FP FINANCIAL PARTNERS
momentum
easton Asset Management

www.f-p.hk | Vol. 87 | January 2014

Newsflash

A new month and the 87th issue of Viewpoint from **Financial Partners**.

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Market Commentary

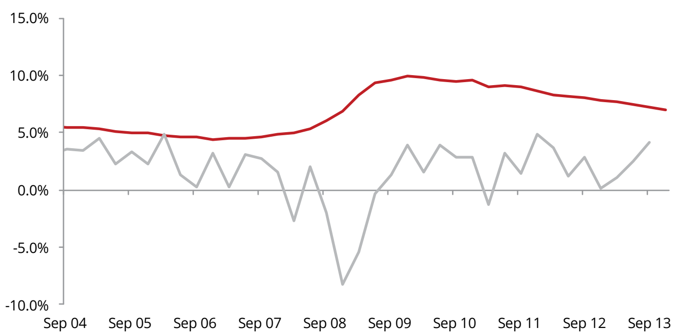
Markets traded sideways ahead of the Federal Reserve's (Fed) meeting on the 17th of December, before staging a strong rally into the year end. Appropriately, given what had gone before for much of the year, December was another month defined by the actions of central banks, and once again the news served to push equity markets higher.

At its monthly meeting, the Federal Reserve (Fed) announced it would start tapering quantitative easing (QE) based on its assessment of the strength of the economic recovery in the US. After several months of speculation, the central bank announced it would scale back its USD 85 billion a month asset purchase programme by USD 10 billion a month, with USD 5 billion coming from both US treasury purchases and mortgage backed securities.

Meanwhile the Bank of England elected to keep policy unchanged - although it has not increased its stock of assets since July 2012 - as did the European Central Bank, with interest rates on hold at a record low of 0.25% following November's surprise cut of a quarter of a percent. Forward looking indicators in much of the Eurozone have improved over the past quarter (the Eurozone Manufacturing Purchasing Managers' Index has now been above 50 for the last six months), although the threat of deflation remains a concern. German Chancellor Angela Merkel was elected to serve for a third term during December, after receiving just over 70% of the vote in the 631-member Bundestag. After failing to gain a majority in September's general election, Merkel's centre-right Christian Democratic Union/Christian Social Union (CDU/CSU) party formed a coalition with the centre-left Social Democratic Party, whose leader Sigmar Gabriel was also appointed to the dual post of Economy Minister and Deputy Chancellor.

The US economy grew at a revised rate of 4.1% in the third quarter, according to the US Commerce Department, marking the fastest pace of growth since 2011. Unemployment has fallen by 0.5% over the quarter to 6.7%, although the Federal Reserve has been keen to play down the significance of the 6.5% target unemployment level introduced in December 2012.

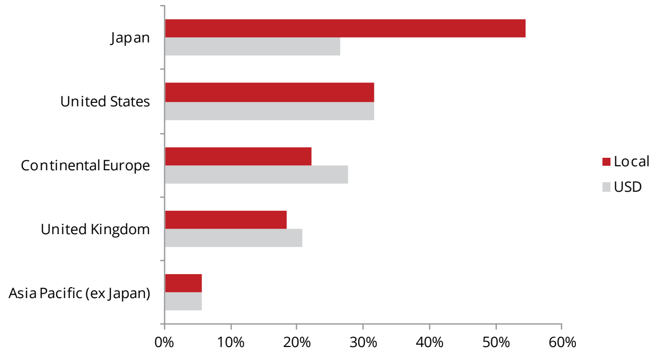
Figure 1: US real GDP and unemployment rate



Negotiations saw the first bipartisan budget deal in four years successfully pass through the US House of Representatives at the start of the month. The budget proposal, after being ratified by the Senate, was approved by President Obama on 26 December, and removes the risk of a further US government shutdown in mid-January. The budget bill, which outlines a two year plan aimed at reducing the country's annual budget deficit by USD 23 billion, sets government spending at USD 1.012 trillion for the current fiscal year.

Global equities returned 2.1% in December, to bring their full year returns to 26.7% - the best year for developed market equities since 2009. Japan was the best performing market in local currency terms, but the Topix index's return of 3.6% over the month in yen terms was trimmed to 1.0% in US dollar terms, after the yen depreciated by a further 2.7% versus the dollar. The US returned 2.5%, the UK 1.6% (GBP) and Continental Europe 0.8% (EUR), whilst Asia Pacific (ex Japan) fell by 1.2%. Global emerging markets on the other hand declined by 1.4% to round off a disappointing year for investors in the asset class.

Figure 2: Performance of major developed market equities in 2013



In fixed income markets, government bonds sold off in response to the prospect of lower demand from central banks, with US Treasuries returning -1.1%, UK gilts -1.3% (GBP) and Japanese government bonds -0.6% (JPY). High yield credit in the US returned 0.5% and 1.9% in Europe (EUR), to round off an impressive year for lower rated debt securities.

Commodities added 1.6% in December, while nonetheless down for the year, and gold fell by a further 3.8% to bring full year returns to -28.0%, the worst year for the precious metal since 1981.

Reflecting on the year as a whole, the big story for investors was the outperformance of leading DM equity markets versus EM equities and safe haven government bonds, both of which suffered negative returns over the year (MSCI World +26.7%; MSCI EM -2.6%; government bonds -4.5%). In general there were had favourable conditions for equities in the past year: monetary policy has been exceptionally loose and accommodating in all the big developed markets, credit conditions have eased especially in the US and the UK

Source: Bloomberg. Returns in US dollars unless otherwise stated. December 2013.

and to a lesser extent in Japan, inflation has been subdued, economies have been sluggish but recovering as the year progressed, and corporate profitability has been very good with profit margins at historically high levels.

Given a continuation of today's steady - albeit relatively slow - economic recovery, the environment for the corporate sector remains good.
However, we do not expect a repeat of 2013's returns in developed markets; equity prices have moved ahead of underlying earnings and although valuations are not yet stretched they are no longer as compelling as they were.

Central banks have dominated the news flow and the direction of markets for some time and this seems set to continue in 2014. In particular the pace of the Fed's tapering will be a major driver behind the markets, as it attempts to create more normal monetary conditions and wean the markets off today's liquidity without stopping the economic recovery before it reaches 'escape velocity'. We have maintained the view for a long time that ultra loose monetary policy will continue well beyond the market's current expectations, and we continue to expect risks to be taken on the side of keeping policy looser for longer, especially as inflation remains subdued.

Source: Bloomberg. Returns in US dollars unless otherwise stated. December 2013.

Market Performance

Asset Class/Region	Index	To 31 December 2013		
		Currency	Month	Year to date
Equities				
UK - All Cap	MSCI UK NR	GBP	1.6%	18.4%
UK - Large Cap	MSCI UK LARGE CAP NR	GBP	1.4%	17.2%
UK - Mid Cap	MSCI UK MID CAP NR	GBP	2.2%	20.9%
UK - Small Cap	MSCI SMALL CAP NR	GBP	3.7%	36.6%
United States	S&P 500 NR	USD	2.5%	31.5%
Continental Europe	MSCI Europe ex UK NR	EUR	0.8%	22.1%
Japan	Topix TR	JPY	3.6%*	54.4%*
Asia Pacific (ex Japan)	MSCI Pacific ex Japan TR	USD	-1.2%	5.6%
Global developed markets	MSCI World NR	GBP	0.9%	24.2%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	-2.7%	-4.5%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	-1.2%	-4.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	-0.5%	-0.6%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	-1.7%	-5.2%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	-1.1%	-6.1%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	-1.8%	0.0%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	-1.7%	-3.0%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	-2.1%	1.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	-1.0%	0.8%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-1.1%	-3.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.2%	-1.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.5%	7.4%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-0.6%	2.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.4%	2.4%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	1.9%	15.0%
Global Government Bonds	JP Morgan Global GBI	GBP	-2.3%	-6.4%
Global Bonds	Citigroup World Broad Investment Grade(WBIG) TR	GBP	-1.8%	-3.9%
Global Convertible Bonds	UBS Global Convertible Bond	GBP	0.2%	15.9%
Emerging Market Bonds	JP Morgan EMBI+	GBP	-1.3%*	-10.1%

** estimate*

Source: Bloomberg

Market Performance

Asset Class/Region	Index	To 31 December 2013		
		Currency	Month	Year to date
Property				
UK Direct Property	UK IPD All Property TR	GBP	3.6%	10.9%
Global Property Securities	S&P Global Property USD TR	GBP	-1.5%	1.7%
Currencies				
Euro		GBP	0.0%	2.3%
US Dollar		GBP	-1.1%	-1.9%
Japanese Yen		GBP	-3.8%	-19.2%
Commodities & Alternatives				
Commodities	RICI TR	GBP	0.4%	-6.4%
Agricultural Commodities	RICI Agriculture TR	GBP	-2.8%	-12.9%
Oil	ICE Crude Oil CR	GBP	-0.8%	-1.1%
Gold	Gold Spot	GBP	-5.0%	-29.4%
Interest Rates			**Current rate**	**Change at meeting**
United Kingdom	5 December 2013	GBP	0.5%	-
United States	18 December 2013	USD	0.3%	-
Eurozone	5 December 2013	EUR	0.3%	-
Japan	20 December 2013	JPY	0.1%	-

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Asset Allocation Dashboard

Positive Neutral Negative

Asset class	View
Equities	
Developed equities	Neutral
UK equities (relative to developed)	Neutral
European equities (relative to developed)	Neutral
US equities (relative to developed)	Negative
Japan equities (relative to developed)	Neutral
Emerging market equities	Positive
Fixed Income	
Government	Negative
Index-linked (relative to government)	Negative
Investment grade (relative to government)	Positive
High yield	Neutral
Loans	Positive
Emerging market debt	Positive
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Hedge funds	Neutral
Property (UK)	Neutral
Currencies	
Dollar	Neutral
Euro	Negative
Yen	Negative
Emerging market currencies	Neutral

Source: Momentum Global Investment Management December 2013

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