

Schroders

Monthly markets review

Overview of markets in May 2015

Highlights:

- Global equities managed to eke out positive returns in May. Emerging markets delivered a negative return, lagging their developed market peers.
- The S&P 500 struck a new all-time high. There was a so-called “reluctant rally” as investors continued to view equities as the least bad option. GDP data was disappointing but largely attributed to poor weather.
- Eurozone equity gains were somewhat muted. GDP growth for the region accelerated to 0.4% but German growth disappointed. UK equities were buoyed by a general election victory for the Conservative Party.
- Japanese stocks registered positive returns amid better economic data and further weakness in the yen.
- In emerging markets, Brazilian shares came under pressure amid fears tax breaks on equities would be ended. Chinese equities experienced weakness as the authorities took steps to rein in the recent market rally.

US

The S&P 500 struck a new all-time high in the period and ended the month up 1.3% overall. There was a so-called “reluctant rally” as investors continued to view equities as the least bad option with interest rates and bond yields anchored at record-low levels. After scaling new heights in the middle part of the month, US equities then retreated following a slew of poor macroeconomic data, including a disappointing first-quarter GDP print of -0.7%. Forward indicators also disappointed, including a notably lower-than-expected Chicago Purchasing Managers’ Index (PMI).

Meanwhile retail sales were flat in April although, on a more positive note, the Conference Board measure of consumer confidence rose in May, albeit the 95.4 reading was still some way off March’s level above 100. Core non-durable goods orders were weak again, further underlining the fragile state of business confidence. However, a rebound in non-farm payrolls in April, after March’s disappointing reading, supported the case for a second-quarter recovery in the US economy. The bulls further emphasised that the first-quarter growth disappointment was down to the poor weather and port closures. Despite the raft of poor data, the dollar strengthened and 10-year Treasury bonds continued to sell off as expectations were maintained that US base rates would rise later this year.

US corporate newsflow was also patchy. Retail giant Wal-Mart Stores reported disappointing first-quarter results amid lacklustre sales growth while profits were hit by rising wages and the strong dollar. Merger and acquisition (M&A) activity was a feature in the market as US regulators agreed to the combination of the country’s second and third largest tobacco groups Reynolds American and Lorillard. There was also talk cloud computing expert Salesforce.com might attract a bid.

Eurozone

Eurozone equities delivered positive returns in May, supported by improving economic growth. First quarter GDP growth for the single currency region was 0.4%, an acceleration from 0.3% in the final three months of 2014. German growth was perceived as somewhat disappointing at 0.3% but France grew 0.6%, Italy 0.3% and Spain 0.9%. Other economic data painted a mixed picture. The flash composite purchasing managers’ index declined for the second successive month in May as the services index fell although manufacturing activity improved. The German Ifo business climate indicator edged lower to 108.5 from 108.6.

European Central Bank board member Benoit Cœuré said the central bank would adjust its asset purchase programme over the spring and summer, increasing purchases in May and June as market liquidity is likely to dry up during July and August. However, the average monthly rate of €60 billion of purchases would not change. Greece's debt crisis continued to make the headlines. Negotiations with international lenders continued but there were mounting concerns that Athens may be unable to make debt repayments due in June.

Italian equities were among the best performers for the month, supported by gains for the financials sector. Spanish shares delivered negative returns following municipal elections that saw the ruling People's Party suffer its worst result in 20 years. Germany's DAX index also posted a slightly negative return. On a sector basis, information technology was the top performer with gains for merger partners Alcatel-Lucent and Nokia. Energy and telecommunications were the only sectors to register a negative return for the month.

UK

UK equities responded positively after the general election gave certainty over the political environment for the next five years, with the FTSE All-Share up 1.4% in the period. The market was one of the best-performing globally following the unexpected news of a majority Conservative government.

The market was given a further fillip by cross-border M&A activity. There was speculation that wireless operator Vodafone might merge with fixed-line operator Liberty Global. International Consolidated Airlines won Irish government support for its bid for Aer Lingus while the asset purchase deals from overseas rivals at FTSE 100 building materials group CRH and Imperial Tobacco moved towards completion.

The banks, housebuilders, bus and rail operators, gaming stocks, certain outsourcing companies and some of the utility groups performed well following the result of the election. The housebuilders in particular rallied strongly, further aided by positive corporate newsflow as Crest Nicholson and Barratt Developments both announced positive trading updates.

The FTSE 250 led the market higher, up 4.2% versus a 0.7% advance in the FTSE 100, aided in part by the recovery in the mid-tier housebuilders and gaming groups. Among the latter, high street betting shop operators Ladbrokes and William Hill performed particularly well in response to the more certain political outlook.

Japan

Japanese equities climbed steadily this month, in defiance of the seasonal weakness typically seen in May. For the month as a whole the Topix rose 5.1% having gained on all but three days. Meanwhile, the yen moved sharply weaker against major currencies, including both the US dollar and sterling. While this was helpful for equity market sentiment, it also reduced the return for a sterling-based investor.

Sector performance was mixed. Banks outperformed the market, together with some cyclical areas including machinery, steels and non-ferrous metals. However, real estate, mining and shipping stocks underperformed. The weakest sector was precision equipment which actually declined in absolute terms, while electric utilities rose strongly on speculation surrounding the restart of nuclear facilities.

Economic data were generally positive. The labour market continued to improve while consumer price data highlighted that inflation, although sluggish, was no worse than expectations. Capital expenditure data were stronger than expected and may lead to upward revisions to GDP. Bank lending data also remained firm in April, supported by lending to real estate and to corporates for M&A.

The corporate results season concluded in May, showing profit growth as expected with relatively few surprises. Corporations appear to have been cautious in making forecasts for this year, and some of these numbers look especially conservative in light of the subsequent move in the currency. The recent positive trend towards increased dividend pay-outs and share buybacks has also continued, as has the increased focus of management on targeting higher returns on equity.

There was one major piece of negative corporate news as Toshiba revealed the possibility of accounting irregularities related to some of its large infrastructure projects undertaken over the last few years. The announcement of an investigation into these issues led the company to delay its results announcement, postpone its AGM and cancel its dividend.

Asia (ex Japan)

Asia ex Japan equities finished May down, as Chinese equities led losses on the back of negative sentiment given a raft of measures aimed at reining in the market's recent vertiginous ascent. Chinese equities fell over the month as a clampdown in margin trading and a raft of new share sales, via initial public offerings, dented investor confidence. Even a further interest rate cut, the third such cut in six months, could not halt the losses as data continued to highlight the extent of the slowdown in the Chinese economy. HSBC's widely-watched manufacturing PMI fell to 48.9 in April, the lowest level since April 2014, while imports and exports for April also posted a worse-than-expected decline.

In Hong Kong, stocks finished marginally down as investor sentiment remained muted on the pullback in China markets. However, over the period Chinese and Hong Kong regulators agreed to a 'mutual recognition' scheme that will see cross-border mutual fund sales between the two markets from 1 July. Over the strait in Taiwan, stocks fell on the back of weakness in materials and financials while fellow exporter Korea saw its market fall on profit-taking following the market's recent outperformance.

In ASEAN, the Philippine market fell on disappointing first GDP growth while Thai stocks also declined given weak trade data and Indonesian stocks bucked the trend to finish the month up. Meanwhile, Indian stocks also registered gains as recent underperformance saw some investors re-enter the market given its more attractive valuations.

Emerging markets

Emerging markets recorded negative returns in May and the MSCI Emerging Markets (EM) index declined in value to underperform MSCI World. Latin America was the worst performing region, led by poor returns in Colombia. Equities declined, reflecting the continued headwind of a lower oil price. Losses were magnified by a 5.9% depreciation in the peso relative to the US dollar. The Brazilian market was down over the period amid rumours that the country's tax breaks on equities would be ended. Economic indicators remained depressed as the government and central bank maintained course on its adjustment programme. Mexico and Chile both outperformed the broader market. In Mexico, a GDP print for the first quarter was marginally ahead of consensus at 2.5% year on year while other data was generally firm.

Emerging EMEA performed poorly on the whole. South Africa lagged the benchmark as a number of macro releases disappointed. In Poland, the local market moved sharply lower following the electoral victory of the main opposition party, which is widely viewed as less business-friendly than the Civic Platform, the governing party for the past eight years. Russia underperformed towards the end of the month as oil prices softened somewhat. Turkish equities were volatile amid uncertainty about the upcoming parliamentary elections, which are scheduled for 7 June. Meanwhile, macro data was broadly positive, and the central bank left rates unchanged as inflation edged up. Greece posted negative returns but outperformed the MSCI EM index, helped by strong performance from Piraeus Bank. This was despite mounting concerns that Athens may be unable to make debt repayments that fall due in early June.

Emerging Asian markets were mixed. Indonesian equities made gains as first quarter GDP growth of 4.7% year on year was broadly in line with expectations. After a recent period of weakness, Indian equities saw some investors re-enter the market given its more attractive valuations. Firm macro data was also supportive. China managed to outperform wider emerging markets despite a fall in the stockmarket, as equities retraced a portion of the significant gains generated in March and April. Macroeconomic data remained relatively weak, with trade data missing expectations. Korea also posted poor performance, largely due to further weakness in the outlook for global growth. This was reflected in weak trade figures for April, which were worse than anticipated.

Global bonds

In May, fixed income markets were once again influenced more by investor speculation than any clear changes in the policy backdrop. Referencing the US' recent moderation in economic growth, the Federal Reserve (Fed) left its key policy rate unchanged. However, the Fed alerted investors to the fact that an initial rate rise could be expected at any meeting from June onwards. The Bank of England's (BoE) May inflation report was less hawkish, revising down growth and inflation forecasts amid more fragile economic data. In Europe, economic growth and productivity improvements persisted from Q1, led by Italy, Spain and France.

Against this backdrop, Treasury and Bund yields rose, whilst gilt yields were little changed or lower. The 10-year US Treasury yield rose from 2.03% to 2.12% and the 10-year Bund yield rose sharply, from 0.37% to 0.49%. Italian and Spanish bond yields also rose more aggressively. The 10-year Italian yield rose from 1.50% to 1.85% and the Spanish equivalent rose from 1.47% to 1.84%. The 10-year gilt yield fell from 1.83% to 1.81%.

As in April, investment grade corporate bond returns reflected the softer sovereign bond returns, and high yield bonds outperformed¹. The investment grade BofA Merrill Lynch Global Corporate Bond index fell -0.36%, while the high yield equivalent gained 0.44%. Sterling credit markets noticeably outperformed dollar and euro equivalents.

¹ 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 May 2015

Equities	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
MSCI World	2.65	0.43	1.14	32.26	6.27	16.81
MSCI World Value	2.19	-0.02	0.69	27.60	2.53	12.70
MSCI World Growth	3.08	0.86	1.57	36.90	10.00	20.92
MSCI World Smaller Companies	3.74	1.49	2.21	33.19	7.02	17.64
MSCI Emerging Markets	-1.87	-3.99	-3.31	24.87	0.33	10.29
MSCI AC Asia ex Japan	-0.45	-2.60	-1.92	37.69	10.63	21.61
S&P500	3.52	1.29	2.00	39.15	11.81	22.90
MSCI EMU	0.76	-1.42	-0.72	15.87	-6.90	2.34
FTSE Europe ex UK	1.30	-0.89	-0.19	18.53	-4.76	4.69
FTSE All-Share	2.86	0.64	1.35	21.68	-2.23	7.47
TOPIX*	3.57	1.33	2.05	44.81	16.36	27.90

Government bonds	1 month			12 months		
	EUR	USD	GBP	EUR	USD	GBP
JPM GBI US All Mats	1.98	-0.22	0.48	28.81	3.50	13.77
JPM GBI UK All Mats	1.96	-0.25	0.46	25.44	0.79	10.79
JPM GBI Japan All Mats**	-1.99	-4.11	-3.43	4.78	-15.81	-7.46
JPM GBI Germany All Mats	-1.08	-3.22	-2.53	7.13	-13.92	-5.38
Corporate bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global Broad Market Corporate	1.04	-1.14	-0.44	20.31	-3.33	6.26
BofA ML US Corporate Master	1.68	-0.52	0.19	28.02	2.86	13.07
BofA ML EMU Corporate ex T1 (5-10Y)	-0.53	-2.68	-1.99	6.15	-14.71	-6.25
BofA ML £ Non-Gilts	1.88	-0.32	0.38	23.38	-0.86	8.97
Non-investment grade bonds	EUR	USD	GBP	EUR	USD	GBP
BofA ML Global High Yield	2.23	0.02	0.73	22.14	-1.86	7.87
BofA ML Euro High Yield	0.15	-2.02	-1.32	4.34	-16.16	-7.84

Source: DataStream. Local currency returns in May 2015: *5.08% **-0.56%. 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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