

# Schroders

## Quarterly markets review

### Overview of markets in Q1 2015

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#### Highlights:

- Global equities registered positive returns over the first quarter with central banks in the eurozone and China easing monetary policy. Crude oil prices stabilised after their previous sharp drop.
- The S&P 500 delivered a modest positive return. The timing of the first interest rate hike now appears more distant. However, concern over the impact of the strong dollar limited the stockmarket's progress.
- Eurozone equities enjoyed strong returns after the European Central Bank's (ECB) announcement that it would buy sovereign bonds. The size of the package surpassed market expectations.
- Japanese equities gained amid some positive corporate earnings and were further supported by hopes that additional stimulus from the Bank of Japan would be forthcoming.
- Emerging markets posted positive returns. Chinese equities were supported by the authorities' moves to boost growth. Russia gained amid the stabilising oil price and hopes of a peace deal with Ukraine. Brazilian equities fell amid anaemic economic growth.

#### US

Merger and acquisition (M&A) activity and hopes of a further delay in the first rise in interest rates helped US equities record a modest gain over the quarter. These factors were counterbalanced by fears about the impact of the strong dollar on corporate earnings and fragile business sentiment.

The healthcare sector was the standout performer as Salix Pharmaceuticals received a counter offer from Irish-headquartered peer Endo Pharmaceuticals, trumping a bid from Canada's Valeant Pharmaceuticals. M&A activity was wide ranging with ketchup maker H. J. Heinz announcing a tie up with Kraft Foods and Charter Communications making a bid for rival cable operator Bright House.

The full-year reporting season underlined fears about the corporate sector. PC giant Microsoft, chemicals business DuPont, industrial conglomerate United Technologies, consumer goods leader Procter & Gamble and Caterpillar, a major supplier of equipment to the resources sector, all announced disappointing results. The first four 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.

Worries about the strong dollar were responsible for an end-of-quarter sell-off in anticipation of a disappointing first-quarter reporting season. Weak core non-durable goods orders gave fuel to the bears. Meanwhile, the bulls latched on to strong monthly non-farm payrolls, which included signs of a pick-up in wage growth. The Conference Board's consumer sentiment index rose to 101.3 in March, almost back to January's seven-and-a-half-year high.

Markets benefited from comments by Federal Reserve (Fed) chair Janet Yellen at her press conference which followed the two-day sitting of the Federal Open Market Committee in March. While the rate-setting body freed its hand to tighten monetary policy by dropping a pledge to be 'patient' in lifting rates, markets saw her comments as dovish and thought the likelihood of a June rise had receded.

#### Eurozone

Eurozone equities delivered strong gains over the first quarter, buoyed by the ECB's long-awaited announcement of full quantitative easing (QE). The package surpassed the market's expectations, with a total

of €60 billion of bond purchases a month until at least September 2016. The news sent the euro lower versus the dollar, suppressed bond yields, and supported equity market gains.

The ECB's QE announcement came in response to below-target inflation figures. Annual inflation was -0.6% in January though this improved to -0.3% in February and again to -0.1% in March. The falling oil price contributed to the weak inflation number but should relieve some pressure on consumers. Economic growth showed a modest improvement at 0.3% quarter-on-quarter for the fourth quarter of 2014, compared to 0.2% for the third quarter. Leading indicators were more robust with the flash composite Purchasing Managers' Index (PMI) reaching 54.1 in March.

The continued weakening of the euro saw the Swiss National Bank abandon the franc's peg to the single currency, in a move that sparked volatility on the Swiss stockmarket. Sweden's Riksbank cut its benchmark interest rate to -0.25%. Another focus was the election in Greece, with anti-austerity party Syriza leading the new government. This led to a renewal of 'Grexit' concerns but there was limited impact on the wider eurozone.

The fourth quarter earnings season was generally encouraging for eurozone corporates, with many exporters starting to reap the benefits of a weaker euro. Top performers over the quarter were economically-sensitive sectors such as consumer discretionary, with auto and auto parts firms enjoying particular strength. The utilities sector was the main laggard but still posted a positive absolute return. By country, Germany and Italy were the strongest major eurozone markets over the quarter.

## UK

It was a volatile quarter, with UK and global markets driven by top-down factors as investors attempted to guess when the US Fed would raise interest rates. The FTSE All-Share index rose 4.7% in the period, outperforming US equities but underperforming the eurozone.

Following a slew of earnings downgrades at the start of the year, expectations were generally met or bettered during the results season. Meanwhile, the UK's dominant resource companies saw their share prices stabilise, along with commodities as the price of oil and industrial metals stabilised. Metal prices and the mining companies were aided by the Chinese central bank's March move to reduce its lending and deposit rates.

M&A activity continued to support markets, in particular driving a strong performance from the healthcare sector. Investors welcomed Shire's acquisition of rival US biotechnology group NPS Pharmaceuticals and cheered the news that GlaxoSmithKline was to partially dispose of its Aspen Pharmacare unit to help shore up the group's finances.

The energy majors' results disappointed at the start of the reporting season. However, the 2014 results of airline group International Consolidated Airlines exceeded expectations, while cruise line operator Carnival also performed well on news of better-than-expected first-quarter results, in part due to lower fuel costs.

The FTSE 250 (6.7%) outperformed the FTSE 100 (4.2%). This was partly the result of M&A, notably a bid for tin can maker Rexam, and a strong showing from the mid-tier financials stocks. By contrast the domestically-focused constituents were volatile. The mid-tier general retailers were responsible for a series of profit warnings, although the housebuilders were buoyed on the back of a solid set of results.

## Japan

The Japanese stockmarket rose strongly throughout the first quarter of 2015, with the TOPIX Index registering a rise of 10.5%. Market optimism was largely driven by expectations of further easing by the Bank of Japan (BoJ) on the back of weaker data while, on another note, there were some encouraging signs that the recent excessive correlation between the stockmarket and the currency may be weakening.

The market was led upwards by strong performance in the pharmaceuticals, electric appliances and transportation equipment sectors. Conversely, given weaker commodity prices, mining and oil & gas were the leading underperformers (and were the only two sectors to finish with negative absolute returns over the period).

Economic data continued to be mixed as a key inflation gauge, which strips out last year's sales tax increase, showed year-on-year inflation in February was at 0%. The BoJ governor Haruhiko Kuroda predicted subdued

inflation was likely to continue and that a dip into negative territory cannot be ruled out. All this downbeat talk served to increase market expectations of further easing by the BoJ over the coming months. Industrial production data were also weaker, as output fell a worse-than-expected 3.4% from the previous month. The labour market data was itself mixed, with a slight rise in the unemployment rate, although labour market conditions remain undeniably tight. Japanese retail sales continued to disappoint as well, rising less than expected in February.

## Asia (ex Japan)

Asia ex Japan equities finished the first quarter of 2015 up strongly as further easing measures in China and a delay in market expectations of an interest rate rise by the US Fed drove gains. Chinese equities were up after central government authorities loosened policy further to support growth. The People's Bank of China (PBoC) cut the required reserve ratio (RRR) by 50 basis points in early February as it stepped up efforts to counter the impact of capital outflows and to alleviate tight liquidity conditions before the Chinese New Year. The central bank then cut interest rates in early March to help boost flagging growth. Towards the end of the period, regulators eased lending and tax policies on real estate as they looked to stop a slide in property prices.

In Hong Kong, equities gained strongly on the back of the Chinese easing measures as well as on the announcement that a trial programme connecting the stock exchanges of Shenzhen and Hong Kong would be launched. Over the strait in Taiwan, the market gained strongly over the month on the back of the island's technology sector as strong momentum for Apple suppliers, along with the Fed's dovish March statement, continued to support sentiment. In Korea, the market finished up as the Bank of Korea lowered interest rates to a record low of 1.75%.

In ASEAN, gains were led by the Philippines which surged on stronger-than-expected fourth quarter GDP figures. Thailand and Indonesia also both gained, with the former up on hopes of a rebound in growth while the latter gained on an unexpected interest rate cut. Meanwhile, Indian stocks again saw a strong quarter following a solid government budget that was broadly perceived as pro-business, with two interest rate cuts by the central bank spurring further gains over the quarter.

## Emerging markets

Emerging markets posted positive gains over the period as the MSCI Emerging Markets Index returned 2.3%. Emerging Asian markets led the advance with Chinese equities surging as the People's Bank of China (PBoC) cut the required reserve ratio (RRR) by 50 basis points in February before slashing interest rates in early March to help boost flagging growth. Market expectations of further easing measures also boosted sentiment. Korean and Taiwanese markets also advanced on optimism over a pick-up in growth for the US economy – a large market for the two exporting juggernauts – while Korea's market also benefited from an interest rate cut.

Emerging EMEA was a sea of red with Russia the only bright spot. The Russian stockmarket gained on a stabilisation in the oil price as well as renewed hopes of a peace settlement with Ukraine. A rebound in the rouble also allowed the central bank to cut interest rates twice during the period, with the latest cut being a 100 basis point reduction in mid-March. Greek stocks plunged as anti-austerity party Syriza emerged from a general election in January to lead a coalition government intent on reversing previously-agreed reforms. Disagreement between the government and the 'troika' of bailout lenders saw the return of speculation over a 'Grexit' and a sharp sell-off, particularly in banking stocks. Turkey's market also declined over the quarter as the lira dropped to an all-time low while a 50 basis point interest rate cut in February, putatively under pressure from the government, raised investor concerns over the central bank's independence.

In Latin American emerging markets, Brazil was the biggest loser as anaemic growth of its economy and ongoing corruption scandals at state-owned energy giant Petrobras weighed on returns. Colombian and Peruvian markets fell on the back of weaker commodity prices, which have exerted pressure on government revenues. Mexican equities also finished the quarter lower as weaker industrial production and manufacturing data dented investor confidence.

## Global bonds

The first quarter of 2015 was, broadly speaking, another period of yield compression in global bond markets. Speculation on the timing of first Fed rate hike continued, but the US central bank remained moderate in its appraisal of the economy's progress. Globally, monetary policy accommodation remained high or increased,

and 21 central banks have cut policy rates so far this year. Gilt, Treasury and Bund yields broadly fell, particularly with reference to bonds at the longer end of the yield curve.

The 10-year US Treasury yield fell from 2.17% to 1.92% and the 10-year gilt yield fell from 1.76% to 1.58%. The 10-year Bund yield fell from 0.54% to 0.18%. In peripheral Europe, Italian 10-year yields fell from 1.89% to 1.24% and the equivalent Spanish yield fell from 1.61% to 1.21%.

In corporate bond markets, investment grade bonds were marginally outperformed by high yield<sup>1</sup>. In both instances, bond prices responded positively to a firmer macroeconomic environment. The investment grade BofA Merrill Lynch Global Corporate Bond index rose by 2.13% but the high yield equivalent rose by 2.66%. Sterling corporate bonds outperformed US dollar and euro equivalents.

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<sup>1</sup> Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

## Overview: total returns (%) – to end of Q1 2015

Equities	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	15.44	2.45	7.61	36.81	6.60	19.72
MSCI World Value	13.06	0.34	5.39	31.54	2.50	15.11
MSCI World Growth	17.75	4.51	9.77	42.07	10.71	24.33
MSCI World Smaller Companies	17.80	4.55	9.82	33.37	3.93	16.71
MSCI Emerging Markets	15.24	2.28	7.43	29.35	0.79	13.19
MSCI AC Asia ex Japan	18.20	4.90	10.19	42.48	11.02	24.68
S&P500	13.74	0.95	6.03	44.67	12.73	26.60
MSCI EMU	18.74	5.39	10.69	21.35	-5.44	6.19
FTSE Europe ex UK	18.59	5.26	10.56	22.81	-4.30	7.48
FTSE All-Share	12.28	-0.35	4.67	21.78	-5.10	6.57
TOPIX*	24.51	10.50	16.07	44.03	12.23	26.04

Government bonds	3 months			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	14.67	1.77	6.90	36.32	6.23	19.30
JPM GBI UK All Mats	10.42	-2.00	2.93	31.11	2.17	14.74
JPM GBI Japan All Mats**	12.04	-0.56	4.45	13.95	-11.21	-0.29
JPM GBI Germany All Mats	3.71	-7.95	-3.32	11.63	-13.01	-2.31
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	11.18	-1.33	3.64	27.25	-0.84	11.36
BofA ML US Corporate Master	15.22	2.26	7.41	37.02	6.77	19.91
BofA ML EMU Corporate ex T1 (5-10Y)	1.74	-9.71	-5.16	10.33	-14.03	-3.45
BofA ML £ Non-Gilts	10.82	-1.64	3.31	29.43	0.86	13.27
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	13.06	0.34	5.39	25.07	-2.54	9.45
BofA ML Euro High Yield	3.00	-8.59	-3.98	5.36	-17.90	-7.80

Source: DataStream. Local currency returns in Q1 2015. \*10.53% \*\*-0.53%.

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