currency strategy, monetary credibility and a banking sector 12 times the size of Scotland's GDP. "Kilt-edged securities would sell at higher yields. Scotland would have to pay more to borrow than the UK, and accept shorter maturities," BlackRock said. "The country's likely high debt, fiscal deficit, weak economic growth, lack of institutional frameworks and low forex reserves suggest a higher-than-normal debut sovereign yield spread. This would add to Scotland's fiscal stress."

AXA Framlington, BlackRock, First State and Schroders are fund managers for St. James's Place Wealth Management.

The 'St. James's Place Partnership' and the titles 'Partner' and 'Partner Practice' are marketing terms used to describe St. James's Place representatives.
Members of the St. James's Place Partnership represent St. James's Place Wealth Management plc, which is authorised and regulated by the Financial Conduct Authority.
St. James's Place Wealth Management plc, St. James's Place UK plc, St. James's Place Unit Trust Group Ltd and St. James's Place International plc are members of the St. James's Place Wealth Management Group.
St. James's Place UK plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
St. James's Place Unit Trust Group Ltd is authorised and regulated by the Financial Conduct Authority.
St. James's Place International plc is authorised and regulated by the Central Bank of Ireland.
St. James's Place Wealth Management plc Registered Office: St. James's Place House, 1 Tetbury Road, Cirencester, Gloucestershire, GL7 1FP, United Kingdom.
Registered in England Number 4113955.