IFPC Market Commentary April 2012

Market commentary - for the period 6th October 2011 to 5th April 2012

Equity markets rallied strongly towards the end of 2011 as the European Central Bank (ECB) announced it's long term refinancing operation (LTRO) on the 19th December 2011 to avert an impending secondary banking crisis in Europe. The facility offered European banks approximately 1 trillion Euros in cheap loans at 1% interest rates, with a repayment period of three years to shore-up bank finances in the face of continuing bad debts. The announcement provided much needed support for financial markets as any lingering optimism of a resolution to the European debt crisis ebbed away following the announcement by the Greek parliament of a referendum on austerity. The turbulent political events that followed culminated in the resignation of the Greek Prime Minister, George Papendreou, whilst a vote of no confidence in the Italian Parliament forced Prime Minister Silvio Berlusconi to resign over his handling of the economy. On a more optimistic note, data from the United States provided further evidence of a tentative economic recovery as unemployment numbers continued their downward trend from the 10.2% highs of October 2009 down to the 8.1% reported in March 2012. This is in stark contrast to most of Europe where unemployment rates remain elevated.

UK equities FTSE All Share Index +10.99%

UK equities rallied from their October lows as some of the money from the LTRO found its way into the UK equity market boosting share prices across the board. This review period was characterised by extremely high levels of volatility with the FTSE 100 bouncing from the lows of 4890 in early October back up to 5750, a full 860 point swing at the end of October before falling back to 5075 in November. Unfortunately, the conditions under which the market changed directions owed more to political announcements than conventional investment analysis making it difficult for most active fund managers to exploit the movements.

The best performing market sectors were metals and mining, banks, oil and equipment services, financial services and general industrials as investors were rewarded for holding the riskiest asset classes. The FTSE 100 Index rose to 5989 in March, just short of the psychological 6,000 barrier before falling back on fears of slower economic growth in China and the debt problems in Greece. The FTSE All Share Index currently provides investors with a dividend yield of 3.69% which looks compelling relative to a ten year UK Gilt yield of 1.78% on the assumption that dividend pay-outs from companies remain firm. This is one financial metric that provides a positive reason for buying UK equities at this time.

In the first quarter of 2012, the UK economy entered a technical recession defined by economists as two calendar quarters of back to back, negative economic growth (-0.2% in the first quarter of 2012 following on from -0.3% in the fourth quarter of 2011). The Office for National Statistics published data for the first quarter in 2012 showing that 8 out of 13 industries in the economy experienced generally small but positive growth whilst the construction industry and mining/quarrying were cited as experiencing a significant downturn in fortunes. However, with national unemployment rising to 8.4% and economic growth struggling below 1% annualised since the onset of the financial crisis, it is inevitable that the economy will suffer negative quarters from time to time as conditions remain unstable. Indeed, the economic recovery can still only be described as bumping along the bottom at best. The outlook for the UK economy must continue to be viewed in the greater context of a five year government austerity plan which is negatively impacting on household incomes, confidence and employment. UK growth is likely to remain below historical trends and interest rates should remain low during this period as the private sector, banks and government continue to reduce their overall debt burden through a deleveraging cycle.

The Consumer Price Index (CPI), a measure of inflation, was 3.5% in March down from the highs of 5.1% as stated in the last commentary as the effects of the rise in V.A.T. and high energy prices fell out of the statistics. Inflation continues to impact upon general living standards as wage growth is not generally meeting inflation on a national basis whilst investment returns remain low.

International equities FTSE World (excl.UK) Index +13.57% (Sterling terms)

The S&P 500 Index rose by +16.6% during the period under review to an index level of 1398, a meaningful recovery since the lows of October 2011 when it touched 1074. U.S. company profits have risen 69% since 2009 to record levels whilst the stock market has only risen 22% during the same period.

However, economic growth has been slower than any post-recession period since at least the 1940's and combined with extreme levels of volatility in the market, investors have remained nervous of increasing their portfolio weightings too heavily into the U.S. To put the volatility into context, the market index moved an average of 1.3% in each day from April 2011 to the end of the year compared with the 50 year average of 0.6% before the financial crisis of 2008. It is these daily swings which are keeping private and professional investors alike feeling rather uncertain. The principal concern in the U.S. is the public spending cuts scheduled to start in 2013 as a new government post the October elections is likely to increase austerity measures.

In European markets, the FTSE World Europe (excl. UK) Index returned +7.3% although the Euro weakened by -5.1% against the pound reducing total returns to low single digits for Sterling based investors. Political events in the Eurozone most notably in Greece continue to weigh on sentiment. At the time of writing, German bond yields (government borrowing costs essentially) have reached record lows of +0.07% for two year Bunds. Investors lending to the German government will receive no interest payments whatsoever and virtually no return on their two year money. However, institutional investors continue to buy German bonds as this is one of the few safe havens to deposit money and they are prepared to pay a high price for the ultimate security of their assets. In contrast, the Italian government is borrowing over ten years at 5.6% and Spain is borrowing over ten years at 6.1%. France is borrowing at a much lower rate of 2.7% in a tentative sign that markets believe the newly elected President Hollande is unlikely to push for economic measures as extreme as first reported but highlights the great borrowing cost divide between the northern and southern European countries.

In Japan, the TOPIX 500 Index rose by +3.5% although the Yen weakened significantly against the pound reducing returns to Sterling based investors by -9.9% on currency conversion. The economy grew by +4.1% in the first quarter driven by personal consumption and public spending. In addition, there has been a strong rebound in exports from Japan to the rest of Asia which are likely to move to all-time highs as the economy normalises following the earthquake of 2011. Japan's stock market remains deeply valued with many companies trading below their book value although their stock of public debt remains the highest of all of the largest industrialised nations.

In the Asia-Pacific region, the benchmark MSCI (AC) Far East (excl. Japan) Index posted a strong rebound of +17.85% including currency gains. Economic growth is clearly slowing in China as it enters a new phase of below 10% annualised growth rates which it has enjoyed for over twenty years. However, the index of the 25 largest shares by market capitalisation is trading at over 50% below it's March 2008 peak providing a salutary lesson that fast economic growth rates are not necessarily translated into good investment returns from the financial markets. China is the world's second largest economy, the world's largest exporter and holder of foreign reserves but is the world's largest emissions producer and ranks 115th for per capita GDP (economic wealth per citizen). Dr Kerry Brown of Chatham House calls China the world's first rich-poor country and is under no illusion of the huge task of political, social and legal reforms that China has to undertake in the coming decades.

The MSCI (AC) Emerging Markets Index rose +18.2% during the period under review. However, towards the end of the first quarter, the evidence of a slowing Chinese economy and commodity price weakness was starting to pressurise those economies reliant on exports of natural resources.

Fixed interest securities FTSE British Govt All Stocks Index +2.4%

Ten year UK Gilts are currently yielding* +1.78% before tax. Yields have continued to fall to record lows as international investors search for the scarce safe havens that exist around the world. The case for Britain is that it has a AAA credit rating with it's own currency, offers political stability and is taking fiscal measures to control it's budget deficit. When compared with countries in the Eurozone (except Germany), the choice is stark. Unfortunately, at current inflation rates, these returns offer little more than a short term home for money as over the long term investors are likely to experience negative real returns.

* yield - an estimation of the expected annual return if a bond is held to maturity and combines both capital returns and income reinvested.

Commercial property IPD UK All property Index +2.5%

Offices returned +3.0%, retail +1.8% and industrial units +3.0% including rents. Capital values declined for the second consecutive quarter (to March 2012) marking the onset of a technical recession. In broad terms, values are 31% below 2007 levels and there is nearly £300 billion of debt secured against UK commercial property of which over 40% of loans are set at loan to value ratios of 80% or more. A significant portion of these cannot be refinanced on current terms and with negative equity prevalent across the sector, there are severe funding pressures ahead. In the previous property downturn, commercial property values had already recovered to within 15% of their pre-crash levels in the five years to June 1993 demonstrating the severity of this current downturn. Whilst outside of London the picture is bleak, prices within the capital continue to perform well as high quality West End and City properties are now trading well above their 2007 peaks.

Alternative investments

The spot price of Gold reached $1,901 per ounce last September but currently stands at $1,541, some 19% down from the peak. The reasons to stay positive on gold prevail, namely its role as an alternative to fiat currencies, central bank gold allocations are historically low and will surely rise particularly in the developing and emerging nations whilst interest rates below the level of inflation offer poor alternative returns.

Commodity prices have continued to soften across the board including precious and industrial metals, energy, industrial and soft commodities alike due to slowing demand from China and the broader global economic slowdown. Brent crude oil has fallen from it's March 2012 high of $125 to $105 whilst in soft commodities, cotton is trading almost 70% below its March 2011 high and coffee is almost 45% below last year's April high.

period.

If you would like to find out more or speak to one of our advisers, please contact us:

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Important Information

IFPC Ltd is authorised and regulated by the Financial Conduct Authority
Index performance: for period 6th October 2011 to 5th April 2012, total return with income reinvested for sterling based investor.

Source of statistics: Financial Express, Alpha Terminal, Bank of England, Office for National Statistics, Investment Property Databank, CFA Institute (UK)