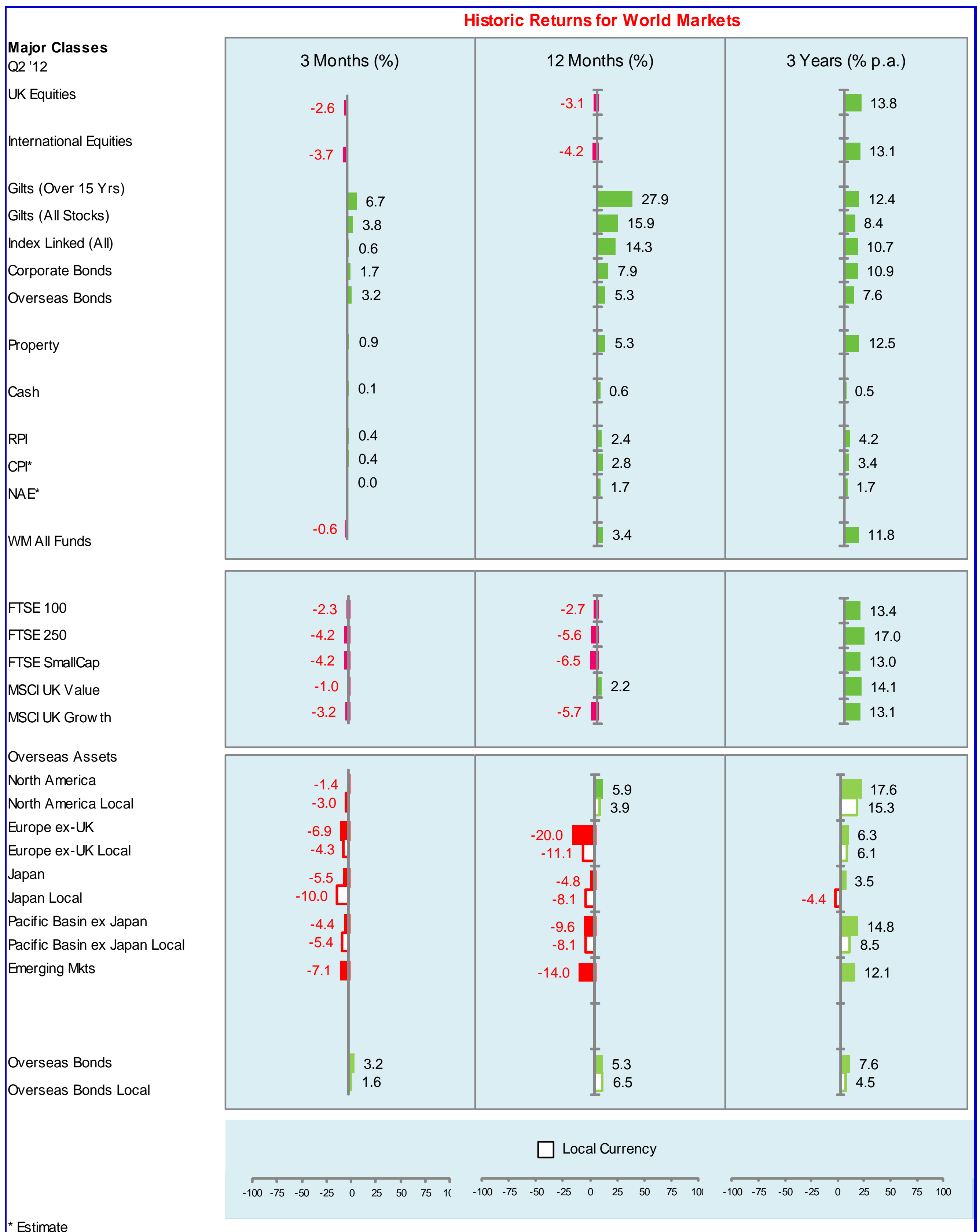
# Market conditions – second quarter of 2012



# Q2 commentary

An intriguing mix of political, economic and financial factors contributed to a sense of crisis throughout the quarter. Political uncertainty in Greece, and the burden of debt in certain European nations (particularly Spain and Greece), threatened the viability of the Euro which, not for the first time, seemed close to 'collapse'. The newly elected President of France challenged the established consensus on how to deal with difficulties in the Eurozone, by promoting a switch in emphasis from austerity to growth.

The deteriorating global economic backdrop offered little solace to investors, with the UK, and much of Europe, falling into recession, mixed data in the US and reduced activity in China. Nevertheless, the difficulties of the Eurozone were widely cited as the greatest threat to global economic activity.

In the UK, the Bank of England cut its economic growth forecast for 2012, from 1.2% to 0.8%. This compares with an average of 0.3% made by 'independent' forecasters and just 0.1% by the British Chambers of Commerce. In June, the Chancellor of the Exchequer announced a £100bn support programme for the economy, with a 'funding for lending' scheme at its core. The Governor of the Bank of England hinted that short-term interest rates might be cut to zero, in order to stimulate the economy.

Key events during the quarter:

### Global Economy

- EU agreed €100bn 'bailout' facility for Spanish banks.
- Ratings agencies cut credit ratings of UK, European and US banks.
- Short-term interest rates were unchanged in the UK, US and Eurozone.
- China cut key interest rate on concerns over prospects for economic growth.
- France, Germany, Italy and Spain agreed €130bn economic growth package.

### Equities

- Equities were highly volatile, reflecting the ebb and flow of economic and financial news.
- The strongest sectors relative to 'All World' Index were defensives – Telecoms (+8.4%) and Health Care (+7.3%); the weakest were cyclical – Basic Materials (-6.3%) and Oil & Gas (-3.7%).

### Bonds

- Yields on UK, German and US government bonds reached record lows in early June on continued flight to safety.
- Borrowing costs for Spain and Italy rose to levels not sustainable in the long term.

The bailout of Spanish banks and other 'rescue' packages have dealt effectively with the immediate crisis in the Eurozone. The longer-term outlook remains uncertain. Much depends on the recently agreed EU fiscal treaty and proposed Europe-wide banking supervision.

# Market Conditions

## General

The market operated in "risk-off" basis over the second quarter of 2012. All equity markets suffered negative returns, even allowing for the sharp rallies which occurred on 29 June, following the late night deal agreed by EU leaders to help Spain and Italy survive the Eurozone crisis. Equity markets remain in positive territory year to date but most markets are in negative territory over 12 months. As might be expected, bond markets performed well over Q2, with long-dated safe haven government bonds the best performers.

## Equities

In sterling terms, global equities returned -3.6% over Q2 (as measured by the FTSE All-Countries World index). The weakest market in local currency terms was Japan (-10%), with Emerging Markets returning -7%. Europe (ex UK) equities returned -4.3% and North American equities returned -3% in local currency terms; the FTSE All-Share returned -2.6%. Over the quarter, the Yen strengthened against sterling by 4.5%, the US$ strengthened by 1.6%, while the euro weakened by 2.5%. Over the 12 months ending 30 June 2012, North American equities returned almost 6% in sterling terms. UK equities delivered -3.1%. Other regional equity markets delivered sharply negative returns; Europe ex UK returned -20% in sterling terms and Emerging Markets returned -14%.

Over Q2, the strongest relative return came from Telecoms (+8.3%) particularly fixed line suppliers, followed by Healthcare (+7.3%) particularly pharmaceutical companies. The weakest relative returns came from Basic Materials (-6.3%) and Oil & Gas (-3.7%), both falls resulting from weakening commodity prices. The Technology sector was also weak (-3.6% relative). Growth stocks underperformed value stocks by approximately 0.5% over the quarter; over 12 months to end June, growth stocks outperformed value stocks by approximately 2%.

## UK equities

Large cap stocks (FTSE 100) returned -2.3%, outperforming the FTSE 250 (mid cap stocks) and Small Cap which both returned -4.2%. Over the 12 months ending 30 June 2012, the FTSE 100 returned -2.7% with FTSE 250 returning -5.6% and Small Cap returning -6.5%. Value stocks outperformed growth stocks by almost 6% over the 12 months to end June. Materials (-9.9%) and Oil & Gas (-2.1%) reflected international equity sector returns, resulting from weakening commodity prices. Technology (-3.5%) and Financials (-2.5%) were also weak. The strongest sectors were Utilities (+10.9%) and Telecommunications (+9%), essentially Mobile.

Three of the ten best performing stocks in the FTSE 100 over Q2 were Utilities (United Utilities +19%, Severn Trent +17% and National Grid +14.3%). The ten weakest FTSE 100 stocks included Barclays (-28.6%) and Royal Bank of Scotland (-20%) and four Mining stocks (ENRC -28%, Vedanta – 23.7%, Xstrata -22.1% and Kazakhmys -17.2%).

## Bonds

In a quarter that was kind to secure assets, the performance of fixed interest bonds reflected their risk grading. The strongest performance came from long-dated gilts (+6.7%); the All-Stocks Gilts index returned 3.8%. Investment grade corporate bonds returned 1.7% in aggregate, with AA-rated credit returning 3.5%, A-rated returning 2.4% and BBB-rated credit returning 0.2%. Index-linked gilt stocks were quite subdued returning 0.7%, as inflation eased off considerably.

## Property

The IPD Monthly index return for April was +0.2 % and for May was virtually flat. There is no data yet available for Q2. It is likely, however, that the net return from All Balanced pooled funds will be modestly negative (i.e. after taking account of management fees).

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**Risk Warning**

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.