

Monthly Update

May 2010

Markets Overview

World Markets

Cash

Sterling:

The major news for sterling cash markets was the general election result on 6 May, which failed to return a majority government. David Cameron did eventually emerge as the prime minister of the first UK coalition government since the early 1970s as the Conservatives negotiated terms with the Liberal Democrats. During the month, the Monetary Policy Committee maintained the UK base rate at 0.5% and there was no change to the current capped quantitative easing spending. The Bank of England's governor, Mervyn King, was forced to write to the chancellor to explain the rise in UK CPI figures from 3.4% to 3.7%, which he argued was temporary and he expected inflation to fall in the near term.

US Dollar:

The next meeting of the Federal Open Market Committee is timetabled for 23 June. Official interest rates are likely to remain unchanged given the tone of the statement which followed the last meeting, and the growing concern that economic recovery could be hampered by the fall in consumer demand through Europe as austerity measures start to bite. A pressing issue for the Fed will be the strengthening of the dollar across currency markets which will stifle the competitiveness of US exports - the dollar rose 7.4% against the euro in May. The disappointing non-farm payroll numbers for May has dented confidence in the momentum of the recovery, although recent remarks from Ben Bernanke advising he expected US GDP growth to be between 3% and 4% in 2010, has helped calm nervous investors.

Bonds

Sterling:

The turmoil in European markets was a fillip for gilts with yields falling sharply as capital flowed into UK government paper. With economists starting to argue economic growth in the UK could slow in the second half of the year, support for gilts is likely to continue. The new government has been vocal in expressing its determination to tackle the fiscal deficit and reduce debt, and this rhetoric has been well received by bond investors. An emergency budget has been announced for 22 June and market participants are awaiting details of the revised taxation and public spending policies.

US Dollar:

Sovereign rating downgrades in Europe coupled with the €750 billion emergency funding package served to reinforce the severity of the deficit issues faced by governments in Europe, and this triggered a wave of buying of US treasuries, which performed very strongly through the month of May. In local currency terms, returns were enhanced by the strengthening dollar. Corporate bond markets were impacted by the sell-off in risk assets and spreads widened. The number of new issues coming to the market has fallen markedly in 2010, with some high yield new issuance having to be delayed due to weakening investor appetite.

Property (Sterling and US dollar):

Commercial property performance in the UK continued to slow in May as investor demand weakened as a result of growing nervousness over the economy and renewed financial market uncertainty. Analysts have outlined that rental fragilities and declines are still present across most property sectors, with central London the only exception. All property rents fell by 0.1% in May and by 0.8% since the start of 2010 according to CB Richard Ellis monthly index. Reports also suggest volatility is returning to the property lending market given the renewed focus on the strength of bank balance sheets in the wake of the European government bond market bailout. The future direction of inflation and interest rates have added to the uncertainty.

| Index | Price | Up/Down on month |
|-----------------|-----------|------------------|
| FTSE 100 | 5,188.43 | ↓ |
| DJ Ind. Average | 10,136.63 | ↓ |
| S&P Comp | 1,089.41 | ↓ |
| NASDAQ | 1,852.39 | ↓ |
| Nikkei | 9,768.70 | ↓ |
| £/\$ | 1.4538 | ↓ |
| €/£ | 0.84648 | ↓ |
| €/\$ | 1.2306 | ↓ |
| £Base Rate | 0.50% | ↔ |
| Brent Crude | 74.65 | ↓ |
| Gold | 1,216.20 | ↑ |

Prices quoted as at 31/05/10

Source: Bloomberg

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Equities (Sterling and US dollar):

May was the weakest month for global equities since February 2009, blown off course by a number of macro headwinds including Chinese monetary tightening, Germany's move to implement restrictions on short-selling and sovereign debt default risk among the peripheral Eurozone countries. Confidence was drained by the "flash crash" on 6 May when US stockmarkets posted their largest ever intraday decline. Over the month, the MSCI World Index posted a fall of close to 10% - this is the second correction of this magnitude this year, which is very rare. Out of the last 36 years only five have contained two or more falls in excess of 10%. By sector, energy, financials and materials were the biggest fallers, with the traditional defensive sectors of consumer staples, health care and utilities outperforming the market. From a valuation perspective, equities would appear attractively priced against government bonds although it is likely that investor's appetites will be tempered in the near term if macro newsflow continues to be negative.

Alternative Investments (Sterling and US dollar):

Hedge Funds:

Hedge fund managers did not escape the challenges of a turbulent month with May returns the worst posted since November 2008 according to Hedge Fund Research (HFR). Recent data published by the same firm highlighted that 240 hedge funds were liquidated in the first quarter of 2010 - a number that has risen for the first time in over a year. Fund of funds were the worst hit with more than 100 closed in the first three months of the year, marking the seventh straight quarter in which failures exceeded new launches.

Commodities:

Commodity prices were almost universally lower in May with price movements closely linked to Chinese policies, the tentative upswing in demand from the US, and the current poor outlook in Europe. Brent Crude fell over \$12 to \$73 a barrel. Investor's loss of confidence in fiat money and the fear of inflation resulted in the long term bull run in gold remaining in tact, with the price reaching new highs over \$1,200 an ounce. Even if the global economy enters a deflationary phase, gold could go higher as a store of value - gold increased throughout the Great Depression.

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Prices quoted as at 31/05/10

Source: Bloomberg



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