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VIEWPOINT

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Newsflash

A new month and the 72nd issue of Viewpoint from FP.

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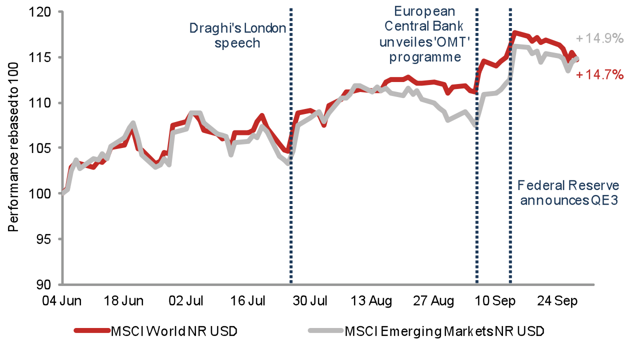
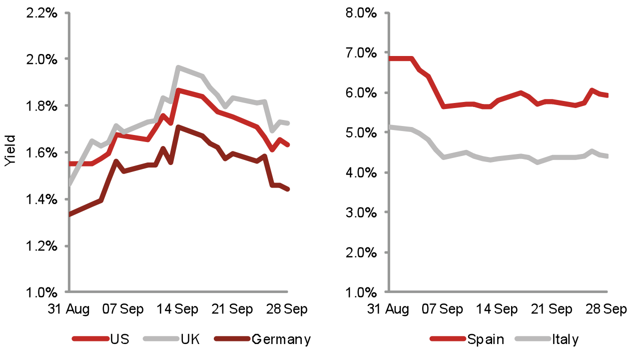
September proved to be another positive month for equities, rounding off a strong third quarter for investors in both developed and emerging market stocks. Markets began to move higher in early June, post April / May's sell off; since then the MSCI World index has added 14.7% to the end of last month.

Figure 1: Performance of developed and emerging market equities post June low



Markets were led by peripheral European stocks last month (Greece up 14%, Portugal 4.5%, Spain 4%), along with bank shares and selected emerging markets (India 8.5%). Emerging markets generally outperformed over the period, with the MSCI Emerging Markets index adding 6% compared to 2.7% for the developed market aggregate, although China again underperformed, gaining 2.1% on the month to lift its third quarter return to -5.5% in renminbi terms. As higher risk/return assets rallied, traditional 'safe haven' government bonds (including US treasuries, UK gilts and German bunds) saw their yields rise – especially in the early part of the month – leading to negative capital returns, whereas peripheral bond markets alternatively enjoyed gains (Spanish 10 year government bonds up 4.4%, Italian 10 year government bonds 4%).

Figure 2: Path of 10 year government bond yields during September



Commodity returns were mixed last month, with oil declining by 1.4% after its strong bounce in August, whilst copper (9%) and gold (7.7%) posted gains. In currency markets, the US dollar depreciated against a broad basket of major traded currencies, with the euro gaining 2.1% over the month. The single currency has now added 7% versus the US dollar since mid July.

The big question on investors' minds going into September was whether central banks could match the market's expectations for new liquidity. After Mario Draghi's end of July, "we will do whatever it takes to preserve the euro", statement – followed by Ben Bernanke's Jackson Hole speech, in which the Federal Reserve Chairman dropped strong hints around further quantitative easing – the concern was that policymakers would fail to deliver on their promises. In the event, not only did both central banks deliver, but the scale of the new measures appeared to exceed expectations, prompting a sharp rally in equities.

The European Central Bank (ECB) was the first to move, announcing in early September that it was prepared to buy the bonds of distressed Eurozone member countries in the secondary market, that it would do so in unlimited quantities and would not sub-ordinate other holders of such bonds, on condition that the affected countries first applied for a bailout from the European Stability Mechanism (the Eurozone bailout fund for countries in financial difficulty).

This was quickly followed by the Federal Reserve (Fed) in mid September, who announced a third round of quantitative easing (QE), this time focussing on the purchase of mortgage backed securities at an initial rate of USD 40 billion per month. At the same time the Fed extended 'Operation Twist' – its programme aimed at increasing the average maturity of treasury assets held on the central bank's balance sheet – to the end of the year, whilst also pushing out its interest rate guidance to mid 2015. This was a key announcement, with the Fed linking its policy decisions to the labour market for the first time, and introducing QE on an open ended basis, whereas in previous rounds a finite limit to the asset purchases has been established at the outset. The Fed indicated that it would continue to ease monetary conditions until such time as there was a clear improvement in the labour market. The central bank also stated that it would consider further measures using whatever policy tools it has at its disposal, should labour market conditions warrant it.

Both the ECB and the Fed's announcements appear to have exceeded expectations, based on the market's reaction to the news. The ECB has effectively put a backstop in place for the euro and distressed Eurozone members, and has bought politicians time to try and solve the underlying fiscal and structural problems. While its asset purchases are to be limited to maturities of between one and three years, and also carry conditionality, the move nonetheless represents a dramatic shift in the central bank's stance. The Fed is providing huge liquidity and has committed to doing more should conditions warrant it, making it clear that it will maintain a highly accommodative policy until there is sustained improvement in the economy.

These huge injections of liquidity, with the pledge of more to come if needed, have provided significant support for asset prices in the past few weeks. However, the real economy has shown few signs of improvement, with the Eurozone in

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

a mild recession (whilst peripheral members suffer a serious recession), Japan stagnating, the UK flat to mildly positive and the US growing at an annualised rate of around 1.5%. Furthermore, China remains a concern for investors. The economy has slowed substantially this year, and shows no signs of a recovery yet. Weakening Chinese demand has been the key factor behind the falls in industrial commodity prices this year, although it was notable that the copper price rallied by over 8% in September. Beijing has greater policy flexibility than most other countries, although major initiatives are unlikely to come ahead of the leadership change later this year.

It was encouraging to see the oil price slip back slightly in September after its sharp rise the previous month. Fears over supply shortages arising from the sanctions on imports from Iran were alleviated by Saudi Arabia's offer of increased supplies and high levels of both production and inventory in the US, as well as relatively weak demand due to the global slowdown.

Markets have now rallied very sharply from their mid year lows. Valuations are less compelling as a result. Furthermore, the markets have been buoyed by liquidity from central banks whereas economic activity will only respond to the pump priming with a lag. The liquidity boost to markets cannot continue without ultimately being supported by improved economic fundamentals. While the news in September was almost entirely positive, and above expectations, risks still remain. The key issue in Europe is whether and when Spain will ask for a bailout, enabling the ECB to buy its bonds through its Outright Monetary Transactions (OMT) programme. The Spanish government is stalling over the decision at present, reluctant to request a bailout due to the political ramifications; some form of assistance still appears likely in the near term, however, given the dire state of the banking industry, the economy and debt levels in both the public and private sectors. In the US, there is the presidential election in November and the 'fiscal cliff'. Whilst automatic tax increases and spending cuts are unlikely to come into effect in their current form, political horse-trading towards the end of the year runs the risk of unnerving markets. As a result of these issues, some consolidation in markets should not be ruled out.

A number of key tail risks undermining markets have been removed in the past month, in particular the risk of a disorderly outcome in the Eurozone. Exceptionally loose monetary policy from major central banks around the world is expected to continue for the foreseeable future. This provides a strong underpinning to markets. While valuations are not quite as attractive as earlier in the year, the longer term trend for equities remains constructive; 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 underpinning equity markets are attractive and in some cases compelling valuations.

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

Asset Class Performances

Asset Class/Region	Index	Currency	Month (To 28 September 2012)	Year to date (To 28 September 2012)
Developed Markets Equities				
United States	S&P 500 NR	USD	2.5%	15.9%
United Kingdom	FTSE All Share TR	GBP	1.1%	8.2%
Continental Europe	MSCI Europe ex UK NR	EUR	1.2%	12.7%
Japan	Topix TR	JPY	1.8%	3.5%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	USD	3.9%	17.6%
Global	MSCI World NR	USD	2.7%	13.0%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	4.7%	16.8%
Emerging Asia	MSCI EM Asia NR	USD	7.3%	14.1%
Emerging Latin America	MSCI EM Latin America NR	USD	3.9%	4.2%
BRICs	MSCI BRIC NR	USD	6.5%	7.4%
Global Emerging Market	MSCI EM (Emerging Markets) NR	USD	6.0%	12.0%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.4%	2.3%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	0.5%	6.5%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.7%	8.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.4%	12.1%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	-0.7%	3.0%
UK Corporate (Investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	0.8%	10.9%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	1.3%	7.4%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	0.8%	10.9%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	2.3%	19.6%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.3%	1.9%
Australian Government	JP Morgan Australia GBI TR	AUD	0.6%	6.4%
Global Government Bonds	JP Morgan Global GBI	USD	1.0%	3.2%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.2%	4.4%
Global Convertible Bonds	UBS Global Convertible Bond	USD	1.9%	10.1%
Emerging Market Bonds	JP Morgan EMBI +	USD	1.4%	14.3%

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

Asset Class/Region	Index	Currency	Month	Year to date
		To 28 September 2012		
Property				
US Property Securities	MSCI US REIT TR	**USD**	-2.0%	14.0%
UK Property Securities	FTSE EPRA/NAREIT United Kingdom TR	**GBP**	-0.9%	20.5%
Europe ex UK Property Securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	**EUR**	-0.2%	16.3%
Australian Property Securities	FTSE EPRA/NAREIT Australia TR	**AUD**	1.1%	24.4%
Asia Property Securities	FTSE EPRA/NAREIT Developed Asia TR	**USD**	6.7%	33.2%
Global Property Securities	FTSE EPRA/NAREIT Developed TR	**USD**	1.6%	21.6%
Currencies				
Euro		**USD**	2.1%	-0.9%
UK Pound Sterling		**USD**	1.7%	3.9%
Japanese Yen		**USD**	0.6%	-1.1%
Australian Dollar		**USD**	0.6%	1.4%
South African Rand		**USD**	2.1%	-2.2%
Commodities				
Commodities	RICI TR	**USD**	0.4%	5.5%
Agricultural Commodities	RICI Agriculture TR	**USD**	-2.7%	8.0%
Oil	ICE Crude Oil CR	**USD**	-1.4%	3.6%
Gold	Gold index	**USD**	7.7%	16.0%
Hedge Funds	HFRX Global Hedge Fund	**USD**	0.4%	2.7%
Interest Rates			**Current rate**	**Change at meeting**
United States	13 September 2012	**USD**	0.25%	-
United Kingdom	4 October 2012	**GBP**	0.50%	-
Eurozone	4 October 2012	**EUR**	0.75%	-
Japan	4 October 2012	**JPY**	0.10%	-
Australia	2 October 2012	**AUD**	3.25%	-0.25%
South Africa	20 September 2012	**ZAR**	5.00%	-0.50%

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

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