VIEWPOINT

www.f-p.hk | Vol. 80 | June 2013

Newsflash

A new month and the 80th issue of Viewpoint from FP.

This document will be made available on our website www.f-p.hk

Table of Contents

momentum

easton Asset Management

Market commentary

As May progressed, investors' attention gradually began to shift towards the US Federal Reserve and the possibility that the central bank may reduce the rate of quantitative easing (QE) earlier than originally anticipated. If market moves in the latter part of the month offer any guide to what will happen when the Federal Reserve actually begins to unwind its QE programme investors are set for a challenging period, as volatility spiked upwards, the US dollar appreciated, bond yields rose and some asset classes suffered sharp falls.

Figure 1: Volatility spikes upwards

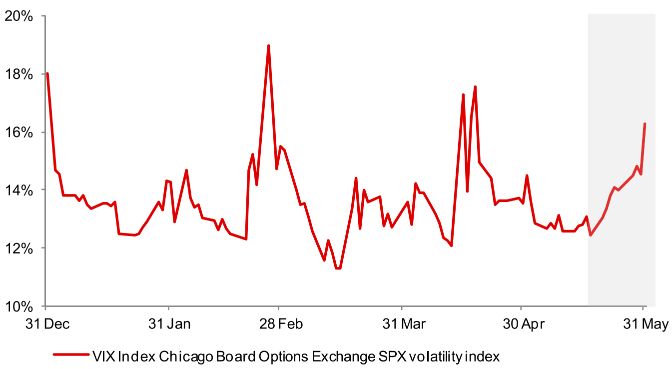


Figure 2: The US dollar appreciates

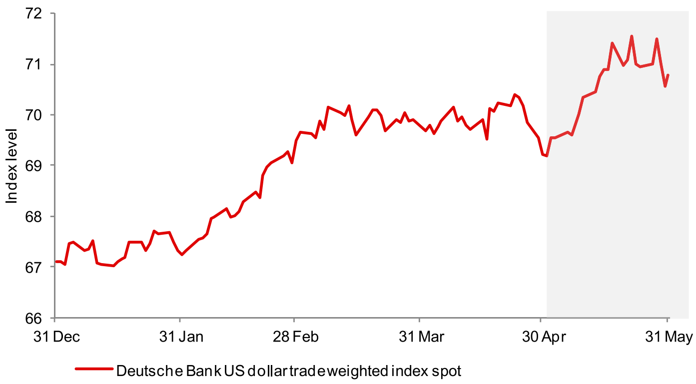


Figure 3: US Treasury yields rise...

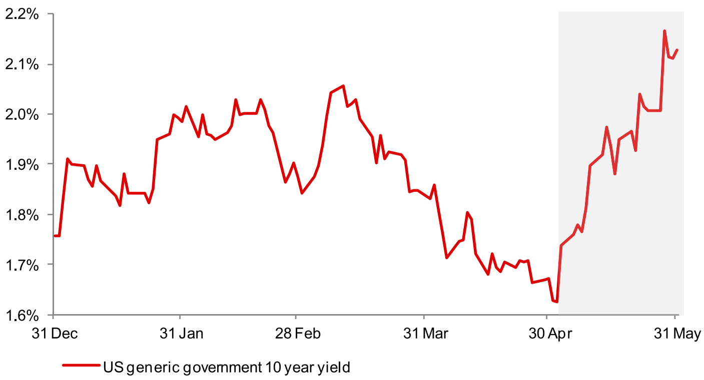
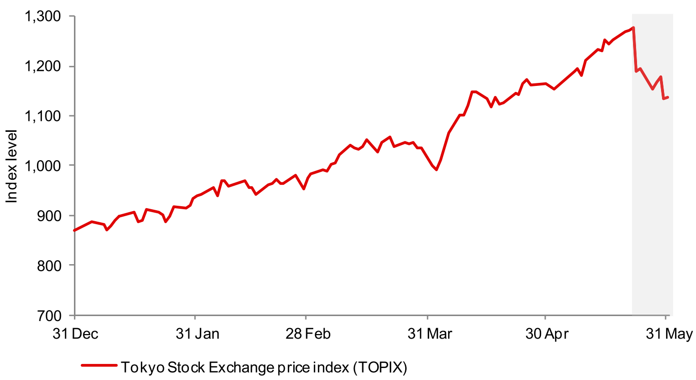


Figure 4: ...and Japanese equities suffer sharp falls



The immediate catalyst for the rise in expectations over QE 'tapering' was the release of the minutes of the FOMC (Federal Open Market Committee) meeting of 30 April, which showed support from several Fed officials for adjusting the rate of asset purchases downwards as early as June, together with a series of data showing the US economy performing ahead of expectations. In particular, the US budget deficit appears to be narrowing quicker than expected, with economic growth pushing up tax revenues alongside cuts to government spending; jobless claims were lower than anticipated at the start of the month; house prices and home sales continue to improve, and consumer confidence is at a five year high. The data was not universally bullish: first quarter economic growth was revised down to 2.4% from 2.5%; manufacturing is a weak area of the economy, and many sectors show a pattern of mixed data month by month which suggests that the recovery remains fragile. Nevertheless investors drew sufficient positives from the numbers to begin to build in expectations of QE tapering.

The impact of this rise in expectations was most clearly seen in bond and currency markets. Yields on 10 year US Treasuries rose by 0.5% to 2.1%, with other government bond markets moving in the same direction. In May, US Treasuries returned -2.0%; inflation indexed securities (TIPS) fared even worse (-4.7%), and global government bonds returned -3.4% as currencies generally weakened against the US dollar.

The yen continued to depreciate, down by a further 3.1% to USDJPY 100.5, but the big falls were in commodity currencies (Australian dollar -7.7%) and emerging market (EM) currencies, with most Latin American currencies down by around 6% over the month. Liquidity fears briefly surfaced in emerging markets, as debt markets saw sharp falls, with the 'hard currency' (debt denominated in foreign currencies such as the US dollar) index down by 4.3% and EM debt denominated in local currencies falling by over 6%. The EM weakness was exacerbated by signs of moderating growth, with disappointing data from manufacturers. China's unofficial manufacturing PMI (Purchasing Managers' Index) fell into contractionary territory and the IMF revised its growth forecast for the country down to 7.8% for 2013 and 2014, from figures over 8% previously. Growth in South Africa and Brazil is currently running at around 2% per annum, yet currency weakness is creating inflationary pressure and in Brazil's case led to a half point (0.5%) increase in interest rates to 8% during May. Towards the end of the month political unrest in Turkey was a reminder of the risks investors face when investing in emerging markets, with bond yields spiking sharply and equities falling by 15% in a week. Only the Chinese renminbi escaped the falls in EM currencies, with a small rise over the

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

month. In equities, global emerging markets fell by 2.6% compared to developed markets which were stable over the month, taking the year to date underperformance of emerging markets versus developed markets to close to 15% (developed markets 11.2%, EM -3.4%).

Credit also came under pressure as sovereign bond yields moved higher. Investment grade credit matched the performance of Treasuries in the US but outperformed sovereign paper in the UK and Europe, whereas high yield, with its income premium over investment grade debt, produced better returns in the US (albeit still in negative territory) of -0.6%. Convertible bonds were helped by the embedded equity option and added 1.2% over the month, taking year to date returns to 7.1%.

Within developed markets there was again a range of outcomes, with the US, the UK and Europe all delivering returns in excess of 2%, whereas Japan finally saw a degree of profit taking by investors, to record falls of 2.5% over the month. Year to date returns for Japanese investors are 33%, although equities in Japan are now down some 14% from their peak, with high attendant volatility. In contrast Asia ex Japan was down by 9%, following weakness in Australia and the Australian dollar. Notably, there was a significant shift away from stocks regarded as dividend income plays during the month, as bond yields backed up: utilities and telecoms sharply underperformed while property stocks were particularly weak, with Global REITS down by 7.7%.

With global growth remaining subdued and the weak trend in China continuing, commodity prices remained under pressure. Oil fell by a further 1.5% (which will help to keep inflation contained) and gold by 6% following its sharp decline in April.
Subdued global growth saw central banks keep faith with extremely loose monetary policy, as the European Central Bank and the Reserve Bank of Australia both cut rates by 0.25% at the start of the month. The Eurozone remains mired in recession with first quarter growth recording its sixth consecutive negative print of -0.2% quarter-on-quarter. There are early signs, however, that conditions may begin to improve as the year progresses. Eurozone PMIs rose to a three month high in May, with Germany revealing some particularly strong industrial production figures. The EU has eased its hard line stance on austerity in the face of growing unease about youth unemployment and general dissatisfaction with EU policies, allowing several countries to extend the time period to reach the 3% budget deficit target in return for labour market reforms. The UK is also experiencing a gradual recovery with most indicators pointing to modest and rising growth as the year progresses: manufacturing PMIs are at a 14 month high and consumer confidence has been improving, while there are signs that the housing market is beginning to recover outside of London and the South East.

In Japan early evidence suggests that the ‘Abe medicine’ may be having a positive effect on the real economy. Industrial production rose by 1.7% in April and Japanese GDP grew by 0.9% during the first quarter (later revised up to 1.0%). Perhaps more importantly the policies are having a big impact on inflation expectations, with 5 year breakeven rates increasing from 0.8% in December to 1.8% now. Similarly, the yield on 10 year Japanese government bonds has doubled from 0.45% to 0.9% since Kuroda made his first policy move in April.

Without question, however, the key development last month and the issue which is likely to have the biggest impact on markets in the medium term is the discussion taking place at the Federal Reserve about reducing the rate of QE. There appears to be growing support from members of the central bank for some tapering sooner rather than later. Chairman Bernanke has consistently emphasised the dangers of premature tightening, and pointed to a gradually reduced flow of asset purchases if the economic outlook and labour market continues to improve in

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

a real and sustainable way. It is important to remember that the Federal Reserve is expected to moderate QE only slowly, and the central bank could equally increase the pace of purchases if economic conditions require it. However, market moves in the past month serve to illustrate the extent to which liquidity has become one of the main factors behind rising market prices. The rise in bond yields, the knock to emerging market bonds and currencies and the equity sector shifts all show the areas which have become especially dependent on central bank 'pump priming' and warn of the dangers to come. At the same time it is important to bear in mind that bond markets have been expensive for a long time and equity markets have needed a pause after the sharp rises of the past nine months. This is especially true in the case of Japan which has enjoyed a frenzied index performance of late. In the short term the Japanese market will be looking for problems or disappointment with the Abe government's programme. However, the determination of the new government to push the country out of its deflationary spiral should not be underestimated. Overall, massive liquidity will continue to underpin markets but ultimately the underlying fundamentals will need to improve to sustain recent trends. We remain positive about the outlook for markets on a medium term view, and with subdued economic activity and falling inflation the long period of ultra loose monetary policy is set to extend even further, but a period of consolidation is now underway.

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

Market performance

Asset Class/Region	Index	Currency	To 31 May2012 Month	Year to date
Developed Markets Equities				
United States	S&P 500 NR	**USD**	2.3%	15.1%
United Kingdom	FTSE All Share TR	**GBP**	2.9%	14.2%
Continental Europe	MSCI Europe ex UK NR	**EUR**	1.9%	10.1%
Japan	Topix TR	**JPY**	-2.5%	33.3%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	**USD**	-9.0%	1.4%
Global	MSCI World NR	**USD**	0.0%	11.2%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-1.7%	-4.9%
Emerging Asia	MSCI EM Asia NR	**USD**	-0.9%	-0.8%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-6.9%	-6.4%
BRICs	MSCI BRIC NR	**USD**	-3.2%	-4.9%
Global Emerging Market	MSCI EM (Emerging Markets) NR	**USD**	-2.6%	-3.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-2.0%	-1.2%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-4.7%	-4.2%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	-2.3%	-0.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-0.6%	4.1%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	-2.6%	-0.8%
UK Corporate (Investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	-1.7%	2.5%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-1.3%	1.6%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	-0.2%	1.8%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	-1.5%	2.5%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	-1.3%	0.6%
Australian Government	JP Morgan Australia GBI TR	**AUD**	-0.6%	1.1%
Global Government Bonds	JP Morgan Global GBI	**USD**	-3.4%	-5.2%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-2.9%	-3.4%
Global Convertible Bonds	UBS Global Convertible Bond	**USD**	1.2%	7.1%
Emerging Market Bonds	JP Morgan EMBI +	**USD**	-4.3%	-4.3%

* estimate

Source: Bloomberg. May 2013.

Market performance

Asset Class/Region	Index	Currency	Month	Year to date
			To 31 May 2013	
Property				
US Property Securities	MSCI US REIT TR	USD	-6.0%	8.0%
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	3.8%	14.4%
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	EUR	0.6%	7.0%
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	AUD	-3.7%	9.5%
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	USD	-12.7%	2.0%
Global Property Securities	FTSE EPRA/NAREIT Developed TR	USD	-7.7%	5.2%
Currencies				
Euro		USD	-1.3%	-1.5%
UK Pound Sterling		USD	-2.2%	-6.5%
Japanese Yen		USD	-3.1%	-13.7%
Australian Dollar		USD	-7.7%	-7.9%
South African Rand		USD	-11.1%	-16.0%
Commodities				
Commodities	RICI TR	USD	-1.7%	-5.0%
Agricultural Commodities	RICI Agriculture TR	USD	-2.1%	-3.9%
Oil	ICE Crude Oil CR	USD	-1.5%	-7.9%
Gold	Gold index	USD	-6.0%	-17.2%
Hedge Funds	HFRX Global Hedge Fund	USD	0.7%	4.6%
Interest Rates			**Current rate**	**Change at meeting**
United States	1 May 2013	USD	0.25%	-
United Kingdom	6 June 2013	GBP	0.50%	-
Eurozone	6 June 2013	EUR	0.75%	-
Japan	11 June 2013	JPY	0.10%	-
Australia	4 June 2013	AUD	3.25%	-
South Africa	23 May 2013	ZAR	5.00%	-

* estimate

Source: Bloomberg. May 2013.

Asset allocation dashboard

🟢 Positive	🟡 Neutral	🔴 Negative

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

Source: Momentum Global Investment Management May 2013

Important Notes

This document is only intended for use by the original recipient, either a Momentum GIM client or prospective client, and does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient. The original recipient is solely responsible for any actions in further distributing this document, and in doing so should be satisfied that there is no breach of local legislation or regulation. This document should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this document is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, Momentum GIM does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at 20 Gracechurch Street, London, EC3V 0BG.

Momentum Global Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom, and is an authorised Financial Services Provider pursuant to the Financial Advisory and Intermediary Services Act 37 of 2002 in South Africa.