Market Review

July 2014

Investment markets were more volatile through July with equities experiencing losses in local currency terms following initial gains while fixed income markets continued to move higher. Equity markets rose earlier in the month on the back of a positive earnings reporting season in the US which to date is approx. 5% ahead of forecasts .Corporate activity also remained a supportive feature, highlighted by the bid for Time Warner by 21st Century Fox with a number of other proposed smaller takeovers also announced. While a Fed paper suggested valuations in some sectors of the equity market such as social media and biotechnology are stretched at current levels, Fed Chairperson Janet Yellen indicated that prices of investment markets remain generally in line with historic norms and were not a cause of concern for the Fed. Her comments on monetary policy remained dovish in testimony to a Senate banking committee while the Fed statement post the July meeting was also seen as indicating that policy would remain accommodative. While it mentioned that risks of persistently lower inflation were seen as having diminished somewhat and unemployment was noted as having declined further, the Fed highlighted that a range of indicators suggested significant underutilisation of labour resources remains a feature within the US economy. On the macro front, global economic data generally tended to surprise to the upside through the month. The escalation of tensions and conflict in Ukraine and the Middle East gave rise to concerns within markets and partly contributed to the flight to safe have assets such as bonds. In Portugal, moves by three companies within the Espirito Santo Group to seek creditor protection and an order from the Portuguese Central Bank to Banco Espirito Santo to raise additional capital following the announcement of substantial losses in its first half results also added to uncertainties across Europe. The declaration by the credit rating agency S&P of a debt default by Argentina following the failure to reach an agreement on debt repayments on legacy bonds where the holders had not accepted previous restructuring terms also contributed to some anxiety in markets at month end. A higher than expected wage inflation reading in the US on the last day of the month also led to renewed concerns over the possible timing of rate rises by the Fed. Over the month the FTSE World equity index fell -0.5% in local currency (+0.9% in €). Pacific Basin markets rose 3.4% (4.9% in €) and Emerging Markets gained 3.1% (4.4% in €), benefiting from generally stronger Chinese economic data. Japan rose 2.1% (3.0% in €), supported by a weaker Yen against the dollar as disappointing economic data increased the probability of further stimulus from the Bank of Japan. The US fell -1.4% (+0.8% in €) following profit taking at month end. European equities fell -2.6% (-2.7% in €) following developments in Ukraine and events at the Espirito Santo Group. The Euro fell to 1.338 against the US dollar as the low Eurozone inflation reading of 0.4% maintained pressure on the ECB to ease monetary policy further. Eurozone bonds rose 1.3%, benefiting from a flight to defensive assets following global geo-political tensions and the potential for further ECB policy initiatives. Commodities fell -5.6% with weakness evident across most commodity categories.

On the economic front, releases generally tended to surprise positively during the month. In the US, Q2 GDP was ahead of expectations at 4.0% annualised while Q1 was revised up by 0.8% to -2.1% annualised. Elsewhere in the US, while housing data was mixed, other indicators such as durable goods, consumer confidence and the labour market were positive and stronger than expected. In Europe, following some recent disappointments, economic releases improved somewhat with Eurozone PMI sentiment readings rebounding and unemployment continuing to nudge lower to 11.5%. In the UK, releases were a little mixed but remained consistent with growth of around 3% being maintained. Q2 GDP was in line with expectations at 0.8% q/q and resulted in the level of UK GDP exceeding its pre-crisis level in 2008 for the first time. Other monthly releases such as industrial production and retail sales were slightly below expectations but remain strong on a y/y basis. In China, the recent improvement in releases continued with HSBC manufacturing PMI rising to 51.7, Q2 GDP grew 2.0% q/q or 7.5% y/y and industrial production rose 9.2% y/y. Japanese data was slightly disappointing following generally better than expected readings in recent months. Retail sales and industrial production were below expectations while business sentiment surveys, despite remaining positive and being in expansionary territory, were somewhat mixed with some rolling over evident in many surveys. Overall, momentum in the global economy remains positive and looks set to continue to modestly improve through the remainder of the year.

Markets In July		
	Local Returns	**Euro Return**
Ireland	-1.1	-1.1
UK	-0.1	0.9
US	-1.4	0.8
North America	-1.2	1.0
Europe	-2.6	-2.7
Japan	2.1	3.0
Pacific	3.4	4.9
Emerging Markets	3.1	4.4
World	-0.5	0.9
EMU Govt Bonds >5yr	1.3	1.3
Commodities	-5.6	-3.4

Markets YTD		
	Local Returns	**Euro Return**
Ireland	3.4	3.4
UK	1.6	6.7
US	5.6	8.8
North America	6.2	9.2
Europe	4.4	4.3
Japan	-0.3	4.9
Pacific	7.6	13.2
Emerging Markets	8.0	11.7
World	5.2	8.3
EMU Govt Bonds >5yr	12.0	12.0
Commodities	-1.7	1.3

US Economics and Rates

US economic data was generally better than expected with the exception of housing data and suggested momentum was improving in the economy. Q2 GDP surprised positively, rising 4.0% annualized while Q1 was revised higher by 0.8% to -2.1% annualized. Non-farm payrolls rose 288,000 and unemployment fell to 6.1% from 6.3%. Consumer confidence rose 4.5 to 90.9 while retail sales ex autos rose 0.4% m/m. Housing data was generally disappointing. House prices in the top 20 cities fell -0.3% m/m and were up 9.3% y/y from 10.8% previously. Pending home sales fell -1.1% m/m and -4.5% y/y. New home sales fell -8.1% m/m although existing home sales rose 2.6% m/m. Housing starts fell -9.3% m/m while building permits were down -4.2% m/m. Durable goods orders rose 0.7% m/m while capital goods shipments fell -1.0% m/m although capital goods orders rose 1.4% m/m. Industrial production rose 0.2% m/m although factory orders fell -0.5% m/m. ISM services slipped slightly by -0.3 to 56.0 while ISM manufacturing was down -0.1 to 55.3 although both remain firmly in expansionary territory. The employment cost index rose 0.7% in Q2 giving rise to some concerns that wage inflation was beginning to accelerate. CPI was unchanged at 2.1% y/y.

The Fed reduced monthly asset purchases by another $10bn to $25bn. The statement post the July meeting was seen by the market as generally dovish. While noting that the unemployment rate has fallen, the Fed highlighted that a number of measures in the labour market point to significant underutilization of labour resources, suggesting that accommodative monetary policies are still required. This was similar to earlier comments in the month from Fed Chairperson Janet Yellen when she spoke of continued slack in the labour market. With regards to inflation, the Fed said inflation has moved somewhat closer to its target and that the risks of low inflation had also diminished somewhat. The statement again indicated that interest rates will remain at current levels for a considerable period after QE3 tapering ends which is expected in October.

European Economics and Rates

European sentiment surveys generally improved during the month although hard data was more mixed. The Eurozone composite PMI rose 1.2 to 54.0 as services rose 1.6 to 54.4 while manufacturing PMI rose 0.1 to 50.9. The Sentix business sentiment reading rose 1.6 to 10.1 although ZEW expectations fell 10.3 to 48.1. Retail sales were flat m/m and were up 0.7% y/y. Consumer confidence was flat at -8.4. European Commission industrial confidence rose 0.5 to -3.8 while services confidence fell -0.6 to 3.6. Construction output fell -1.5% m/m but was up 3.5% y/y while industrial production fell -1.1% m/m but was up 0.5% y/y. Unemployment fell 0.1% to 11.5%. CPI fell 0.1% to 0.4% y/y.

In Germany, both survey and hard data were somewhat mixed. Retail sales rose 1.3% m/m and 0.4% y/y. Consumer confidence rose 0.1 to 9.0 and unemployment was unchanged at 6.7%. Manufacturing PMI rose 0.9 to 52.9, services rose 2.0 to 56.6 and the composite PMI rose 1.9 to 55.9. The IFO business climate reading however fell 1.7 to 108.0 while ZEW expectations were down 2.7 to 27.1. Industrial production fell -1.8% m/m but was up 1.3% y/y while factory orders fell -1.7% m/m but were up 5.5% y/y. In France while data remained mixed, generally releases improved somewhat. Consumption grew 0.9% m/m and 1.8% y/y while consumer confidence was flat at 86. The composite PMI rose 1.3 to 49.4 with services PMI up 2.2 to 50.4 although manufacturing fell -0.6 to 47.6. Industrial production fell -1.7% m/m and -3.7% y/y. Business sentiment increased 1 to 93. Spanish Q2 GDP rose 0.6% q/q and 1.2% y/y. Retail sales rose 0.2% y/y from 0.5% previously while industrial production rose 2.5% y/y from 4.1% previously. Unemployment fell to 24.5% from 25.9%. Manufacturing PMI rose 1.7 to 54.6 although services fell 0.9 to 54.8.

Following the significant policy measures announced in June, there were no new initiatives announced at the July ECB meeting. It was announced that from January 2015, a fuller account of deliberations at ECB meetings will be published while the ECB will also switch to a six–weekly meeting schedule compared to the current monthly schedule. The door to additional unconventional measures was again left open and it was indicated that if inflation appeared likely to remain lower for longer than currently expected, further policy measures would be introduced. Details of borrowing allowances for banks in the new Targeted Long Term Refinancing Operations (TLTRO) were announced. If banks grew net lending for the 12 months to April 2014, then they can borrow up to three times their increase in net lending for the year to April 2015 and for the year to April 2016 in subsequent quarterly LTRO operations. For those banks where lending fell over the 12 months to April 2014, the pace of reduction over the next 18 months will have to slow and by April 2016 the loan book will need to have stopped shrinking for banks to qualify to obtain funds from the LTRO.

UK Economics and Rates

UK Q2 GDP was in line with expectations at 0.8% q/q or 3.1% y/y and resulted in absolute UK GDP exceeding its pre-crisis level in 2008 for the first time. Retail sales ex autos fell -0.1% m/m but were up 4.0% y/y. Consumer confidence fell 3 to -2. Unemployment fell 0.1% to 6.5% while numbers employed grew 254,000 over three months. Average weekly earnings excluding bonuses grew 0.7% y/y. The Halifax house price index fell -0.6% m/m but was up 8.8% annualised over 3 months. Mortgage approvals rebounded to 67,200 per month from 61,700. CPI rose to 1.9% y/y from 1.5%. Construction output fell -1.1% m/m but was up 3.5% y/y. Industrial production fell -1.7% m/m but was up 2.3% y/y. The composite PMI fell 1 to 58.0, manufacturing rose 0.5 to 57.5, services fell 1.1 to 57.7 while construction rose 2.6 to 62.6 although all remain firmly in expansionary territory.

The Bank of England (BoE) again unanimously agreed to leave policy unchanged. It was again indicated that the rate decision had become more balanced for some members in recent months. However members appeared to be surprised and confused over the recent pattern of weak wage growth alongside strong employment gains and the implications for the level of slack in the overall economy. It was highlighted that strong growth in employment was becoming harder to reconcile with weak wages growth and could reflect either a delay in the timing of a pick-up in wage growth or a structural rise in labour supply. It was however suggested that that the risk of a small rate rise derailing the expansion had receded and that slack within the economy could possibly be currently being absorbed more quickly than previously expected although it was also noted that inflation was still below target and that a rate rise while real wages were still stagnating could destabilise the economy. The minutes of the meeting indicated that members thought that the recent increase in inflation might reflect a change in the timing of summer sales rather than an underlying rise in inflation. Overall, there was little clear guidance in relation to the possible timing of the first rate rise in the UK.

Asian Economics and Rates

Japanese data was mixed but generally disappointed. Industrial production fell -3.3% m/m but was up 3.2% y/y. Retail sales rose 0.4% m/m but were down -0.6% y/y. Small business confidence rose 1.4 to 48.7. The Economy Watchers survey current reading rose 2.6 to 47.7 although the outlook reading slipped 0.5 to 53.3. The composite PMI rose 0.8 to 50.0. The Tankan large manufacturing index fell 5 to 12. CPI was down 0.1% to 3.6% y/y and excluding the impact of the April sales tax rise, was down 0.1% to 1.3% y/y. Exports fell -2.0% y/y while imports rose 8.4% y/y. Machine tool orders rose 34.1% y/y.

The Bank of Japan (BoJ) agreed unanimously to leave policy unchanged. The policy statement and post meeting press conference comments indicated the BOJ remains confident about a recovery in the second half in both activity and inflation levels. While recent hard economic data has disappointed, the BoJ appeared willing to look through the recent weakness, believing that growth and inflation will pick-up in the second half. The GDP forecast for the year to March 2015 was downgraded slightly by 0.1% to 1.0% with other forecasts for inflation and future years growth forecasts left unchanged with inflation of 1.9% still forecast by March 2015. Business sentiment was noted as generally having remained at a favourable level. Recent weakness in data was described as being within the BoJ’s expectations and the impact of the April sales tax hike is expected to wane with consumer spending expected to remain solid. The export recovery was said to have been delayed due to a slower than expected pick-up in demand from ASEAN countries and structural headwinds such as off-shoring of manufacturing facilities by Japanese corporates.

Chinese data continued to improve through July. Q2 GDP surprised positively, rising 2.0% q/q or 7.5% y/y from 7.4% the previous quarter. The HSBC composite PMI rose 2.2 to 52.4, services rose 1.4 to 53.1 while manufacturing rose 1.0 to 51.7. Official manufacturing PMI rose 1.7 to 51.7 while services fell -0.5 to 55.0. Exports rose 7.2% y/y while imports rose 5.5% y/y. Fixed asset investments improved to 17.3% y/y from 17.2% previously, retail sales were unchanged at 12.1% y/y while industrial production improved from 8.8% y/y to 9.2% y/y.

Irish Economics

Economic releases were generally positive through the month. Q1 GDP surprised positively, rising 2.7% q/q and 4.1% y/y. Consumption grew 0.2% y/y although was down -0.1% q/q while investment grew 2.9% y/y although it too was down q/q at -8.1%. Construction was up 8% y/y and business investment rose 40% y/y. Overall domestic demand grew 1.2% y/y and when excluding the volatile aircraft investment component rose 3.3% y/y. Net exports had a strong quarter, up 5.8% q/q with exports up 1.8% q/q and imports up 0.8% q/q. A change in the calculation methodology of GDP which included R&D expenditure and illegal economic activities led to an increase in the absolute level of GDP of €10.7bn or 6.5% for 2013 and results in the debt/GDP ratio for 2013 falling from 123.7% to 116.1%. 2013 GDP was revised up from -0.3% to a positive 0.2%. Numbers on the Live Register fell 3,400 to 382,800 seasonally adjusted and unemployment fell 0.1% to 11.5%. Retail sales fell -1.7% y/y but were up 4.8% y/y. Sales ex autos were flat m/m and rose 3.6% y/y. In Q2, core retail sales ex autos rose 4.0% y/y versus 2.8% y/y in Q1. National residential property prices rose 2.9% m/m and 12.5% y/y. Dublin prices rose 3.1% m/m and 23.9% y/y. Prices outside Dublin rose 2.4% m/m and 3.4% y/y. Transaction volumes were up 26.0% y/y. The trade surplus rose to €3,344m from €2,876m. with exports up 15% m/m to €7.9bn and imports up 14% m/m to €4.6bn. CPI was unchanged at 0.4% y/y. The composite PMI rose 0.3 to 59.7 with services up 0.9 to 62.6 and manufacturing up 0.3 to 55.3. Exchequer returns were positive with a budget deficit for the first 6 months of €4,938m against €6,593m for the same period last year. Tax revenues were up 4.9% y/y while net voted expenditure was down 1.9% y/y.

Bonds

Bond markets posted another strong rally in July continuing their strong performance all year. The Merrill Lynch Eurozone Government bond index >5 years posted a gain of 1.33% in July bringing year to date returns to +12.0%.

Geo-political concerns dominated trading in July with light summer volumes exacerbating some price moves. The developments in Ukraine put added pressure on core bond yields driving the 10 year bund to all-time lows of 1.11%. Deflation risks for the Eurozone have been pushing down core yields all year. One of the largest banks in Portugal is likely to need state support as its parent company filed for bankruptcy protection to which it had significant exposure. There has been limited impact on Portuguese government bond spreads which is a positive for the wider peripheral sentiment. Italian spreads tightened slightly over the course of the month to end at 155bps.

Argentina failed to pay hold-out creditors from its last restructuring in 2001 which it had been ordered to pay under a US court ruling. The default hasn't impacted the rest of the market so far. The Federal Reserve continued to taper its QE program with stronger Q2 GDP growth announced. Recent jobs and inflation data have been improving, reducing the risks of a secular stagnation.

Emerging Markets

Emerging Market equities outperformed in July, rising 3.1% (4.4% in €), benefiting from the continued improvement in Chinese economic data. Asian markets rose 5.9% led by China which was up 10.7% and Indonesia which also rose 10.7% following the Presidential election and hopes for the introduction of new reforms. Latin American markets rose 3.9%. European markets underperformed, falling -3.6% following the escalation of tensions in Ukraine with Russia falling -6.3%. On a sector basis, telecoms and financials outperformed while energy and technology stocks underperformed. Emerging market equity funds saw strong inflows during July of US$8.1bn.

Corporate Bonds

Corporate bonds underperformed sovereign bonds given the flight to perceived safe haven assets with geo-political concerns in Ukraine and the Middle East and concerns relating to financial difficulties at the Espirito Santo Group in Portugal and the declaration by S&P of a default by Argentina. European corporate bonds outperformed those in the US while lower credit rated bonds underperformed in both regions with high yielding bonds tending to lag in the risk off environment. European AAA/AA bonds rose 0.6% while BBB bonds gained 0.3%. In the US, AAA/AA bonds were down -0.1% while CCC bonds were down -1.6%. In Europe, core corporate bonds tended to outperform those in peripheral markets.

Commodities

Commodities fell -5.6% during the month. Energy prices fell -5.8% as oil prices fell with Brent down -5.6% and West Texas Intermediate down -6.8% during the month. The stabilization of tensions in Iraq without any disruption to supplies lowered prices as did reports that a key refinery would be closed for longer than previously expected which lowered demand for oil. Precious metals fell -3.1% with gold also down -3.1% following the stronger US GDP figures and higher employment cost index reading while the hoped for cut in Indian gold import duty did not materialise. Livestock prices fell -2.6% with lean hog prices falling -12.5% following previous increases which had been due to a virus. Industrial metals were the exception among commodity categories, rising 2.7%, helped by the stronger economic data in China. Zinc rose 6.6% on reports that inventories continued to fall to their lowest levels since December 2010 while aluminium rose 5.4% on similar reports of declining stockpiles.

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