MACRO AND MARKET REVIEW

May 2014

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MACRO REVIEW

The attention of financial markets was dominated by monetary policy issues, while economic data pointed out to a more mixed picture. The divergence between the Eurozone and the US is becoming more evident. The main headlines in May were:

- The **anticipation of the ECB policy easing**, i.e. the use of monetary stimulus to counteract low inflation, signaled further monetary accommodation at the next June meeting in light of low levels of growth (+0.2%) and inflation.
- **The above-trend growth in the UK**, which continued into Q2, alongside continued gains in employment.
- In the US, **the Fed's maintenance** of the steady **reduction of its asset purchases**, a stance confirmed by **improving numbers on inflation and unemployment** (6.3%), despite a **slowdown in the housing market,** which was perceived as a risk to growth.
- In Asia, the **Chinese economy slowed further**, while inflation (+1.8%) stayed benign. **In Japan, the GDP growth of +1.5% beat expectations**.

Elsewhere, **in India** there was the notable **landslide victory for the reform-minded BJP**. In Europe, the parliamentary elections saw the **endorsement for the Italian prime minister Matteo Renzi**, while the **Euro-sceptic parties were unable to dislodge the incumbents**, although the victories, in France for the Front National, and in Britain for the Ukip were reminders of voter's dissatisfaction about the speed of the economic recovery. Finally, **China and Russia signed a USD 400 billion gas supply deal** to import natural gas from Russia's Gazprom. This agreement should provide Moscow with a crucial new export market and stronger ties with China as Europe attempts to reduce its reliance on Russian supplies.

MARKET REVIEW

May was a strong month for both stock indices and government bond markets. The decline in government bond yields benefited from the growing expectations that there would be further policy easing from the ECB, while stock indices benefited from better US economic data. Volatility across many asset classes fell markedly. M&A activity continued to increase.

- **Global equity markets trended upwards.** In the US, the **S&P 500 was up +2.10%.** The MSCI Europe (+1.80%), the MSCI World (+1.63%) did well but underperformed the **MSCI EM (+3.26%)**. **Russia (+12.12%)** and **India (+8.03%)** were notable outperformers. The MSCI Asia rose 3.5%. Japan (+2.29%) did fine. On a sector basis, utilities, consumer staples and IT were the best performers. Stocks, which suffered from the sector rotation recovered sharply.
- In fixed income, the **rally in sovereign bonds** benefited from poor investor positioning and a growing understanding that levels of interest in the medium-term will be lower than in prior cycles. This move extended to **EM**, which **took advantage of significant net inflows in local markets**. The yield on the US 10-Year Treasury bond went from 2.65% down to 2.48%. **Credit spreads continued to tighten**, as investors are still hunting for yield.
- In currencies, the main event was the **strengthening of the USD** against the EUR (-1.67%) to 1.3640 and the GBP (-0.70%) to 1.6760.
- In commodities, **agriculture prices** in wheat, corn, coffee and cotton **retreated** due to better weather conditions in the US and a boost in supply from South America. **Gold** (-3.88%) and silver (-2.29%) **weakened** as risks associated with Ukraine dissipated. **Energy was mixed** with the crude oil (WTI) up +2.98% while the natural gas (-5.67%) weakened.

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