MARKET BULLETIN

ST. JAMES'S PLACE WEALTH MANAGEMENT

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Forward momentum regained

- US economic data disappoints but corporate earnings and central banks' actions boost markets.
- Gold's status as a safe-haven continues to be tested.

Although it ended poorly, the week as a whole was a positive one for equity markets. US and European stocks pulled back after growth concerns in Asia, countering excellent corporate earnings and continued central bank actions. A weaker-than-expected performance from the US economy also contributed to the downbeat mood. This set of data was just the latest economic disappointment, suggesting that the world's largest economy looks to be slowing. Another report showed that US consumer confidence fell in April, although the overall impact was muted. Despite this newsflow, the FTSE 100 closed the week with a gain of over 2%, while Europe and Asia finished ahead more than 3% apiece. In the US market the S&P 500, one of the year's best performers, reached within 8 points of its record high of 1,593 before falling back.

Well-received corporate earnings provided the boost for markets, with companies tending to exceed estimates. The asset purchase programmes of the Bank of Japan and the Federal Reserve continued to comfort investors, although in Europe, Germany was highly critical of proposed action by the European Central Bank. Generally, this is the type of monetary policy that brings out the 'goldbugs', who had a good week. After hitting its two-year low on April 16, the precious metal has risen more than 10%, reaching $1,472 per troy ounce. Whilst good news for those who held gold on the way down, it is hardly the level of volatility expected from a safe-haven; the price is almost 25% down since the summer of 2011.

The belief that gold is a safe-haven is being severely tested on a daily basis. Given the nature of the modern world where trading can be done through a variety of Exchange Traded Funds, *The Daily Telegraph* speculated that the increase in trading opportunity is the reason for greater volatility over the last ten years. With positions being able to be quickly unwound, and the opportunity for automated sales, this causes more marked movements than ever before.

The aforementioned slowdown in the US economic recovery pushed markets slightly downwards on Friday, but had a greater impact on the dollar. Expectations were for annual growth of 3% in the first three months of the year, but the rebound was just 2.5%, significantly lower than anticipated but still the biggest expansion in GDP since 2010. The US figures are calculated over a twelve-month period, unlike the UK which splits out each three-month period. First-quarter growth was driven by a rapid increase in consumer spending, accounting for more than 70% of economic activity, despite a recent 2% tax rise and a significant rise in petrol prices.

Funding for Lending Scheme

- The government's Funding for Lending Scheme extended to 2015.
- The Bank of England also announces that lenders can use the funding for buy-to-let investors.
- Savings rates continue to feel the pressure.

On Wednesday, the Bank of England announced a package of reforms that will see the Funding for Lending Scheme run until 2015, as well as increasing the number of initiatives available to banks to lend to small businesses. The scheme, which offers lenders cheaper funding than available in financial markets in return for increasing lending to households and companies, has already helped lower mortgage rates since its launch in August. The average five-year fixed-rate repayment loan has fallen to 3.97% from 4.73% last summer. In addition, the number of mortgage products available across different loan-to-value bands has increased in recent months, with around 560 deals available for those with a 20% deposit, for example. However, the scheme has come in for criticism after it also brought down the costs of borrowing for buy-to-let landlords, with the average variable rate down to 4.28% from 5.09% (source: Moneyfacts). Some experts have been increasingly vocal in their view that the Bank of England's new focus on encouraging lending to small businesses may actually see banks lend less to individual homeowners.

In a step openly criticised as a measure to manipulate the property market upwards, the Bank of England gave the go-ahead last week for banks to be allowed to lend to property investors. Buy-to-let lending rose 19% last year, and the number of buy-to-let mortgages is at its highest level in four years. While most of the government's initiatives have targeted owner-occupiers, this scheme is the first that has not specifically excluded property investors.

The losers in this situation once again are cash savers. Savings rates have plummeted to all-time lows since the launch of the scheme, further eroding income once inflation is taken into account. For example, the average two-year fixed-rate bond has fallen from 3.29% in August to 2.07% today. Interest rates for instant access accounts have dropped from 1.09% to 0.76% in the same period (source: Moneyfacts). It certainly seems that many lenders no longer need savers to balance their books.

Provisional GDP figures

- GDP figures for the UK surprise on the upside, avoiding a triple-dip recession.
- Nick Purves of RWC Partners comments on the economy and the outlook for the UK market.

By posting a better-than-expected 0.3% quarterly expansion in the first quarter of 2013, the UK has comfortably avoided a triple-dip recession, reversing a similar-sized fall for the previous quarter. The overall picture is still one of relative stagnation but on the bright side, the economy is tentatively moving in the right direction. The rise in GDP will undoubtedly have been a relief to the Chancellor, George Osborne, and although the debate on the triple-dip was fairly meaningless from an economic point of view, the rise was 0.1% better than expected by analysts. The growth was driven by the consumer services and transport sectors, while industrial production also edged upwards. It should be noted that this figure could yet be revised, but this could be upwards or downwards – for example, the double-dip was revised to be much shallower than originally announced. Of course, in the grand scheme of things, a 0.3% expansion would usually be considering tiny, but perhaps this is an indication of how low expectations have fallen for the UK.

Looking ahead, we would imagine that George Osborne will continue to use the data to demonstrate that the austerity plans are correct despite recent criticism from the International Monetary Fund and suggests that there will be no further Quantitative Easing for the time being, especially given that the Funding for Lending Scheme has been extended and Mark Carney does not take over the governorship of the Bank of England until later in the year.

Despite the struggles of the UK economy, equities have had an excellent run and it is not as easy for some managers to find value opportunities as it was two years ago. Nick Purves of RWC Partners, recently gave his views. "In the year to date, the UK economy has shown signs of stress. The Manufacturing Purchasing Managers Index repeatedly comes in well below expectations, and industrial production numbers have generally been negative. On a positive note, house prices have increased and a weaker pound has been helping

UK exporting companies. The majority of corporate news flow around the world continues to be negatively biased though. Major downgrades over the month included the US delivery company, FedEx, where earnings for the previous quarter were down 31%. The stock is often seen as a bellwether for global economic activity. The stock dropped 10% on the news. Caterpillar, the biggest maker of construction and mining equipment, saw its share price drop on the news that sales were falling quicker than previously reported, particularly into the Asia-Pacific region where sales declined 26% from the same period a year earlier.

There continues to be much debate around market valuation. The historic price earnings ratio on the market is around 15x and the dividend yield is 3.3%. In our opinion, there are some areas of the market that are still attractively priced, but such areas are not numerous anymore.

Our best performers have been at the more defensive end of the market. The most significant contributors include AstraZeneca, Vodafone and Reed Elsevier. We have also benefited lately due to lack of exposure to banks and mining. Sir Mervyn King, Bank of England governor, has expressed his concerns that UK banks have capital shortfalls, with RBS and Lloyds the two main offenders. The mining sector has suffered from downgrades as brokers such as Goldman Sachs cut their iron-ore price forecasts for this year due to expectations that demand will moderate and steel production in China will slow.

Overall, with valuations where they are today we continue to believe that it is right to adopt a more cautious investment stance".

Nick Purves also manages funds for St. James's Place.