

# Monthly Update

June 2010

## Markets Overview

## World Markets

### Cash

#### Sterling:

The Monetary Policy Committee (MPC) left rates unchanged at 0.5% following its June meeting and the members also voted to keep the asset purchase programme held at £200bn. The voting to keep rates on hold was seven to one with the dissenting voice arguing for a 0.25% rise. Sterling strengthened during the month, buoyed by the continuing flight of capital from the eurozone and the strong rhetoric which accompanied Chancellor George Osborne's Emergency Budget. The clear intentions to address the fiscal deficit and the actions proposed were well received by market participants. In other news, the fall in headline inflation was in line with recent comments from Mervyn King, Governor of the Bank of England, that the substantial spare capacity in the UK economy will surpress any near term inflationary pressures.

#### US Dollar:

Fears that the US recovery is losing momentum have occupied the minds of the US authorities during June. A downward revision to first quarter GDP from 3% to 2.7%, coupled to setbacks in both employment and housing numbers have spooked investors and, at the recent G20 meeting in Toronto, US officials voiced their concerns that the co-ordinated austerity measures across Europe ran the risk of sapping demand and derailing the global recovery. Confidence was further dented by comments from the IMF, which stated risks to the global economic outlook had risen significantly. Notwithstanding this, the US did report rising industrial production and capacity utilisation, and all eyes will be on second quarter corporate earnings for evidence economic pessimism has been overdone.

### Bonds

#### Sterling:

Government bond yields declined during the month with the 10-year benchmark gilt yielding 3.35% and yields could be set for further declines if the economic recovery slows. Nervousness over the possibility that a peripheral eurozone state will default on its debt persists and Greece remains the most likely candidate. These concerns have continued to fuel the migration of investor capital to the gilt market and an asset that was universally unloved only a few months ago has become increasingly popular among global investors. Bond fund managers continue to report heavy flows into their funds confirming fixed income investing remains at the core of portfolio construction for many.

#### US Dollar:

Once again, the US government bond market was the strongest of the major debt markets with local currency gains enhanced by the strengthening dollar. Corporate bonds weakened slightly through the month, albeit they remain the preferred sub-set within the asset class among many bond investors. The quality of earnings and financial stability of issuers will be paramount if economic headwinds continue to build. The yield differential between corporate debt and the corresponding corporate equity has started to favour the latter on a relative value basis, although the inherent volatility associated with equities will temper the appetite of many to consider this switch between asset classes.

### Property (Sterling and US dollar):

According to a report recently published by BNP Paribas, the UK commercial property market will not regain the value lost during the crash for more than 15 years – it will be 2025 at the earliest before values reach similar pricing to 2006 and 2007, when the market peaked. The report argues capital values in the short term will remain stagnant. Prices are expected to be flat with the exception of prime buildings in central London, where a lack of supply and renewed corporate demand is anticipated to boost values. This news will not be well received by banks as there is about £250bn (\$378bn) of UK property debt outstanding, with more than £160m due for maturity in the next five years and another £50bn in breach or default.

Index	Price	Up/Down on month
FTSE 100	4,916.87	↓
DJ Ind. Average	9,774.02	↓
S&P Comp	1,030.71	↓
NASDAQ	1,739.14	↓
Nikkei	9,382.64	↓
£/\$	1.4945	↑
€/£	0.8188	↓
€/\$	1.2238	↓
£Base Rate	0.50%	↔
Brent Crude	75.01	↓
Gold	1,242.25	↑

Prices quoted as at 30/06/10

Source: Bloomberg

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### Equities (Sterling and US dollar):

The MSCI World Index (\$) lost 3.4% during June, which leaves a year-to-date return of -9.6% from global equities. The S&P 500 lost 5.2% with financial stocks in the spotlight as G20 leaders discussed increased bank capital adequacy requirements, and the US Senate debated the banking reform bill. Elsewhere, markets did react positively to the news China was relaxing its US dollar peg and while the rally was short lived, this move is likely to be a positive influence over the longer term. The precipitous falls across global equity indices has prompted many analysts to argue, from a valuation perspective, the asset class is now attractively valued. Volatility is, however, likely to persist as economic newsflow is assessed and the recent trend in sentiment gyration, from very positive to very negative, continues. Students of global liquidity flows have reported conditions have tightened, partly caused by central bank action and also caused by the private sector's unwillingness to invest while the economic landscape remains so opaque.

### Alternative Investments (Sterling and US dollar):

#### Hedge Funds:

According to Hedge Fund Research, the average energy commodity fund has lost 2% since the beginning of the year (to end of May), compared to gains of 1.3% for the whole hedge fund industry. Unusually volatile commodity prices and the Gulf of Mexico oil spill have created very unpredictable trading conditions for managers. From a more general perspective, the difficulties currently being endured by equity investors have once again brought hedge funds centre stage in the minds of investors. The delivery of attractive risk-adjusted returns means good hedge fund managers are not finding it difficult to capture new assets.

#### Commodities:

Continuing doubts over the economic recovery inevitably had a negative impact on commodity prices. Base metals were lower as leading indicators softened, although oil prices were slightly higher. Risk aversion again provided support to the gold price which traded at new highs of over \$1,242 an ounce.

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