



Economic and market overview

Optimism reaches epidemic proportions

North America

For a third month running, investors around the world chose to interpret evidence of a deceleration in the rate of economic decline as a sign that a recovery might not be too distant. Better than expected GDP figures, a slowing rate of job losses and improving consumer confidence boosted investor sentiment. Even so, the numbers would make harrowing reading in more prosperous times.

Onlookers were cheered by May figures which showed the US economy had contracted by 5.7% in the first three months of the year as prior estimates had forecast a drop of 6.1%. Meanwhile, US consumer confidence rose to its highest level since last September.

Although US unemployment continued to rise, it did so at a slower pace than in recent months. It rose to 9.4% in May with the 345,000 job losses recorded only equal to around half of the average monthly decline seen over the previous six months. There were also some positive signs in the beleaguered US housing market. Despite US house prices falling by 19.1% in the year to April, according to the S&P/Case-Shiller Index, existing home sales rose, suggesting that lower prices might be tempting buyers back to the market.

Meanwhile, after months of speculation, the US car giant General Motors filed for the largest ever industrial bankruptcy shortly after the month end, leaving 72.5% of the company in the hands of the US and Canadian governments.

Against this backdrop, the FTSE All-World North America Index (which includes Canada), marginally underperformed the global average; it returned 6% over the month, compared to the FTSE All-World return of 6.7%, in local currency terms. The financial, oil and gas and basic materials sectors led the way, with the financial heavyweights Wells Fargo, Bank of America and JPMorgan Chase notable outperformers. By contrast, the telecoms sector was one of the few to end the period in negative territory.

With investor risk appetite remaining robust, the US yield curve steepened considerably with 30-year US government bonds delivering a loss of 4.3% as investor demand for “safe-haven” assets subsided.



Latin America

As inflationary pressures waned across the region, Latin American central banks continued to reduce their policy interest rates in a sustained effort to stimulate their economies. The month saw cuts in Chile, Colombia and Mexico. By contrast, with no interest rate decisions scheduled for May, the key Brazilian rate remained unchanged at 10.25%.

Meanwhile, month-on-month industrial production rose by 3.3% in Argentina and 1.1% in Brazil, contrasting with a 5.2% decline in Chile. Industrial output from most Latin American countries nevertheless remains below levels witnessed a year ago. Elsewhere, tensions grew between the Venezuelan authorities and privately owned companies after President Chavez declared that he was nationalising a number of oil service and industrial metals companies.

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Latin American equity markets extended their rally, generating a strong positive performance with the FTSE All-World Latin America Index rising 12.1% versus the FTSE All-World return of 6.7%, in local currency terms. Brazil rose 11.3% in May, boosted by the largest company in the index, Petrobras, a major energy stock which soared on the back of a recovery in the oil price. The industrial metals company SID Nacional similarly benefited from improving sentiment, while strong performance also came from the Sao Paulo stock exchange operator BM&F Bovespa and the Bank, Bradesco.

Mexico, the region’s second largest market returned 11.8% in May, helped by a recovery in the shares of the telecoms giant America Movil and the cement company, Cemex. The top performing countries over the month were Peru and Argentina, which rose 28.5% and 20.9% respectively.

Europe

Economic data in Europe over the month weren’t nearly as sanguine as its stock markets. In the Eurozone, GDP fell 2.5% in the first quarter to be 4.8% down on a year earlier. Germany’s economy was the worst casualty; it shrank close to 7% while Italy’s declined 6%. The French and Spanish economies were also at least 3% smaller. Meanwhile, industrial output in the single currency zone was nearly 20% down on the year before.

As expected, the European Central Bank (ECB) delivered a further 0.25% cut to take headline European rates to 1%. Meanwhile, European inflation also continued to rise with consumer prices adding 0.6% in the year to the end of April.

This contrasted with the position in the UK where lower energy and food bills helped inflation to drop from 2.9% in March to 2.3% in April. However, other UK data echoed the wider malaise. UK GDP fell 1.9% in the first three months of the year with manufacturing taking the worst hit. Output declined by 6.2% over the period as industrial production suffered its biggest quarterly fall since 1974.

Outside of the Eurozone, Norway’s central bank cut rates by 0.5% to a record low of 1.5%.

Most European equity markets continued to rally in May, albeit at a more restrained pace than in previous months. Europe underperformed global markets, with the FTSE All-World Europe ex UK Index returning 5.7% versus the FTSE All-World return of 6.7%, in local currency terms.

Of the larger Eurozone markets, France was the top performer, delivering 5%, while Germany managed 3.3% in euro terms. Elsewhere, Italy's stock market rose 6% while Spain's gained 5.7%. Meanwhile the region's largest market, the UK, returned 4.4%, in local currency terms.

Outside the Eurozone, Norway returned 15.9%, while Sweden gained 1.7% and Denmark made 8%. The performance of Eastern European countries was more of a mixed bag. The Russian market was by far the top performer in Europe overall, returning 28.4% after rising oil prices sparked a boom in the shares of the energy giants OAO Gazprom and Lukoil, which together account for over half the local market. By contrast, the only markets to lose ground over the month were the Czech Republic and Poland, which fell 0.5% and 1.4% respectively.

Sector leadership continued to be dominated by those areas previously most wounded by the economic downturn. Oil and gas stocks benefited from hardening commodity prices, as did mining companies and metals producers. Elsewhere, banks perceived by investors to be "healthy" relative to the sector overall did well, while those perceived as being vulnerable to further financial shocks were generally punished by the market.

The European Central Bank may have cut interest rates but it continued to resist pressures to adopt quantitative easing measures (increasing the amount of money in circulation). In the absence of such measures, bond yields in the Eurozone rose sharply. Long-dated German bonds lost 6.6% as a result. Meanwhile, UK government bond yields rose most sharply in the middle of the yield curve, with 10-year government bonds delivering a loss of 1.6%.

Asia

The region's central bankers continued to ease monetary policy in May with the Philippines, Singapore and Indonesia all trimming their headline rates to help stimulate their local economies. However, there were already strong signs that China's stimulus programme was gaining traction. Boosted by recently announced tax breaks on car purchases, Chinese car sales rose above the 800,000 mark in April, to set a new record. Despite slowing, industrial production also remained robust. Output rose by 7.3% in the year to April, down from a rise of 8.3% in the year to March.

Elsewhere in the region, Japan's economy shrank by 4% in the first quarter compared with the last three months of 2008, amounting to a 15.2% annual decline. The chief culprits were a drastic exports slump, a strong yen and dire earnings results from its consumer electronics companies. Meanwhile, Japanese unemployment hit 5%, its highest level in over five years. Some respite was provided by industrial output figures which showed a 5.2% uptick in April.

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Over the period, the FTSE All-World Asia ex Japan Index outperformed the global average, returning 11.3% compared to the FTSE All-World Index return of 6.7%, in local currency terms. Indian politics surprised many after the Congress party won the elections, sending the domestic market surging 20% in one day alone on expectations of unhindered economic reform.

Outside of India, the best performing markets in the region were the US dollar-based markets of Hong Kong, Singapore and Taiwan, while Australia and Korea lagged the global average. Elsewhere, the Chinese market returned just over 16%, while Japan progressed 7%.

The Japanese government bond yield curve steepened over the month as investors became increasingly concerned as to the country's rising national debt. As a result, long-dated Japanese government bonds declined 1.8% in May, contrasting with marginally positive returns for shorter-dated bonds. Elsewhere, 10-year Australian government bonds lost 5.2% in May, as the country's authorities announced a record budget deficit.

Commodities & currencies

In a month of bullish investor sentiment, commodity prices rose virtually across the board. Fuel commodities dominated the headlines amid a sharp rise in the oil price, with the cost of a barrel of West Texas Intermediate Crude increasing from US\$51 to US\$66 per barrel. With the exception of aluminium, which fell 4.4% over the month, industrial metal prices continued to rise, with nickel (+19%) and lead (+18.2%) leading the field, followed by zinc and copper, both up 9.3%. It was a similar story for the precious metals, with silver gaining 26.7% while gold rose 9.8%. Meanwhile, coffee and wheat ended the month as the top performing soft commodities, both gaining over 18% in May.

The US dollar remained under pressure, as demand rose for assets of greater risk and concerns grew over the outlook for US sovereign creditworthiness. Against this backdrop, the US dollar declined around 8.6% against sterling, and nearly 6.5% versus the euro. Meanwhile, sterling appreciated against most other major currencies, regaining previously lost ground amid an apparent stabilisation in the UK banking system. Elsewhere, a combination of an increased demand for risk assets and the relative fiscal health of the New Zealand, Australian and Brazilian economies led these commodity-linked currencies to rally strongly against the US dollar. Meanwhile, the Japanese yen continued to weaken against the other major currencies, weighed down by a revival in investor risk appetite.

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