market analysis: December 2011

5 January 2012

December was a mixed month for the equity markets reported here, with small gains in Hong Kong, the UK and the US, whilst the MSCI Emerging Markets index and Eurostoxx 50 were both down. Overall in 2011, the equity markets here were all down since the beginning of the year with the exception of the S&P 500 in the US which ended the year level.

The Eurozone remains the key area of focus for investors and analysts. The meeting of EU leaders in the middle of the month provided drama when David Cameron effectively vetoed the Franco-German plan for an EU wide set of legislation to impose budget targets on all member states. Instead the other 26 EU nations will implement their own agreement which aims to increase the power of the EU to penalise those countries which break budget targets. Another controversial topic was the proposed introduction of a financial transaction tax which Cameron felt would hit London hardest. Elsewhere in the Eurozone, the headline borrowing rate set by the European Central Bank was reduced again by 0.25% to 1.00% and both S&P and Fitch rating agencies warned the European countries that their rating was under threat.

In the UK, the government backed plans which called for a separation of the retail branch of the banks from the perceived riskier investment arm. In light of the increased capital and liquidity requirements for Banks agreed by the EU, these changes have the potential to result in a very different banking sector from that of the 'light touch' regulation of recent years.

There was a significant drop in the price of Gold in December, which finished the month down 10.5% at $1,564 per ounce. These losses may have been a result of profit taking from one of the strongest performing assets throughout 2011 (up 10.2%). Demand for gold remains strong however, witnessed by a substantial rise in purchases by central banks.

Key Data

	30 Nov 2011	30 Dec 2011	+/(-)%	+/(-)% in 2011
FTSE 100	5,505.42	5,572.28	1.2	(5.6)
S&P 500	1,246.96	1,257.60	0.9	0.0
EuroStoxx50	2,330.43	2,316.55	(0.6)	(17.1)
Nikkei 225	8,434.61	8,455.35	0.2	(17.3)
Hang Seng	17,989.35	18,434.39	2.5	(20.0)
MSCI EM	928.32	916.39	(1.3)	(20.4)
Crude Oil (Brent)	$111.25	$107.70	(3.2)	13.8
Gold	$1,748	$1,564	(10.5)	10.2
£ = $	1.561	1.541	(1.3)	(1.2)
Euro = $	1.333	1.296	(2.8)	(3.1)
£ = Euro	1.171	1.189	1.5	2.0
FTSE Index Linked Gilts	3,164.57	3,236.75	2.3	19.9
FTSE Gilts All Stocks	2,786.87	2,834.09	1.7	15.6

Interest Rates

Bank of England Base Rate	0.50%
ECB Refinancing Rate	1.00%
US Fed Funds Target Rate	0.00% -0.25%

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The following sections review some of the major economic events of 2011:

UK

In a year when the Bank of England Base Rate remained at a record low of 0.5%, the UK saw inflation at over 5%, record unemployment levels and sluggish GDP growth. The coalition government's plan to effectively protect the UK's AAA credit rating has worked, with UK government borrowing costs amongst the lowest in Europe.

EUROPE

Undoubtedly the major economic story of 2011 has been the well documented Eurozone crisis. The scale of national and private debts in the Eurozone is staggering and a lack of investor confidence has led to problems in Italy and Spain, much larger economies than Greece and Ireland. The crisis has highlighted the difficulties of managing a single currency for several member states with different fiscal outlooks and the year ended with the prospect of increased EU control of national budgets.

US

The US has proved remarkably resilient in 2011, witnessed by relatively strong GDP growth of over 2% per quarter and a reasonable performance by the S&P 500 which finished the year roughly where it had started. However, 2011 was not all straightforward with the US losing its AAA debt rating and a last minute agreement to raise the national debt averting a default by a matter of days in July.

ASIA/PACIFIC

The headline news in Asia/Pacific in 2011 was undoubtedly the earthquake and tsunami that hit Northern Japan in March. The economic impact of this tragic event was immediate, with the Nikkei 225 dropping nearly 20% on the next day of trading. In other news, China officially overtook Japan as the world's second largest economy whilst both China and India struggled to contain high rates of inflation which threatened economic growth.

EMERGING MARKETS

2011 was a difficult year for emerging markets with the MSCI Emerging Markets index down over 20%. Many emerging markets are dependent on exports to developed economies which are also struggling and are therefore dependent on a global recovery. Local political factors such as the uprisings in many Arab countries also increased economic volatility.

FIXED INTEREST SECURITIES

Many people are now perhaps more familiar than ever with the cost of national borrowing, especially in the EU, as yield rates on sovereign debt became headline news in 2011. The key rate in the EU appeared to be a yield of 7% on 10 year bonds, the rate at which the Greek and Irish economies were deemed to require a bailout and prompted the demise of Silvio Berlusconi in Italy.