Market Review

March 2014

Equity markets were modestly higher in March while bonds also maintained their positive start to the year. Markets remained sensitive to developments in Ukraine through the month although towards month end, comments from participants became more conciliatory with Russia and the US highlighting the need for a diplomatic resolution to the crisis. With a growing belief that the situation would not escalate further, markets recovered losses from earlier in the month. In the US, economic data began to stabilise following weather related weakness in January and February which provided some reassurance that growth would rebound in the second quarter. While releases generally remained firm in Europe, Chinese economic data continued to disappoint, posing risks to the consensus growth forecast of 7.5% for 2014. The US Fed reduced the level of monthly asset purchases by another \$10bn to \$55bn and also removed guidance on interest rate policy related to the 6.5% threshold unemployment level. Both equities and bonds were unsettled by a suggestion from the Fed Chairperson at the post meeting press conference that US interest rates could rise in April 2015, earlier than the market had been anticipating. Markets recovered however as there was a sense that there was an element of miscommunication in Janet Yellen's comments and that rate rises were more likely to occur in the second half of 2015. In Europe, the ECB appeared to back away from further stimulus at its monthly meeting. However, a further fall in Eurozone inflation to 0.5% and remarks from President Draghi highlighting the impact of the stronger Euro on inflation and comments by ECB members relating to the possible use of other policy measures including QE, gave rise to speculation that the ECB could announce additional monetary loosening. Over the month the FTSE World equity index rose 0.5% in local currency (0.7% in €). Emerging markets rebounded from losses earlier in the year, rising 1.9% (3.3% in €). The US rose 0.8% (1.0% in €) while the Pacific Basin gained 0.7% (2.3% in €). The UK lagged, falling -2.6% (-2.9% in €). Eurozone bonds rose 1.3% as German 10 year yields declined 6bps to 1.56% due to the continued low Eurozone inflation readings while peripheral spreads narrowed further with Italian and Spanish yields down to 3.29% and 3.23% respectively as economic data continued to improve. The Euro was marginally lower against the US dollar at 1.378 due to speculation over possible additional policy initiatives from the ECB. Commodities fell 0.1% as gold and gas declined on easing tensions in Ukraine.

Despite the overall tone of the US Fed statement and commentary during the press conference suggesting interest rates would remain low for some time, markets temporarily sold off when Janet Yellen suggested rates could rise in April 2015. She did however highlight that any decision on rates would be data dependent. Subsequently she confirmed that significant slack remains in the labour market, that the extraordinary commitment of the central bank is still needed and that accommodative policy is still required for some time in the US. This went some way towards easing the concerns regarding the possibility of an early rate hike in the US.

In terms of economic data, one of the most notable developments was the stabilisation of releases in the US following the weather related weakness through the first two months of the year. While data was still mixed overall, non-farm payrolls, consumer confidence, house prices, industrial production, retail sales and ISM manufacturing all surprised positively and suggested growth would rebound again in the second quarter. In Europe, data generally remained firm. While headline Eurozone PMI's fell slightly, they still remained firmly in expansionary territory above 50 and suggested upside to consensus growth forecasts of 1.1%. Consumer confidence hit a six year high and most business sentiment indicators remained strong although there was some negative impact on expectations readings from developments in Ukraine. Similarly, UK economic data remained strong with retail sales, manufacturing and construction all surprising positively while key PMI's remain in the high 50's to low 60's, consistent with the recent strong GDP growth being maintained. Chinese data however continued to disappoint, even allowing for some distortions related to the timing of Chinese New Year and suggested consensus growth forecasts of 7.5% for 2014 could be at risk. The HSBC manufacturing PMI fell to 48.1 while key indicators such as retail sales and industrial production showed declines in y/y growth rates. While Japanese data had remained solid through much of the month, there were some disappointing releases at month end which suggested some slowing prior to the introduction of the 3% sales tax increase on 1st April. In particular industrial production and the manufacturing PMI both declined m/m although earlier, retail sales, machine tool orders and small business sentiment had been stronger than expected. Overall, momentum in the global economy is expected to improve through the remainder of the year, helped by a recovery in the US as it exits the weather related soft patch in January and February.

Markets In March		
	Local Returns	Euro Return
Ireland	-3.3	-3.3
UK	-2.6	-2.9
US	0.8	1.0
North America	0.8	1.0
Europe	0.5	0.5
Japan	-0.2	-0.9
Pacific	0.7	2.3
Emerging Markets	1.9	3.3
World	0.5	0.7
EMU Govt Bonds >5yr	1.3	1.3

Markets YTD		
	Local Returns	Euro Return
Ireland	10.8	10.8
UK	-1.4	-0.8
US	1.9	1.8
North America	2.1	1.8
Europe	3.6	3.7
Japan	-7.3	-5.4
Pacific	0.7	1.6
Emerging Markets	-0.5	-0.4
World	1.1	1.3
EMU Govt Bonds >5yr	5.8	5.8

US Economics and Rates

Economic data remained somewhat mixed but began to show some signs of stabilization following the weather related soft patch in January and February. Fourth quarter GDP was revised up by 0.2% to 2.6% annualized as consumption was revised 0.7% higher to 3.3%. The composite PMI rose 1.7 to 55.8, the services PMI gained 1.2 to 55.5 although manufacturing PMI fell -1.6 to 55.5. ISM manufacturing recovered some of January's losses, rising 1.1 to 53.2, however ISM services fell -2.4 to 51.6. Headline durable goods rose 2.2% m/m but orders ex transport rose only 0.2% m/m while core capital goods orders fell -1.3% m/m. Non-farm payrolls surprised positively, rising 175,000 from a revised 129,000 the previous month while unemployment rose 0.1% to 6.7%. Initial weekly unemployment claims continued to fall, down to 311,000 from 348,000. Retail sales grew 0.3% m/m while personal income and spending also both rose 0.3% m/m. Consumer confidence rose 4.0 to a six year high of 82.3. Housing data remained mixed. House prices in the top twenty cities rose 0.9% m/m and 13.2% y/y while building permits rose 7.7% m/m. Home builder sentiment rose 1 to 47 after a fall of 10.0 the previous month. New home sales however were down -3.3% m/m, existing home sales fell -0.4% m/m and housing starts fell -0.2% m/m. Industrial production rose 0.6% m/m and capacity utilization rose 0.7% to 78.8% although small business optimism was down 2.7 to 91.4.

The Fed reduced the level of monthly asset purchases under QE3 by another $10bn to $55bn. The guidance on interest rate policy related to the unemployment threshold of 6.5% was dropped. Instead, a more traditional qualitative approach was adopted with future interest rate levels to be determined by realized and expected progress towards the objectives of maximum employment and 2% inflation. Overall, the tone of the Fed statement and commentary at the post meeting press conference was dovish, suggesting interest rates would be maintained at current levels for some time. While the Fed committee's median expectations for the level of interest rates for the end of 2015 rose 25bps to 1.0% and by 50bps for the end of 2016 to 2.25%, Janet Yellen, the Fed Chairperson, indicated this should not be interpreted as a change in policy intentions. It was stated that interest rates would remain at current levels for a considerable period of time after QE3 tapering has ended and that even after employment and inflation are near mandated levels, a target Fed funds rate below what would be viewed as normal would be warranted. In response to a question in Q&A as to when the first interest rate rise could occur, Yellen said that a considerable period of time after QE3 tapering ends could mean something in the order of six months, thereby suggesting rates could rise in April 2015, earlier than the market had been anticipating. Towards month end in a subsequent speech, she tried to temper this suggestion when saying the extraordinary commitment which has been made by the central bank is still needed given the significant slack which exists in the labour market and that accommodative monetary policy is still required for some time in the US.

European Economics and Rates

European data generally remained firm through March. Eurozone PMI's did fall marginally but remain well above 50. The composite PMI fell -0.1 to 53.2, manufacturing and service PMI's both fell -0.2 to 53.0 and 52.4 respectively. Other sentiment indicators tended to increase with the Sentix business confidence up 0.6 to 13.9, economic confidence up 1.2 to 102.4, industrial confidence up 0.1 to -3.3 and services confidence up 1.0 to 4.2. ZEW business expectations did however fall 7.0 to 61.5, impacted by the tensions in Ukraine. Eurozone consumer confidence rose to a six year high of -9.3 as employment across the region was up 0.1% q/q and retail sales grew 1.6% m/m and 1.3% y/y. Construction output grew 1.5% m/m and 8.8% y/y while industrial production fell -0.2% m/m but was up 2.1% y/y. Eurozone inflation continued to fall, down to 0.5% y/y. In Germany, retail sales rose 1.3% m/m and 2.0% y/y while industrial production rose 0.8% m/m and 5.0% y/y with factory orders rising 0.8% m/m. Current business sentiment surveys improved but as with the Eurozone in general, expectations were down due to developments in Ukraine. The IFO current assessment reading rose 0.8 to 115.2 with expectations down -1.9 to 106.4 as the overall business climate reading fell -0.6 to 110.7. The composite PMI fell 1.4 to 55.0 with manufacturing PMI down -1.0 to 53.8 while the services PMI fell -1.9 to 54.0 although all remain well above 50 in expansionary territory. French data surprised positively with the composite PMI rising 4.0 to 51.6, manufacturing PMI up 2.2 to 51.9 and services PMI up 4.2 to 51.4. Business confidence was up 1 to 95 while consumer confidence rose 3 to 88. Retail sales grew 0.1% m/m but fell -0.3% y/y. Industrial production fell -0.2% m/m and -0.1% y/y. In Spain, manufacturing PMI rose 0.3 to 52.5 while services fell -1.2 to 53.7. Industrial production was up 1.1% y/y from 1.7% while retail sales were up 0.5% from the previous -1.0% y/y.

The ECB left policy unchanged and as previously, indicated that interest rates would remain at or below current levels for a considerable period of time with the degree of slack in the economy being emphasized on a number of occasions at the post meeting press conference. Economic forecasts were updated with GDP estimated at 1.2% for 2014, 1.5% in 2015 and 1.8% in 2016. Inflation was forecast at 1.0% in 2014, 1.3% in 2015 and 1.5% in 2016 although by Q4 2016 it is forecast to be running at 1.7%. Overall growth risks were seen as being to the downside and inflation risks were seen as balanced. No new policy measures were implemented because there had been no unwarranted tightening of monetary conditions. There was much discussion at the press conference in relation to the impact of the stronger Euro on inflation and President Draghi estimated the 8%

increase in the trade weighted value of the currency since the trough in 2012 had reduced inflation by 0.4%. While the various policy options open to the ECB were outlined, the general sense after the meeting was that the ECB seemed less likely to provide further stimulus than had been the case the previous month. However In subsequent speeches, President Draghi again highlighted the impact of the level of the Euro on inflation while other members outlined the policy options available to the ECB, including quantitative easing, which led to increased speculation that additional stimulus could be forthcoming, particularly given the further fall in inflation to 0.5% y/y.

UK Economics and Rates

Overall, UK economic releases remained strong. Retail sales rose 1.7% m/m and 3.7% y/y while sales ex autos rose 1.8% m/m and 4.2% y/y. Consumer confidence rose 2 to -5. Unemployment was unchanged at 7.2% while numbers employed grew 105,000 over three months compared to 193,000 previously. Construction output grew 1.8% m/m and 5.4% y/y. Industrial production was up 0.1% m/m and 2.9% y/y. Manufacturing PMI rose 0.2 to 56.9 although services PMI fell -0.1 to 58.2 and construction PMI fell -2.0 to 62.6. The Halifax house price index rose 2.4% m/m and 7.9% y/y over three months although mortgage approvals fell 6,600 to 70,300 per month. CPI fell to 1.7%, below the target of 2%

The Bank of England unanimously agreed to leave policy unchanged. While the minutes revealed that there were a wide range of views relating to the outlook for inflation over the medium term, a stronger sterling and lower household inflation expectations were seen as pointing towards downside risks to inflation over the medium term. It was noted that recent wage growth had been slightly higher than anticipated but its impact on inflation was being partly offset by productivity growth returning to historic average levels. Later in the month, Mark Carney, the BoE Governor, highlighted the potential risks to financial stability from a prolonged period of low interest rates. However he emphasised that the BoE and Financial Policy Committee were constantly monitoring the issue and would introduce any macroprudential policies required to deal with any risks which might be posed to financial stability from a sustained period of low rates. He also outlined a new strategic plan for the BoE with the intention to in future have greater co-ordination and overlap between monetary policy, financial supervision and financial stability to try and prevent but ultimately resolve any future financial crises.

Asian Economics and Rates

Japanese data generally remained strong for most of the month although there were some disappointing releases towards month end. Retail sales rose 0.3% m/m and 3.6% y/y. Small business confidence rose 2.9 to 53.5. Exports rose 9.8% y/y from 9.5% previously. Machine tool orders rose 26.1% y/y. Capacity utilization rose 5.9% m/m while the tertiary index was up 0.9% m/m. Fourth quarter GDP was revised down 0.2% to 0.7% annualized as consumption was revised down to 0.4% and business spending to 0.8%. Industrial production fell -2.3% m/m although was up 6.9% y/y. Manufacturing PMI fell 1.6 to 53.9. Consumer confidence fell 2.2 to 38.3 while the Economy Watchers survey current reading fell 1.7 to 53.0.

The Bank of Japan left policy unchanged as it was believed additional stimulus is not currently required. The assessment of the outlook for industrial production and capex were revised slightly higher while the outlook for exports was downgraded marginally. Subsequent comments from the BoJ Governor indicated that economic data post the 3% sales tax increase on 1st April would be closely monitored and reviewed to determine if additional monetary measures are required to meet objectives.

Chinese data continued to disappoint, even allowing for some lingering distortions caused by the timing of Chinese New Year. The HSBC manufacturing PMI index fell to 48.1 although the HSBC services index rose 0.3 to 51.0. The official manufacturing PMI index was down 0.3 to 50.2 while the official services index rose 1.6 to 55.0. Exports were down -18.1% y/y, industrial production growth slipped to 8.6% y/y from 9.7% and retail sales were up 11.8% y/y compared to 13.6% previously. Fixed asset investment did improve to 17.9% y/y from 17.2% although was below expectations. The weaker data flow gave rise to expectations of some policy stimulus from the authorities in efforts to boost growth.

Pacific Basin equities rose 0.7% (2.3% in €). Taiwan outperformed, rising 3.2% while New Zealand was up 2.8%. Hong Kong lagged, falling -0.9% as did Korea which was down -0.1%.

Irish Economics

Economic releases were somewhat mixed. Fourth quarter GDP disappointed, falling -2.3% q/q and -0.3% in 2013. GNP however, excluding multinational sector profits, performed better and was up 0.2% q/q and 3.4% for 2013. Within the breakdown of the GDP figures, exports were up 2.9% y/y in Q4 and 0.2% for the year. Imports rose 6.3% y/y in Q4 and 1.0% for 2013 resulting in a fall in net exports of 2.7% for the year. Domestic demand was up 2.0% y/y in Q4 but was down -0.3% for 2013. Investment rose 20.7% y/y in Q4 and was up 4.2% for the year. Consumption fell -1.1% on a y/y basis in Q4 and for the year as a whole. Monthly retail sales figures fell -1.5% m/m but were up 5.0% y/y. Sales ex autos fell -0.4% m/m but were up 2.3% y/y. Unemployment fell 0.1% to 11.9% while seasonally adjusted numbers on the Live Register fell 2,500 to 398,300. Manufacturing PMI rose slightly by 0.1 to 52.9 but services PMI fell 4.0 to 57.5. National residential property prices rose 0.1% m/m and 8.1% y/y. Dublin prices fell -0.6% m/m but rose 13.3% y/y. Prices outside Dublin rose 0.9% m/m and 4.2% y/y. Property transactions were up 21% over three months and 18% over twelve months. January trade data showed the trade surplus falling to an eleven month low of €3.1bn. Over three months however exports grew 2.1% y/y as pressures in the pharmaceutical sector eased, suggesting the deterioration in the trade data through 2013 could be close to an end.

Bonds

The Merrill Lynch Eurozone Government bond index >5 years posted a gain of 1.35% in March. Ten year German bunds ended the month 6bps tighter at a yield of 1.56% as the market has remained focused on deflation risks in the Eurozone.

After market tensions dissipated around the crisis in Crimea, focus in March moved on to the deflation outlook in Europe and potential action that the ECB may take to counteract it. The March estimate for inflation came in at +0.5% although this should increase to +0.9% in April once seasonal effects are allowed for. Expectations are building for further ECB monetary easing although it may not occur at the ECB Council meeting in April.

Market appetite for risky assets continued to be very strong throughout the month with 10 year Italian spreads dropping from 185bps to 175bps. We would expect this trend to continue over the coming months. If we see deflation risks reducing then yields on core rates should begin to rise, putting some pressure on total returns.

Emerging Markets

Emerging Market equities rose 1.9% (3.3% in €). The region continued to underperform in the first half of the month on the back of the weaker economic news flow in China given the sensitivity of the region to the Chinese economy while uncertainties relating to the tensions in Ukraine also impacted specific markets and overall emerging markets. Markets rallied in the second half of March as stresses in Ukraine eased and fears of an escalation of the crisis began to recede while hopes for some policy response from the Chinese authorities to boost growth also contributed to the rebound. Latin America outperformed, rising 6.0% with strong gains in Colombia which rose 11.3% following better economic data. Asian markets rose 0.9%. European markets fell -0.7% following the developments in Ukraine. On a sector basis, staples, financials and utilities outperformed while healthcare and technology underperformed. Emerging market equity funds saw outflows of $11bn in March although the pace of redemptions had slowed by month end with positive daily flows evident over the last few days of March.

Corporate Bonds

European investment grade corporate bonds rose 0.4% in March, outperforming US bonds which returned 0.1%. Performance across the various rating categories was broadly similar in Europe although lower rated credit outperformed in the US with BBB bonds up 0.3% while AAA/AA were flat. On a sector basis in Europe, media, insurance and transport outperformed while metal and mining, tobacco and autos underperformed.

Commodities

Commodities marginally fell by -0.1% during the month. Precious metals fell -3.4% with gold down -2.9% as tensions in Ukraine eased towards month end. Energy prices fell -1.2% as gas was down -4.1% again due to easing tensions in Ukraine while oil prices were also lower with Brent falling -1.2%. Industrial metal prices fell -2.4% due to weaker economic news flow in China as copper and zinc both fell -5.3%. Agricultural crop prices rose 7.5% due to weather related issues in crop growing areas. Livestock prices were also higher by 4.1%.

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