

# Schroders

## Monthly markets review

### Overview of markets in January 2015

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#### Highlights:

- Global equities as measured by the MSCI World index registered negative returns in January in dollar terms, largely due to weaker performance from US equities. Commodity prices continued to fall with Brent crude oil dropping below \$50/barrel.
- US equities posted negative returns amid a downbeat fourth quarter earnings season, with many companies citing concerns over the impact of the strong dollar.
- Eurozone and UK equities were supported by the European Central Bank's (ECB) announcement of a programme to purchase sovereign bonds which exceeded market expectations. Eurozone equities, in particular, gained strongly. Swiss shares experienced turbulence as the central bank dropped the franc's peg to the euro.
- Japanese equities posted a small positive return. Employment figures showed improvement but inflation data was below expectations, largely due to the lower oil price.
- Emerging markets made modest dollar-denominated gains. India was the best performing market as the central bank made a surprise rate cut. China posted positive returns. Fourth quarter GDP was slightly stronger than forecast at 7.3%.

#### US

The S&P 500 fell 3.0% in January on the back of a disappointing fourth-quarter earnings season, where worries about the impact of the strong dollar and slowing global growth were a recurrent theme. While the consumer may have remained in a buoyant mood, fragile business confidence - evident in disappointing durable goods orders - dominated sentiment. Even a dovish statement following the Federal Reserve's monthly rate-setting committee could not dispel the gloom.

News of better-than-expected December housing starts and home sales was consistent with the Conference Board's Consumer Confidence index striking a seven-and-a-half-year high in January, despite confirmation that December retail sales had disappointed. However, in the final trading days of January technology giant Microsoft, chemicals business DuPont, industrial conglomerate United Technologies, consumer goods leader Procter & Gamble and machinery manufacturer Caterpillar all produced disappointing results. The first four over these variously cited global growth headwinds and the strong dollar, while Caterpillar specifically pointed to the oncoming cut in energy sector capital expenditure plans resulting from the oil price collapse. The poor corporate results coincided with news that core durable goods orders (excluding defence) fell 0.6% in December, following a similar decline in November. The risk-off sentiment was reflected in a further retreat in the yield on benchmark 10-year Treasuries which ended the month at 1.33% versus 1.76% going into it. Worse-than-expected fourth-quarter GDP numbers did not help sentiment either.

Utilities was the month's best-performing sector, as would be expected from a bond proxy at a time of falling rate expectations in anticipation of global disinflation and amid eurozone deflation. Healthcare was another strong performer, where the biotechnology names stood out. The banks performed poorly, particularly the investment banks, as with their preliminary results came news of further provisions to cover regulatory fines, while their fixed income, currency and commodity trading operations struggled with difficult market conditions.

#### Eurozone

Eurozone equities made a strong advance in January with the MSCI EMU index returning 7.4%. Share prices were supported by the ECB's long-awaited announcement of a programme to buy sovereign bonds. The



central bank's asset purchases will total €60 billion per month, starting from March 2015 and running at least until September 2016. The programme is designed to boost growth and increase inflation back towards the ECB's target of close to 2%. Figures for December confirmed that the single currency area had fallen into deflation with an annual inflation rate of -0.2% compared to 0.3% in November. The preliminary inflation rate for January was -0.6%. The ongoing decline in the oil price was largely responsible for the drop.

There was more positive economic news for the eurozone with the flash composite purchasing managers' index (PMI) for January edging up to 52.2 vs 51.4 in December. Meanwhile, the German ZEW and Ifo sentiment surveys showed improvement, supported by the ongoing weaker oil prices. Spain posted Q4 GDP growth of 0.7% quarter on quarter, up from 0.5% in Q3. Germany's Dax was one of the best performing indices over the month while Spain's Ibex 35 was a laggard. All sectors posted positive returns, led by consumer staples and discretionary, while financials underperformed.

Concern over possible eurozone break-up risk was back on the agenda as Greece's general election was won by the left-wing, anti-austerity party Syriza. However, the impact was limited in the wider eurozone with little change to Italian and Spanish government bond yields. Outside of the eurozone, the Swiss National Bank's surprise decision to abandon the Swiss franc's peg to the euro caused significant market volatility with a sharp appreciation of the franc and shares of exporters coming under particular pressure.

## UK

UK equities outperformed in January as investors on this side of the Atlantic welcomed the ECB's decision to embark on a sovereign bond buying programme. The FTSE All-Share gained 2.6%. Stable and dividend-generating sectors of the market in particular were in demand as the ECB's planned monthly liquidity injection coincided with worsening global macroeconomic news, both conspiring to drive down benchmark borrowing costs. The 10-year Gilt ended the month offering 1.33% versus 1.76% going in to the period. Tobacco stocks and life insurers were among the top performers while the telecommunication firms did well too, all three promise respectable dividend yields. The telecommunications sector was further aided by news that Three could be merged with rival mobile network O2, serving to keep the focus on the consolidation potential in the sector, with BT in exclusive talks to buy EE.

Supermarket giant Tesco was a standout performer as the new management's recovery plan gained traction and, along with peer J Sainsbury, the firm reported strong festive trading. This was against an improving backdrop for UK households with news the Consumer Price Index slowed sharply to 0.5% in December. However, the domestically-focused UK companies lagged overall, with the general retailers producing mixed Christmas updates, including notable profit alerts from Debenhams and computer games retailer GAME Digital, while sector heavyweight Marks & Spencer also disappointed.

The house builders lagged as the market worried about a deceleration in house price growth, mortgage availability and uncertainty connected to May's UK general election. Overall, the domestically focused FTSE 250 rose 1.5%, significantly trailing the FTSE 100's 2.9% advance. The resource companies bucked the trend for large cap outperformance. Mining companies fell as metal prices further retreated amid ongoing Chinese growth fears while disappointing results from Royal Dutch Shell, the first multinational oil major to report, weighed on the oil & gas sector.

## Japan

The Japanese stockmarket rose by 0.5% in January after an initial decline was followed by a recovery in the second half of the month. The yen strengthened against most currencies, including a 5% gain against sterling, to improve the return for a UK-based investor.

There were stark differences in sector performance in January. The market was led by strong performances from traditionally defensive sectors such as pharmaceuticals and food, together with beneficiaries of low oil prices, including tyre makers, airlines and transportation companies. In contrast, all financial-related sectors and real estate declined sharply.

Japan's economic data continue to improve, suggesting that the impact of the consumption tax increase may finally be fading. We may therefore see a fairly sharp recovery from the technical recession shown in the previous GDP figures. Data released during January showed a continuation of the long-running trend of labour market tightening. The job-offer-to applicant ratio reached 1.15, the highest level for 22 years. The main negative was the weakening of inflationary pressures, partly caused by the weakness in oil prices. A lower

cost of imported energy is clearly a net positive for the economy but, in the short-term, it also acts against the Bank of Japan's aim of increasing inflationary expectations.

Most other news during the month was international rather than Japan-specific. Market sentiment was impacted by events in Europe, including the Greek elections and the ECB's move to ease monetary policy. A combination of external factors produced an element of 'de-coupling' between equity markets, allowing Japan to rise despite the stronger currency, while US markets declined.

## Asia (ex Japan)

Asia ex Japan equities delivered positive returns in January as the first month of the year saw renewed optimism from investors on Asian prospects given the likelihood of a sustained period of low oil prices and as the ECB's announcement of quantitative easing boosted sentiment for equities globally. Chinese equities recorded another month of gains as fourth quarter GDP came in better-than-expected, expanding 7.3% year-on-year. December output and retail sales numbers finished ahead of expectations while exports in December also recorded a better-than-expected rise. However, this optimism was tempered by HSBC's widely-watched December manufacturing PMI, which fell to 49.6 from a reading of 50 in November. Meanwhile, inflation edged up slightly to 1.5% year-on-year in December from 1.4% in November. For the whole of 2014, consumer price inflation came in at 2% compared to 2013 and well below the government's target of 3.5%.

In Hong Kong, equities gained strongly as investor sentiment was boosted by positive China data and hopes of further easing measures by Chinese authorities. Over the strait in Taiwan, the market finished up on the back of a strong showing for the island's technology sector. Fellow export-oriented market Korea saw its stocks gain as foreign investors returned to the market following hopes of improved corporate governance by large corporates.

In ASEAN, Philippine stocks were the biggest winner as the archipelago's fourth quarter GDP came in well ahead of expectations. Thailand's market also advanced while Indonesia's market finished down, with investors taking profits following its recent outperformance. Meanwhile, Indian stocks surged, and were the region's best performer, after a surprise interest rate cut by the Reserve Bank of India and the first such cut in more than 18 months.

## Emerging markets

Emerging markets recorded modest gains and the MSCI Emerging Markets (EM) index outperformed MSCI World in January. Emerging Asian markets delivered the strongest performance, led by India. The local market gained as the Reserve Bank of India made an unscheduled 25bps rate cut. The bank's governor highlighted easing inflationary pressures as providing headroom for the move amid speculation it heralds the start of a monetary easing cycle. The Philippines performed well as trade data showed a 21.7% year on year rise in exports and inflation dropped to 2.7%. China finished ahead of the benchmark. A Q4 GDP growth reading was slightly stronger than forecast at 7.3% whilst other data was firm; industrial production growth ticked up to 7.9%, retail sales accelerated to 11.9% and official manufacturing PMI was stable at 50.1. Malaysia lagged, with lower oil prices putting pressure on the local market and the ringgit, which fell 3.6%.

Emerging EMEA markets lagged the broader EM index, primarily due to currency weakness in central Europe. Egypt was the strongest market, with large index stock Commercial International Bank supporting performance. South Africa was the only other regional market to register a positive return as inflation eased to 5.3% on the back of falling energy prices. Greece was the regional laggard. Parliamentary elections which took place on 25 January saw left wing Syriza form a coalition with the small right wing Independent Greeks party – who share their anti-austerity view. The result sparked a heavy sell-off in banking stocks in particular.

Latin American markets all posted negative returns and underperformed the benchmark. Chile was the strongest market, down 4.0%, as the price of copper, its main export, declined 11.7%. Peso weakness accounted for all of the negative returns and the market was marginally positive in local terms. In underlying data releases, inflation eased slightly more than expected to 4.6% whilst a proxy GDP print was ahead of consensus at 1.3% year on year. The Brazilian market lagged. Weak commodity prices and an ongoing corruption scandal at Petrobras were the main headwinds to performance. During the month the Banco Central do Brasil hiked rates by 50bps to 12.25% as it continues to aggressively target high inflation. Colombia was the regional laggard as oil price declines weighed on the local market.

## Global bonds

Global bond markets made robust gains in January, as investors digested the ECB's expanded stimulus package and the oil price falling below \$50 for the first time since 2008. In its latest attempt to tackle the eurozone's stagnant macroeconomic data, the ECB unveiled a €60 billion-a-month asset-purchase programme; sending bond yields lower across the region. The euro also slipped a further -6.7% against the US dollar. Meanwhile, the oil price continued to drift downwards, keeping short term inflation expectations stifled.

The 10-year US Treasury yield fell from 2.17% to 1.64%, and the UK the equivalent gilt yield fell from 1.76% to 1.33%. Starting the month at 0.54% the 10-year Bund yield fell to 0.30% in the wake of the ECB's announcement. Peripheral European yields also fell further, the Italian 10-year rate dropping from 1.89% to 1.59% as the Spanish 10-year yield fell from 1.61% to 1.42%.

Investment grade<sup>1</sup> corporate bonds began the year positively. The investment grade BofA Merrill Lynch Global Corporate Index gained 2.34% (in local currency), and the global high yield<sup>2</sup> bond index rose by 0.45%. Corporate bonds advanced across US dollar, sterling and euro denominated indices. However, sterling credit was by far the strongest of the three; sterling investment grade bonds rising 4.99% and high yield gaining 1.74% through the month.

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<sup>1</sup> An investment grade credit rating means that the bond is thought to have a relatively low risk of default.

<sup>2</sup> High yield bonds are more speculative and have a credit rating below investment grade.

## Overview: total returns (%) – to end of January 2015

Equities	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	5.32	-1.79	1.96	28.57	7.58	17.72
MSCI World Value	4.19	-2.84	0.87	25.83	5.29	15.21
MSCI World Growth	6.42	-0.76	3.03	31.25	9.82	20.17
MSCI World Smaller Companies	5.32	-1.79	1.96	22.35	2.37	12.02
MSCI Emerging Markets	7.89	0.61	4.45	26.22	5.62	15.57
MSCI AC Asia ex Japan	9.93	2.51	6.42	35.53	13.40	24.09
S&P500	4.02	-3.00	0.70	36.51	14.22	24.99
MSCI EMU	7.43	0.18	4.00	15.41	-3.43	5.67
FTSE Europe ex UK	7.62	0.35	4.19	17.43	-1.74	7.52
FTSE All-Share	6.00	-1.15	2.62	16.98	-2.12	7.11
TOPIX*	10.05	2.62	6.54	22.73	2.69	12.37

Government bonds	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	10.35	2.91	6.84	28.38	7.42	17.54
JPM GBI UK All Mats	8.94	1.59	5.46	28.60	7.61	17.75
JPM GBI Japan All Mats**	9.46	2.07	5.97	7.81	-9.79	-1.29
JPM GBI Germany All Mats	2.31	-4.60	-0.96	10.66	-7.41	1.32
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	7.35	0.11	3.93	22.31	2.35	11.99
BofA ML US Corporate Master	10.18	2.74	6.66	29.70	8.52	18.75
BofA ML EMU Corporate ex T1 (5-10Y)	1.04	-5.78	-2.18	11.15	-6.99	1.77
BofA ML £ Non-Gilts	8.16	0.86	4.71	25.64	5.13	15.04
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	6.20	-0.97	2.82	18.13	-1.16	8.16
BofA ML Euro High Yield	0.95	-5.86	-2.27	5.69	-11.57	-3.23

Source: DataStream. Local currency returns in January 2015 \*0.54% \*\*0.00%. Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of any overseas investments to rise or fall.

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