VIEWPOINT

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Newsflash

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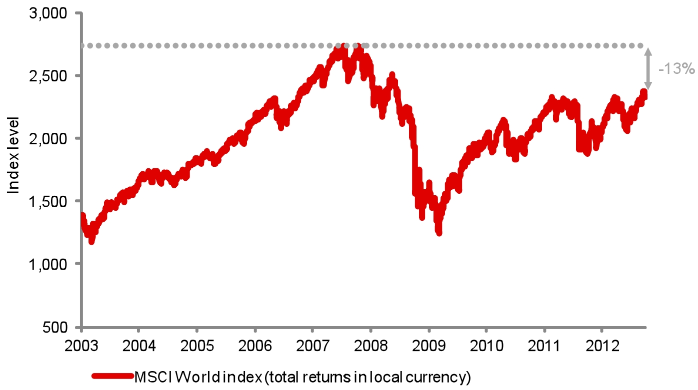
October was a more mixed month for markets, after the excitement created by central bank announcements in September. Last month's modest falls by global equities were perhaps unsurprising, after markets had moved to within 13% of their 2007 highs (in local currency terms) during September, propelled by major commitments from central bankers on both sides of the Atlantic.

Figure 1: Global stock markets move to within 13% of their 2007 highs

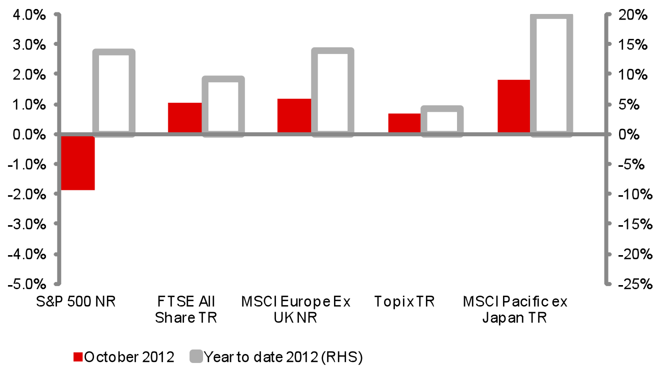


The general undertone remained broadly positive, however, with positive returns from a significant number of regional equity markets and from the majority of credit markets.

The MSCI World index fell by 0.7% during the period, largely due to a 1.9% decline by stocks in the US. All other major markets were up, with Asia ex Japan adding 1.8%, Continental

Europe 1.2%, the UK 1.0% and Japan 0.7% (returns in local currency terms, including reinvested dividends). Emerging markets fell by 0.6%, to leave their year to date returns slightly behind those of developed markets.

Figure 2: Performance of regional equity markets (local currency terms)



In fixed income markets, government bonds produced small negative returns, as yields edged marginally higher, but the impact of this on the broad aggregate index was largely offset by another strong performance from credit and also from peripheral European government bonds. Encouragingly, Spanish and Italian bond yields continued to fall after the initial round of buying that followed the European Central Bank's (ECB) announcements in September, with Spanish government bonds returning 2.5% in October, versus 1.8% for Italian government bonds. The Citigroup World Broad Investment Grade (BIG) index fell by 0.1% over the period, despite strong returns from the credit component of circa 1%. High yield bonds and emerging market bonds also produced good returns, reflecting growing risk appetite amongst investors.

In currency markets, the euro continued to strengthen versus the US dollar (up 0.7%), whilst sterling slipped slightly and the yen fell by 2.7%, following the Japanese authorities' signal that they were ready to act to curb the appreciation of the local currency. Finally, turning to commodities, industrial metals were generally weaker last month (with copper down by over 6%), oil and agricultural commodities fell by around 2%, and precious metals were marked down significantly (gold -3.2%; silver -6.6%).

After the dramatic actions by the ECB and Federal Reserve (Fed) in September, October was a quieter month for markets. That is, until Hurricane Sandy hit the eastern seaboard of the US at the end of the month, causing major disruptions in New York City and the closure of the New York Stock Exchange for two days. Damage from the windstorm is still being calculated, but appears to be in the order of USD 40 billion, with insured losses of around USD 15 billion: whilst sizeable, these estimates fall short of the damage caused by Katrina in 2005, which resulted in insured losses of USD 45 billion. The recovery and reconstruction will start immediately and could have a material impact on fourth quarter GDP in the US, with some estimates of the incremental benefit reaching as high as 0.5%.

The news from the global economy continued to paint a mixed picture last month, with a weak growth environment nonetheless revealing select pockets of improvement. In the US, the latest data from the housing market continued to point towards a more sustained recovery: new home sales rose by 5.7% in September, with housing starts up by 15%. As always, the importance of the housing market to the broader recovery should not be underestimated. The labour market offered another bright spot for the US economy, with initial jobless claims falling by more than expected. Businesses, however, remain extremely cautious in this environment, with surveys pointing to rising fears over the impact of the 'fiscal cliff', the recession in Europe and weaker growth in Asia.

The sluggish state of both the US and the global economy in the past few months has been reflected in corporate results. With most of the earnings for the latest quarter now in, a clear trend has emerged for weaker revenues but relatively strong earnings, driven by companies going to great lengths to control their costs.

The UK reported a notable data surprise last month, with third quarter GDP recovering strongly after the weakness witnessed during the previous three quarters. The 1%

Source: Lipper Hindsight / Bloomberg. Returns in US dollars unless otherwise stated. October 2012.

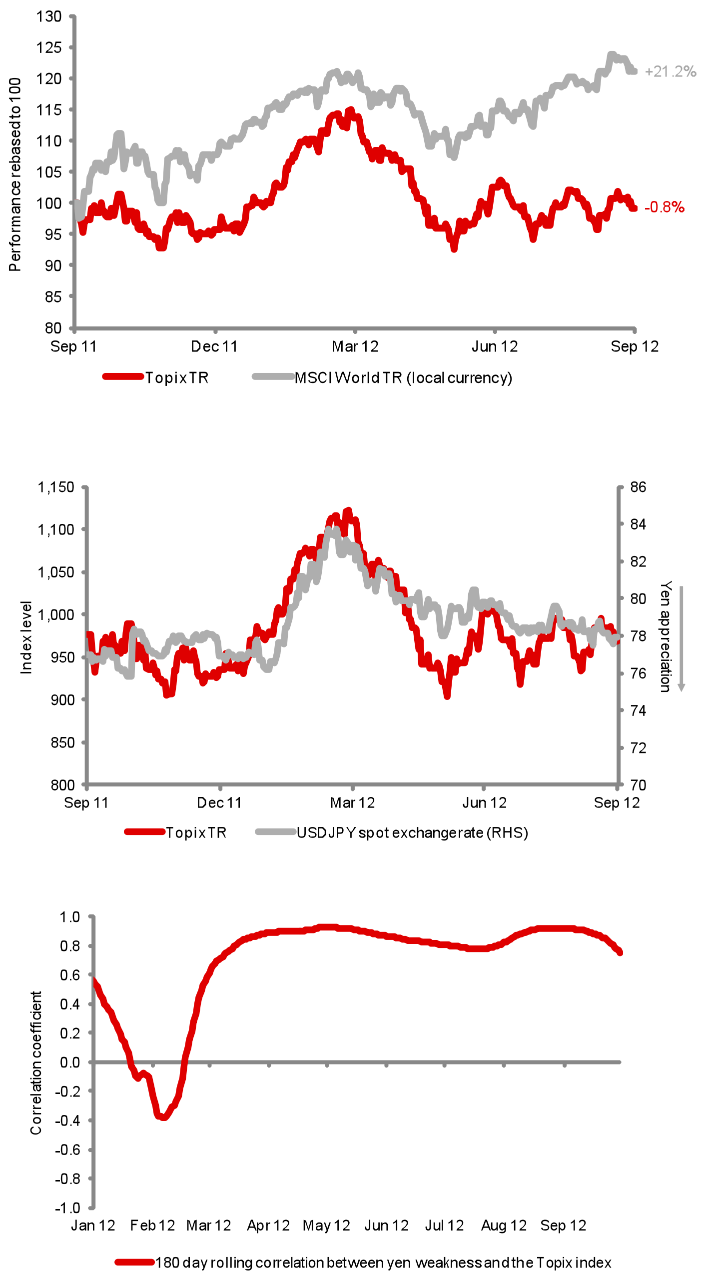
growth in headline output between July and September was exaggerated by spending on the London Olympics, but nonetheless confirms anecdotal evidence of a pickup in activity in the UK economy. Unsurprisingly, in the face of the government's austerity programme and the global slowdown, the economy has essentially flat-lined over the past year, with most forecasters continuing to predict only modest growth for the coming year.

The European economy remains weak, but whilst the periphery appears to be stabilising, it is now the core which is slowing. Spanish third quarter GDP, despite contracting for the fourth successive quarter, was better than expected at -0.3%, whereas purchasing managers' indices in France and Germany both fell below 50 in a sign of a possible recession. In the largest European economy, Germany, business confidence fell for the sixth month in succession during October.

Finally turning to Asia, Japanese industrial production contracted by 4.1% in September (the third consecutive monthly decline) driven by a fall in exports to China. The decline in trade between Asia's two largest economies coincides with the territorial dispute over the Senkaku islands. China itself has experienced a sharp slowdown in growth this year but appears to be stabilising, with the government's official manufacturing PMI moving above 50 in October, to reach a four month high. There has also been some restocking of iron ore by China's largest steel mills, pushing the iron ore price back above USD 120 per tonne, for the first time in three months.

It is no surprise that in these very tough economic conditions central banks remain committed to exceptionally loose monetary policy. This month the Bank of Japan (BoJ) moved to increase its quantitative easing programme, up by JPY 11 trillion to JPY 91 trillion (circa USD 1.2 trillion). Importantly, the BoJ indicated that it will continue to purchase assets until inflation has reached its target rate of 1%. Despite these huge injections of liquidity, the Japanese stock market has been a poor performer over the past 12 months, underperforming other major markets by over 10% in local currency terms. The market is very sensitive to global economic activity as well as the value of the yen; some stabilisation in activity and a further weakening of the yen could well see the Tokyo stock market recover some of the relative ground lost to other markets.

Figure 3: Japanese equities and the yen



One of the strongest stock market sectors so far this year has been real estate, with rises of over 20% in many markets. This has been driven principally by a rerating of the sector by investors, as most underlying property markets remain subdued. Hong Kong is the exception, with loose monetary policy and very low interest rates (effectively set by the Fed given that the Hong Kong dollar is pegged to the US dollar), combined with huge buying from mainland China, pushing property prices up by over 20% this year, to levels which price most locals out of the market. The Hong Kong authorities finally took action to curb speculative activity in the market, by imposing additional taxes on property transactions, notably a 15% purchase tax on non permanent residents. Hong Kong property stocks reacted negatively, but overall the stock market was still up by 4% last month to bring year to date returns to 22%.

On the whole, news was positive for markets during October. Central banks continue to provide liquidity when needed and are committed to providing more if necessary; economies remain sluggish and in some cases in recession but there are signs that conditions may be stabilising after the drop in activity levels earlier this year; corporate earnings have become more mixed with an increase in the number of 'misses' versus analysts' forecasts, but the private sector nonetheless remains in good health. The falls in commodity prices, especially the oil price, over the past two months are encouraging, in so far as they ease cost pressures on companies and the household sector.

After a relatively quiet month for news flow, the start of November heralded a number of big political announcements. Barack Obama was re-elected for a second term as President of the United States at the start of last week. With a total of 332 electoral votes, President Obama ended up claiming a comfortable victory over Republican challenger Mitt Romney. Markets opened down the following day, with the S&P 500 index and the blue-chip Dow Jones Industrial Average both falling by 2.4% – respectively their third worst and worst one day performances of the year. The banking sector bore the brunt of the selling activity by investors, with Morgan Stanley, Bank of America and Goldman Sachs sliding by 8.6%, 7.1% and 6.5% respectively, after hopes of a repeal of the Dodd-Frank Wall Street Reform Act – which will see banks subject to greater prudential oversight from regulators – were dashed.

Over in China, current President Hu Jintao brought the weeklong Communist Party Congress to a close today, ahead of the announcement of the new line-up for the country's executive committee. The new leadership faces very clear challenges: longer term, in the form of a structural slowdown in the economy and a looming demographic problem as the working age population peaks and then begins to shrink; shorter term, to arrest the sharp slowdown in growth this year via additional fiscal stimulus, but importantly without triggering a surge in inflation.

Problems in the Eurozone will remain of key interest for investors. Spain has still not applied for a bailout, which in turn would trigger ECB purchases of its bonds, while Greece continues to negotiate with the Troika for a two year extension to its budget target deadlines. Although there remains plenty of room for policy error and market disruption, the ECB backstop announced by Draghi in September is buying considerable time for countries to stabilise their finances and implement structural reforms.

Markets have rallied very sharply from their mid year lows and have received huge support from central bankers. The uncertainties ahead – namely the US fiscal cliff, the outlook for growth in Asia and the ongoing Eurozone problems – all present significant risks, and have the potential to halt the market's progress. Furthermore, markets have been buoyed by liquidity from central banks, whereas economic activity has not yet responded to the pump priming and remains weak. The liquidity boost to markets cannot continue without ultimately being supported by economic fundamentals.

But it is important to recognise that some key tail risks undermining markets have been removed in the past few months. In particular the risk of a disorderly outcome in the Eurozone has been removed and central banks appear committed to exceptionally loose monetary policy for the foreseeable future. Whilst valuations are not quite as

Source: Lipper Hindsight / Bloomberg. Returns in US dollars unless otherwise stated. October 2012.

attractive as earlier in the year, the longer term trend for equities remains constructive in this environment: valuations are still at reasonable levels and profits are growing in general, albeit at lower rates in the face of the global slowdown. We expect continuing volatility in markets in the months ahead, with periods of risk seeking behaviour punctuated by risk aversion, but overall further upward progress in equity markets is anticipated over the next 12 months.

Source: Lipper Hindsight / Bloomberg. Returns in US dollars unless otherwise stated. October 2012.

Asset Class Performances

Asset Class/Region	Index	Currency	Month	Year to date
		To 31 October 2012		
Developed Markets Equities				
United States	S&P 500 NR	USD	-1.9%	13.7%
United Kingdom	FTSE All Share TR	GBP	1.0%	9.3%
Continental Europe	MSCI Europe ex UK NR	EUR	1.2%	14.0%
Japan	Topix TR	JPY	0.7%	4.2%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	USD	1.8%	19.7%
Global	MSCI World NR	USD	-0.7%	12.3%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	-0.5%	16.2%
Emerging Asia	MSCI EM Asia NR	USD	-0.4%	13.6%
Emerging Latin America	MSCI EM Latin America NR	USD	-0.4%	3.8%
BRICs	MSCI BRIC NR	USD	0.9%	8.4%
Global Emerging Market	MSCI EM (Emerging Markets) NR	USD	-6.0%	11.3%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.2%	16.2%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.0%	7.5%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	1..3%	10.1%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.9%	13.1%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-0.7%	2.3%
UK Corporate (Investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	0.7%	11.7%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.8%	8.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.1%	11.5%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	2.2%	22.2%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	-0.1%	1.8%
Australian Government	JP Morgan Australia GBI TR	AUD	-0.4%	6.0%
Global Government Bonds	JP Morgan Global GBI	USD	-0.7%	2.5%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	-0.1%	4.3%
Global Convertible Bonds	UBS Global Convertible Bond	USD	0.1%	10.1%
Emerging Market Bonds	JP Morgan EMBI +	USD	0.6%	15.0%

Source: Momentum Global Investment Management / Lipper Hindsight. October 2012

			To 31 October 2012	
Asset Class/Region	**Index**	**Currency**	**Month**	**Year to date**
Property				
US Property Securities	MSCI US REIT TR	**USD**	-0.9%	13.0%
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	**GBP**	3.9%	25.2%
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	**EUR**	5.5%	22.8%
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	**AUD**	5.3%	30.9%
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	**USD**	2.0%	35.8%
Global Property Securities	FTSE EPRA/NAREIT Developed TR	**USD**	0.8%	22.7%
Currencies				
Euro		**USD**	0.7%	-0.2%
UK Pound Sterling		**USD**	-0.2%	3.7%
Japanese Yen		**USD**	-2.7%	-3.7%
Australian Dollar		**USD**	-0.3%	1.1%
South African Rand		**USD**	-5.2%	-7.2%
Commodities				
Commodities	RICI TR	**USD**	-4.2%	1.1%
Agricultural Commodities	RICI Agriculture TR	**USD**	-2.0%	5.9%
Oil	ICE Crude Oil CR	**USD**	-1.9%	1.7%
Gold	Gold index	**USD**	-3.2%	12.3%
Hedge Funds	HFRX Global Hedge Fund	**USD**	-0.5%	2.2%
Interest Rates			**Current rate**	**Change at meeting**
United States	24 October 2012	**USD**	0.25%	-
United Kingdom	8 November 2012	**GBP**	0.50%	-
Eurozone	8 November 2012	**EUR**	0.75%	-
Japan	30 October 2012	**JPY**	0.10%	-
Australia	6 November 2012	**AUD**	3.25%	-
South Africa	20 September 2012	**ZAR**	5.00%	-

Source: Momentum Global Investment Management / Lipper Hindsight. October 2012

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