

Monthly Update

June 2011

Markets Overview

World Markets

Cash

Sterling:

The Bank of England's Monetary Policy Committee (MPC) voted on 9 June to maintain the official rate at 0.50%. The MPC also voted to maintain the stock of asset purchases financed by the issuance of central bank reserves at £200 billion. Chances of a rise in 2011 ebbed away after the publication of the minutes from that meeting and subsequent downbeat news on the British economy with further quantitative easing now seen as a possibility. Andrew Sentence, who had called for rate rises since the summer of 2010 – and for 50 basis points rises for most of 2011 – was replaced by former Goldman Sachs economist Ben Broadbent in June. Initially, Broadbent was expected to call for a rise but disappointed savers with a 'hold' vote, which resulted in a 7-2 favour of a hold versus a rise – it had been a 6-3 vote from February through to May. Interest rate futures point to a rise in September or October 2012 but just three months ago had suggested that a rise was imminent. A poll of analysts by Reuters showed 55% expect a rise by the end of the year - a few weeks ago the figure was 70%.

US Dollar:

Speaking at the International Monetary Conference in Atlanta, Ben Bernanke gave a relatively downbeat assessment of the economy, acknowledging recent weak economic data and reaffirming the Federal Reserve's commitment to accommodative policy. Mr Bernanke kept the door open on additional quantitative easing when he stated that the US economy "is still producing at levels well below its potential; consequently, accommodative monetary policies are still needed. Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established." If the current recovery is not considered to be "truly established" there stands a heightened prospect of further accommodative policy actions. This should be read as longer-term dollar bearish and, potentially, commodity price bullish. A further downside risk to the dollar is the European Central Bank (ECB) rate hikes during a period where the Fed remains accommodative. In this case euro would strengthen, as would a number of other currencies.

Bonds

Sterling:

Bond markets in June were dominated by the Greek crisis. Core government bonds were, for much of the month, supported by the risk aversion related to the crisis and by further signs of slowing economic growth. However, later in the month, a sharp sell off resulted in negative returns. Yields on 10-year UK gilts were eight basis points higher at 3.57% while, in a market weary of taking risks, corporate debt underperformed core government bonds with the sterling investment grade corporate market falling 1.3% in the month with the spread over gilts rising 18 basis points. There were particular concerns about the level of Greek exposure of some banks and bank debt gave back some of last year's gains.

US Dollar:

Yields on 10-year US Treasuries were up 10 basis points to 3.16% in June and the investment grade credit market returned -0.73%. Investment grade credit spreads widened by five basis points and yields rose 0.14% to 3.65%, as represented by the Barclay's U.S. Credit Index. High grade bonds encountered a rather volatile month in June as political and economical uncertainty in both the US and Europe continued to weigh on investor risk appetite. The technicals for investment grade credit remain strong, however, as profitability continues to return to the sector despite rather tepid economic growth in the quarter. Amid evolving global economic concerns stemming from Greece and deteriorating economic data, the high yield bond market posted a negative return in June, the first in seven months. Spreads widened over the month as speculative grade yields rose and government rates declined. The Merrill Lynch Global High Yield Constrained Index was down 1.09%, underperforming high grade corporates.

Property (Sterling and US dollar):

After several months of strong relative and absolute performance, real estate stocks fell back slightly in June, with the EPRA Index down by 2% over the month. In the US, mounting foreclosures continue to depress house prices, and many would-be buyers appear to be holding back from purchasing as they anticipate a further drop in house prices. Overall demand for houses also remains soft as mortgage conditions remain tight, and unemployment levels remain elevated.

Index	Price	Up/Down on month
FTSE 100	5,945.71	↓
DJ Ind. Average	12,414.34	↓
S&P Comp	1,320.64	↓
NASDAQ	2,325.07	↓
Nikkei	9,816.09	↑
£/\$	1.6053	↓
€/£	0.9034	↑
€/\$	1.4502	↑
£Base Rate	0.50%	↔
Brent Crude	112.48	↓
Gold	1,500.35	↓

Prices quoted as at 30/06/11

Source: Bloomberg

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Equities (Sterling and US dollar):

Markets sold off going into June, however, they rallied on both technical and fundamental factors in the last four trading days of the month. Developed market equities, as represented by the MSCI World Index, fell 1.55% in the full month with emerging market equities down about the same number. This negative first part of the month was a result of a further softening of economic data, especially out of the US, running in tandem with the deteriorating position in Greece. Preliminary estimates suggest the US economy grew at a sub par 2% during the first half of the year. According to BCA Research, given the depth of the recession, if this was a normal recovery, growth should have averaged 6% over the last two years. In fact, it has averaged only half of this. BCA go on to say, since 1960, each time year-on-year GDP growth has fallen below 2%, a recession has followed. Growth is estimated to fall to 2.4% year-on-year in quarter two of 2011 – not far away from this 2% threshold.

Alternative Investments (Sterling and US dollar):

Hedge Funds:

Hedge funds were generally down during the month of June with the HFRX Global Hedge Index posting -1.59%. The major detractors from performance were within the HFRX Equity Hedge Index, which followed the equity markets downwards, and the HFRX Macro Index which followed suit with most asset classes in the month. Hedge fund managers who maintained market neutrality or were allocated to real estate or maintained a short bias managed to outperform the broader index. Investors continued to allocate new capital to hedge funds through, and despite, the volatile performance environment in quarter two, as new allocations to the hedge fund industry totalled nearly \$30 billion.

Commodities:

The Dow Jones-UBS Commodity Index was down 6.62% for the month of June as weaker US economic data and Eurozone uncertainty over Greek austerity measures loomed. A decision on 23 June by the International Energy Agency (IEA) to release up to 60 million barrels, or two million barrels a day for a month, prompted Brent crude oil to tumble by more than \$7 a barrel, or 6%, to a seven-week low of \$105.7. The announcement added to the downward momentum already caused by a strong dollar and weak equity markets. In June, we saw the continuation of the divergence between gold spot and gold equities. Year-to-date the gold price has risen by more than 6% to above \$1,500 an ounce, while the NYSE Gold Bugs Index has fallen by more than 9%. The difference in performance in June alone was greater than 3%.

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