

Monthly Update

August 2011

Markets Overview

World Markets

Cash

Sterling:

Members of the Monetary Policy Committee voted unanimously to keep interest rates at 0.5% for a further month in August. Additionally, there was no change to the Asset Purchase Programme. These decisions have been repeated, once more, in September making it the 30th consecutive month that rates have remained on hold. The Bank of England warned that headwinds to the UK economy are 'growing stronger by the day' and it cut its growth forecast for 2011 from 1.8% to 1.5%. Consumer confidence waned further and retail sales growth grew at an anaemic 0.2% in July. To further exacerbate policymakers, the Consumer Price Index, rose in August to 4.5%, and the Retail Price Index increased to 5.2% in August from 5.0% in July.

US dollar:

Cash markets were dominated by the news from the Federal Open Market Committee that it would keep interest rates at 'exceptionally low' levels until at least the middle of 2013. A raft of poor economic data surrounding the labour market, housing and output prompted this action from the Fed and Ben Bernanke remains open to further policy action should data deteriorate further. Latest figures reveal 25 million Americans are looking for full-time employment, and for those in work, the progressive reduction in living standards was confirmed with last year being the third successive year in which household inflation-adjusted income fell. The typical full-time male worker, adjusted for inflation, now earns no more than he did in the early 1970s.

Bonds

During the month, German bunds and US Treasuries confirmed their 'safe haven' status while credit spreads widened. By sector, financials were the worst performing - subordinated financials were particularly weak, because of ongoing concerns over sovereign debt risk issues. Global bond market volatility intensified in August and markets continued to be dominated by investor risk aversion. More than in July, investors fretted about signs of economic slowdown in the US and Europe and on the financial problems of the 'peripheral' euro area countries and policy makers' inability to address them. Over the month as a whole, 'core' government bonds performed well while most classes of credit lagged (many significantly). At month-end, the UK 10-year gilt yield was down 26 basis points (bps) to 2.6%. In the US, the 10-year Treasury ended down 57bps at 2.22% while the two year ended at just 0.2%. The German 10-year bund yield closed at 2.22%, down 32bps. Corporate bonds, which also have interest rate sensitivity, benefitted from the core government rally but this was outweighed by falling appetite for credit risk. According to data from Merrill Lynch, the yield on sterling investment grade in August fell by 9bps but the spread widened by 22bps with the more credit sensitive, lower-rated sections of the market doing the worst.

Property

Underlying property fundamentals continued to support the characterisation of a two-speed global economic recovery. Key Asian markets (Hong Kong and Singapore) have witnessed improvements in cash flows due to strong economies and tenant demand as well as low vacancy levels and limited new supply, and the current outlook is for further improvements in underlying property fundamentals. Indeed, Hong Kong is unquestionably the best commercial real estate market in the world with regard to strength of operating fundamentals. In contrast, most Western markets (and Japan) are slowly recovering (or bottoming) from significant declines in rents and occupancies. In these markets, the key issue is a recovery of tenant demand. Valuations for property equities in Europe ended the month trading at a discount to net asset value (NAV) based on reported NAVs, which only reflect marginal asset value declines since the start of the credit crisis due to limited transactional evidence. Valuations in the UK ended the month trading at a meaningful discount to reported NAVs, which have partially recovered since experiencing significant declines since June 2007. It is notable, however, that investment transaction activity has been focused on high quality assets with secure income streams, and this activity dropped off in August, which is typically a slow period and as buyers re-evaluated their return requirements in a more uncertain world.

Index	Price	Up/Down on month
FTSE 100	5,394.53	↓
DJ Ind. Average	11,613.53	↓
S&P Comp	1,218.89	↓
NASDAQ	2,241.01	↓
Nikkei	8,955.20	↓
£/\$	1.6250	↓
€/£	0.8843	↑
€/\$	1.4369	↓
£Base Rate	0.50%	↔
Brent Crude	114.85	↓
Gold	1,825.72	↑

Prices quoted as at 31/08/11

Source: Bloomberg

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Equities

Global stock markets experienced significant bouts of volatility in August, with some experiencing record-breaking falls as worries over a slowdown in growth and fears over the eurozone sovereign debt crisis intensified. Top of the list was Germany, which saw its biggest one day decline in nine years and, in the US, the combined indices of the S&P 500 index, Dow Jones and NASDAQ had their worst August since 2001. The MSCI World index tumbling 6.72% over the month, in US dollar terms, resulting in a decline year to date. On a regional basis the euro bloc markets underperformed for the month with the heartland of union, Germany, suffering its savage sell off. Japan and the UK also underperformed. Switzerland, the US and Australia outperformed on a relative basis. On a sector basis no group was spared absolute declines but the traditional defensive sectors continued to outperform in relative terms with telecoms, healthcare, utilities and consumer staples outperforming.

Alternative Investments

Hedge Funds:

Hedge fund returns were almost uniformly negative, although global macro managers were closer to flat on average. Trend-following commodity trading advisors (CTAs) drew down, primarily on the reversal in energies and the range-bound fluctuation in foreign exchange. Short-term CTAs were the exception to the rule, capturing the pronounced short-term moves and reversals.

Commodities:

Physical commodities exhibited varied returns. Products dependent on the economic cycle such as base metals and energies depreciated on declining expectations of global demand. Instruments that more strongly reflect inflation, such as gold and agricultural commodities, realised gains. The Dow Jones UBS Commodity TR Index finished the month positively, up approximately 1%, however, the S&P Goldman Sachs Commodity TR index finished down 1.8%. Overall, commodity markets have held up better than equity markets, given that they are fundamentally tight, but this may change if global growth slows and a double dip recession occurs. The price of gold rose by 12.7% to approximately \$1,825 by early September, which means gold has reached nominal highs, although it should be noted that gold has yet to climb to the record highs of the 1980s. Oil prices were little changed in August closing at \$114.85. With very little spare capacity, the only risk of oversupply in global crude markets stems from demand destruction.

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