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Newsflash

A new month and the 89th issue of Viewpoint from **Financial Partners**.

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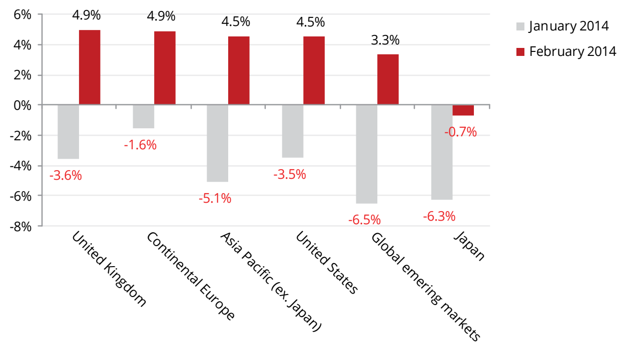
Market Commentary

February was a month in which the majority of the news was subsumed by a rapid and substantial shift in the geopolitical environment - in this instance, the deterioration of the political situation in Ukraine, already the worst political crisis in Europe so far this century.

Until then, markets had recovered well post January's weak start to the year, with a number of major equity markets reaching multi year, and in some cases (notably the US), all time highs. A combination of mixed economic data and dovish comments from new Federal Reserve Chair Janet Yellen pushed expectations for the first rise in US interest rates further out. While the Fed intends to continue with its current plan to taper in measured steps, the central bank also intends to remain extraordinarily accommodative, focusing on broader measures than just the headline unemployment rate to gauge the health of the US labour market.

This, together with greater stability in emerging market currencies that had been hit hard in the preceding twelve months, helped markets to recover. The US, Europe and UK all saw rises of close to 5%, with only Japan failing to participate out of the major markets, down by 0.7% in yen terms. The MSCI World index added 5% over the month, while emerging markets also recovered with gains of 3.3%.

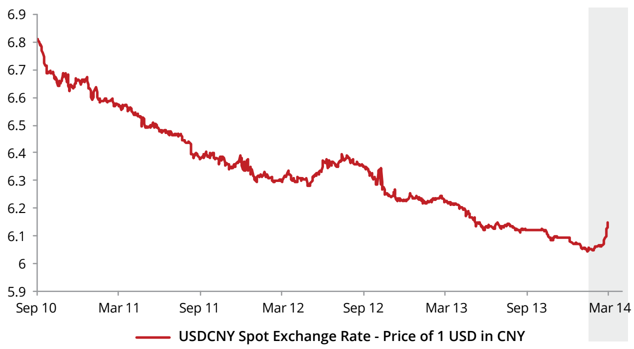
Figure 1: Equity markets recover post January's sell off (returns in local currency terms)



Outside the US the news appeared to support the case for a continuation of today's ultra loose monetary policy. In the euro area inflation remains very subdued, below 1% across the block, and in some countries in negative territory. Although the European Central Bank's view is that inflation is being held back by price adjustments in peripheral states and there is no broader evidence of deflation, it is inconceivable that policy will remain anything other than exceptionally loose for a long time to come. The same applies in Japan where the Bank of Japan is taking measures to ease further in view of some disappointing growth statistics and in anticipation of the 3% sales tax hike in April. Only in the UK, where the economic recovery is steadily gaining traction, is there any prospect of a tightening of monetary policy in the next couple of years, but even there the Bank of England is using forward guidance to ensure market expectations remain well anchored.

Outside developed markets, events in China caused concerns and confusion during the month. In particular, the sudden move by the People's Bank of China (PBOC) to weaken the renminbi led to heightened investor uncertainty and confusion around the reasons for the fall. Although modest in scale - a decline of 1.4% over the month - the fall happened in a period of only a few days and represents the biggest fall in the currency since the devaluation in 1994. The one way climb of the currency since that time has encouraged huge capital inflows and speculative carry trade positions, and it might be the central bank's tactic to discourage these flows by reminding the market that the currency is susceptible to volatility. Whatever the reasons, the fall came in the wake of further disappointing data confirming the slowdown underway in China.

Figure 2: USDCNY spikes upwards during the middle of the month



The factors which drove equity markets higher - namely signs of the continued recovery in the developed world, but at levels that are unlikely to trigger an early tightening of monetary policy - also pushed bond markets higher. Yields on safe haven government bonds declined slightly over the month, while credit performed well.

A key factor in driving the prices of safe haven assets higher in the last few days of the month was the rapid deterioration of the political situation in Ukraine. The overthrow of the President and emergence of a new pro-west interim government, led to an immediate and powerful response from Russia. The military takeover of Crimea was declared necessary by Russia in order to protect the security of the region's near 60% Russian speakers. Russia points to the overthrow of a democratically elected government, a current government which lacks an inclusive and nationwide mandate, lawlessness and nationalist extremists. What it does not mention is the enormous strategic importance of Ukraine, with Russia's Black Sea fleet based in Crimea providing it with one of only two warm water, year-round ports as well as access to oceans otherwise a long way from Russia's Arctic ports. Western leaders have so far talked about pulling out of G8 meetings and other diplomatic moves, but it remains to be seen what impact this will have on Russia.

Source: Bloomberg. Returns in US dollars unless otherwise stated. February 2014.

As at the time of writing, the most likely outcome appears to be a referendum. However, there is considerable uncertainty about the end result of the crisis, even if it seems to us that the risks of this becoming a drawn out political drama between Russia and the west are slim. The immediate impact on markets has been to weaken the ruble (down about 10% so far this year) while Russia's stock market has also fallen sharply, -7% in the first week of March. However there has been no widespread indiscriminate sell off and safe haven assets such as US treasuries and gold have not spiked upwards. Investors are hoping to see a peaceful and diplomatic solution to the problem, and so far appear to have placed a low probability on a major fallout.

If anything we believe that events such as this, which at the margin result in reduced business confidence and the prospect of a negative jolt to growth, will ensure that central banks will be even more cautious about tightening policy. The issue is, however, a timely reminder of the risks of investing in emerging markets. Russia for some time has appeared to be an extremely cheap market; this episode serves to remind investors why a low valuation may at times be appropriate to the level of risk.

Source: Bloomberg. Returns in US dollars unless otherwise stated. February 2014.

Market Performance

Asset Class/Region	Index	To 28 February 2014		
		Currency	Month	Year to date
Equities				
UK - All Cap	MSCI UK NR	GBP	4.9%	1.2%
UK - Large Cap	MSCI UK LARGE CAP NR	GBP	4.7%	0.5%
UK - Mid Cap	MSCI UK MID CAP NR	GBP	6.0%	4.9%
UK - Small Cap	MSCI SMALL CAP NR	GBP	7.6%	6.1%
United States	S&P 500 NR	USD	4.5%	0.9%
Continental Europe	MSCI Europe ex UK NR	EUR	4.9%	3.3%
Japan	Topix TR	JPY	-0.7%	-6.9%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	4.5%	-0.8%
Global developed markets	MSCI World NR	GBP	3.3%	0.1%
Global emerging markets	MSCI EM (Emerging Markets) NR	GBP	1.7%	-4.3%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	GBP	0.1%	2.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	GBP	0.1%	0.5%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	GBP	0.1%	2.4%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	GBP	0.2%	3.3%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	GBP	0.1%	1.6%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	GBP	0.0%	1.7%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	GBP	0.1%	1.9%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	0.3%	2.6%
US Treasuries	JP Morgan United States Government Bond Index TR	USD	0.3%	1.9%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1.0%	2.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	2.0%	2.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.7%	2.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.6%	1.9%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	4.1%	2.5%
Global Government Bonds	JP Morgan Global GBI	GBP	-0.4%	1.9%
Global Bonds	Citigroup World Broad Investment Grade(WBIG) TR	GBP	-0.2%	1.5%
Global Convertible Bonds	UBS Global Focus Convertible Bond	GBP	2.3%	2.8%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	2.1%	1.1%

** estimate*

Source: Bloomberg

Market Performance

Asset Class/Region	Index	To 28 February 2014		
		Currency	Month	Year to date
Property				
UK Direct Property	UK IPD All Property TR	GBP	0.0%*	1.1%*
Global Property Securities	S&P Global Property USD TR	GBP	2.2%	1.9%
Currencies				
Euro		GBP	0.5%	-0.7%
US Dollar		GBP	-1.8%	-1.1%
Japanese Yen		GBP	-1.6%	2.3%
Commodities & Alternatives				
Commodities	RICI TR	GBP	3.7%	3.1%
Agricultural Commodities	RICI Agriculture TR	GBP	5.5%	5.3%
Oil	ICE Crude Oil CR	GBP	-0.9%	-3.3%
Gold	Gold Spot	GBP	4.9%	9.0%
Interest Rates			**Current rate**	**Change at meeting**
United Kingdom	6 February 2014	GBP	0.5%	-
United States	29 January 2014	USD	0.3%	-
Eurozone	6 February 2014	EUR	0.3%	-
Japan		JPY	0.1%	-

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)	Neutral
High yield	Neutral
Loans	Positive
Emerging market debt	Positive
Convertible bonds	Neutral
Alternatives	
Commodities	Neutral
Property (UK)	Neutral
Currencies	
Dollar	Neutral
Euro	Neutral
Yen	Negative
Emerging market currencies	Neutral

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