IFPC Market Commentary April 2013

For the period 6th October 2012 to 5th April 2013

Equities registered reasonably strong returns in the period under review against the backdrop of a slowing global economy. Indeed, following Mario Draghi's 'saving the Euro speech' of last July, financial conditions appear to have entered a phase of relatively low volatility not experienced since before the financial crisis in 2007. Market sentiment has picked up significantly since mid-summer 2012 and even the bail-out (or bail-in in some cases) of the largest banks in Cyprus barely registered in the broader markets as bondholders and non-insured deposit holders bore some of the banks losses. The major central banks continue to print money through Quantitative Easing and they have been joined by the Bank of Japan, which announced a package of measures that will dwarf even the Americans money printing efforts.

UK equities FTSE All Share Index +9.1%

The UK economy continues to suffer it's worst economic recovery for a generation with mildly positive domestic demand in 2012, a pronounced fall in exports but strong growth in employment. On a more optimistic note, the Bank of England's latest inflation report happily states 'that it is the Committee's best collective judgment that the economy is likely to see a modest and sustained recovery over the next three years'. In the currency markets, the pound weakened against the Dollar by -4.9% and by -4.6% against the Euro as the UK lost it's AAA debt rating following a downgrade from Moody's, the credit rating agency. Sterling remains under pressure against some of the major currencies (except the Yen) as export growth has failed to materialise and the current account deficit remains at historically low levels commensurate with previous Sterling crises.

In spite of the macro-economic concerns, the FTSE All Share Index posted a good performance with the constituent FTSE 100, FTSE 250 and FTSE Small Cap Indices (excl. Investment Trusts) returning +8.3%, +12.9% and +16.5% respectively. Aggregate corporate profits actually declined in 2012 suggesting that investors are starting to see through short term disappointments and are looking towards the longer term. Estimated corporate profits for 2012 were +52% above 2009's numbers posted during the height of the financial crisis and the long term trend of growing profits in the UK market still remains intact. However, share prices tend to be driven more by profit expectations than the latest reported numbers and the market is forecasting a positive +8.3% increase for 2013 and similar growth into 2014 suggesting better times ahead.

The more distinct aspect of share price rises in 2012 was the positive re-rating in company valuations as investors became more willing to pay higher share prices for potentially more secure profit streams. This phenomena has largely been driven by generally cautious bond investors receiving lower yields than the dividend yields available from some of the top FTSE 100 companies. At the margin, these investors have bought shares in companies with economically defensive characteristics in their business models, offering relatively high but safe dividend yields, strong balance sheets with low levels of outstanding debt. At the sectorial level, housebuilders, food producers, beverages, banks, aerospace and defense have been the pick of some of the best performers whilst industrial metals, mining and oil and gas continue to perform poorly.

International equities FTSE World (excl. UK) Index +12.6%

In the U.S., the S&P 500 returned +13.0% including currency adjustments. The economic and political concern was the so-called Fiscal Cliff, the combination of automatic spending cuts and tax rises that is projected to create a 3-4% drag on 2013 economic output. Important deadlines passed with minimal market reaction such as 'the Sequester', a package of spending cuts and tax rises that came into force on March 1st. The large annual fiscal deficit of over 7% is still likely to provide economic headwinds through 2013 and beyond. In contrast to the performance of financial markets, much of the economic data was fairly downbeat with company profits falling for two successive quarters, real disposable incomes declining over the year as well as various regional manufacturing indices in decline. It maybe that investors are looking through the current weakness and taking the view that the U.S is well on it's way to recovery having made significant progress in reducing personal and corporate debt levels and restoring the health of it's banking system. Cautious investors looking for security are looking beyond US Treasury Bonds offering yields of below 2% preferring to buy companies with healthy balance sheets and stable profits offering high dividend yields. Buying high income yielding stocks is an admirable approach to investing in itself but the demand for this sector of the market has driven valuations to levels not seen for thirty five years, although the demand continues unabated.

In Europe, the FTSE World Europe (ex UK) Index returned a credible +12.6% given the uncertainty that prevails in the region. Whilst industrial data from the Eurozone suggests some stabilisation over the last nine months, the recovery still looks in jeopardy as inflation is falling fast and the numbers are uncomfortably close to registering outright deflation. High levels of unemployment imply that economies are working well below their productive capacity and many countries are still in outright recession with conditions deteriorating in Spain in particular. Government bond yields have come down sharply since the height of the European Debt Crisis lowering government borrowing costs but economists are still projecting economic contraction for the region over the next two years. From an investment perspective, company valuations still trade at healthy discounts to other developed nations and there are good companies (mostly exporters) to be found whose trading is transcending the macro-economic headlines.

In Japan, the TOPIX Index returned +25.0% over the period as the new Governor of the Central Bank of Japan, Haruhiko Kuroda engaged in a policy of Quantitative Easing (QE) at unprecedented levels in an attempt to revive the flagging economy. Under the guidance of Prime Minister Shinzo Abe and economic policies now commonly known as 'Abenomics', the Central Bank of Japan announced a bond buying programme similar in the style to that of the United States but at twice the scale as a proportion of their respective countries GDP. The policy is designed to drive government bond yields (interest rates for all intents and purposes) over the medium and long term down to levels that will entice Japanese investors to sell their bond holdings and invest in more productive assets. The short term effect is already evident as the value of the Yen has depreciated by -19.5% against Sterling and -24% against the dollar providing a useful competitive edge to Japan's export economy. Japan's trading partners are already feeling the pressure and have complained at the political level that Japan is deliberately weakening their currency to be able to compete more effectively with other nations in the Asia Pacific region and will surely cause trade disputes over the coming years. Ultimately, Abenomics must result in tangible growth in the economy and break the deflationary psyche that Japan has suffered for the last twenty years because it already has the highest borrowing levels of the developed nations and failure of the policy to spark a Japanese economic revival would be a disaster.

Performance in the Asia Pacific region measured by the MSCI Far East (ex Japan) Index returned a creditable +8.3%. In China, first quarter economic growth fell to an annualised 7.7% from 7.9% in the fourth quarter of 2012, suggesting that the much vaunted rebalancing of the economy towards domestic consumption and away from investment has started but has a long way to go. It appears at this stage that China experienced a relatively hard economic landing in the middle of last year but the Chinese government has proved it's willingness to step in with economic policies to provide support to sharper downturns. The development of a middle class in China is a long term structural growth story and will provide more stable albeit lower returns than the investment led boom of recent years.

Fixed Interest Securities FTSE British Government All-Stocks Index +2.4%

Ten year UK Gilts are yielding +1.87%. The UK Government lost it's much coveted AAA debt rating according to the rating agency Moodys, as the debt and growth dynamics of the UK economy have deteriorated in recent years since the financial crisis. Under normal financial conditions, this announcement would have pushed interest rates (Gilt yields) higher as the risk of lending to the Government with a lower credit rating would have implied higher risk to the lender. However, these are not normal conditions and financial repression through the programme of Quantitative Easing is still holding interest rates down artificially at historic low levels. In addition, the rating of Government bonds is a relative game and many other AAA countries around the world are suffering the same fate. Institutional investors have to put their money somewhere and the UK still holds an allure as a political stable nation with an independent currency and a well-structured bond market.

The outlook for cautious investors has changed significantly over the last year as there is a dearth of low risk assets available to them and income yields are now very low. This group of investors has been well rewarded in recent years receiving relatively high levels of return relative to their bank deposits whilst taking low levels of risk. The search for higher levels of income has become increasingly difficult particularly as UK and US investment grade corporate bonds are now yielding barely a percentage point above Gilts at or around 3% with added downside risks if interest rates were to rise. Cautious investors have a dilemma in deciding if they should accept low levels of return or start to push further up the risk scale for better real rates of return.

Commercial property **IPD UK All property Index +1.6%**

Offices returned +2.4%, retail +0.7% and industrial units +2.3% including rents. Sentiment surrounding the London prime market is starting to shift as pockets of performance around the UK regions are starting to come through. Income yields are now at higher levels than Central London as investors are looking for the stability of income streams through high occupancy levels. Rental increases are stalling in London as the property market enters an uncertain phase and there is still uncertainty on capital values with analysts pricing in possible declines in anticipation of potential bank disposals. Capital growth remains as elusive as ever.

Alternative investments

The Gold spot price suffered its worst single day decline in over thirty years as the price dropped over $200 an ounce to the $1,350 region. Gold is now trading some -28% below it's July 2011 high and has knocked the sentiment of investors who have witnessed twelve straight years of price appreciation. The Gold market has changed dramatically in that time, most notably with the advent of exchange traded funds which can easily be bought by private investors. They can also be easily sold and the industry has suffered record outflows this year. From a fundamental perspective, there is still huge demand from central banks around the world alongside strong jewellery demand from Asia and the Emerging Markets. Real rates of interest (inflation minus interest rates) remain negative which is ordinarily a positive environment for gold and western governments continue to debase the spending power of their currencies with money printing. The conditions for gold to go higher are in place but volatility and possibly lower prices will prevail in the shorter run. With slowing global growth most notably from China, the prices of industrial metals have continued to decline providing a very poor backdrop to investors in the commodity sector. Copper is -31% of it's recent highs and Aluminium is -60% from its pre-financial crisis high.

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 (FCA)

Indices performance statistics are for the period 6th October 2012 to 5th April 2013, total return with income reinvested and currency conversions back into Sterling.

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