US – Share prices fall as investors are underwhelmed by Fed intervention

With US politicians unable to agree a plan to fix the faltering US economy, the Federal Reserve announced a new programme of bond-buying, which it hopes will help “make broader financial conditions more accommodative”. Operation Twist will see it buying some $400 billion of long-dated Treasuries (those maturing over the next six to 30 years); the Fed hopes this will lower mortgage rates, car loan costs and credit-card bills and thereby prop up sagging consumer demand. In contrast to the quantitative easing that preceded it, these bond purchases will be financed by the sale of an equal amount of bonds with three years or less to run, allaying fears that the Fed might be fuelling inflation and debasing the dollar. The stock-market’s response to Operation Twist was, however, less than enthusiastic – falling market indices suggested disappointment that the Fed was unwilling to embark on a third round of fully-fledged quantitative easing. In response, the S&P 500 index fell by 2.8% – its fifth consecutive monthly loss and the longest losing streak since March 2008. Despite tumbling market indices, there was some positive news. The ISM-Chicago survey showed business activity accelerating in September, rising to 60.4 from 56.5 in August. Meanwhile, the University of Michigan consumer-sentiment index climbed to 59.4, rallying from the lowest level since November 2008, indicating that Americans are less pessimistic than they were in August.

UK – Fears of a global double dip weigh on the mining sector

The UK market found itself being punished in September for the international reach of many of its companies. While there was little fresh news on the state of the domestic economy, the FTSE All Share fell, led by the heavyweight mining sector. Metal prices plunged as the International Monetary Fund released a gloomy assessment of the state of the global economy, noting that it had entered a “dangerous new phase”. Investors are worried that a slowdown (or recession) in the US coupled with slowing growth in China might lead to a sharp fall in demand for industrial metals, such as copper. The price of copper fell by 24% on the month, hurting shares of mining groups such as Rio Tinto, BHP Billiton, Kazakhmys and Xstrata. The luxury goods group Burberry, a third of whose sales are generated in the Asia Pacific region, also came under pressure as worries about a slowdown in the Chinese economy mounted. Shares in video-game retailer Game Group fell after it reported a doubling in pre-tax losses reflecting the tough trading conditions on the British High Street. Despite ongoing worries about fragile consumer confidence, the restaurant and pub operator Mitchell & Butler’s received a £941m takeover offer from Piedmont. Meanwhile, the London Stock Exchange (LSE) offered €500m for a majority stake in clearing house LcH.Clearnet. The LSE
hopes the deal will cheer up shareholders disappointed by the failure of its proposed merger with the Toronto Stock Exchange earlier this year.

**Europe ex-UK – Banks under renewed pressure as the sovereign-debt crisis intensifies**

Share prices on European bourses plunged in September, which brought another twist in the convoluted tale of the sovereign-debt crisis. Some eurozone members threatened to withhold bailout funds for Greece leading to feverish speculation that a disorderly Greek debt default might be imminent. Disagreements between the government in Athens and the so-called “troika” of inspectors from the IMF, ECB and the eurozone over the need for further austerity measures added fuel to the fire. Despite an austerity budget designed to eliminate its deficit by 2013, Italy’s credit rating was downgraded from A+ to A by Standard & Poor’s, which cited the country’s weak growth prospects. In equity markets, banks bore the brunt of the sell-off, with shares in French lenders – who are heavily exposed to both the Greek economy and to Greek government bonds – seeing extreme volatility. Moody’s downgrade of Société Générale, one of the ‘big three’ French banks, added to the air of panic, coming shortly after news that the German industrial giant Siemens had withdrawn more than €500mn in cash from the bank amid concerns about SocGen’s financing position. The IMF’s insistence that European banks should be recapitalised – by force if necessary – only added to the jitters. There were signs that market volatility and economic uncertainty were having an impact on the real economy as data showed German retail sales fell by the most in more than four years as concerns about the economic impact of the sovereign-debt crisis sapped consumers’ willingness to spend.

**Japan – Shrinking output and the rising yen weigh on share prices in Tokyo**

Share prices in Tokyo followed the global trend lower in September – at one point the Nikkei 225 touched a two-and-a-half-year low. However, the strength of the yen ensured that sterling-based investors enjoyed a modest positive return on their Japanese holdings. The concerns preoccupying investors in Japan differed slightly from those in other markets. While the rest of the world focused on Europe’s debt crisis and on slowing global growth, the big worries in Japan were the strength of the yen and the question of how to pay for rebuilding the infrastructure destroyed in the March earthquake and tsunami. There was fresh demonstration of the economic damage wrought by the earthquake and the strong yen as revised GDP data showed that the Japanese economy shrank by 2.1% on an annualised basis in the three months to the end of June. Despite ongoing intervention in the currency markets, safe-haven inflows ensured that the yen remained just below the post-World War II high, hurting the country’s exporters, who have responded by reining in capital expenditure. Meanwhile, the government followed up August’s announcement of a ¥13 trillion investment programme by unveiling a surprise privatisation plan, the proceeds of which will go towards the cost of rebuilding the country’s earthquake- and tsunami-devastated Tohoku region. The biggest source of funding will come from the sale of its 50% stake in Japan Tobacco, one of the country’s largest companies. The privatisation programme could raise more than ¥2000bn, reducing the pressure on the government to raise taxes.

**Asia – Global and local concerns combine to send Asian markets lower**

Asian stock markets faced two main challenges in September. The first concern was that a double-dip recession in the West might affect demand for the region’s exports. Those fears was given added weight by the publication of data showing that industrial production in South Korea had fallen by 1.9% in August from the previous month, while confidence among South Korean manufacturers remained at a 21-month low. The second factor was renewed fears that the Chinese economy may be slowing far more quickly than previously expected, prompting renewed fears of a ‘hard landing’ in Asia’s largest and most vibrant market. The purchasing managers’ index for China’s service sector plunged to a record low while the manufacturing index shrank for a third month, the longest contraction since 2009, as export demand declined. As a result, share prices fell sharply, with Hong Kong – a liquid proxy for the Chinese market – plunging by 10.4% on the month. There were also signs of problems in the Australian economy, which has grown increasingly dependent on Chinese demand. Data showed that unemployment rose unexpectedly to a 10-month high. Meanwhile, the NAB business confidence survey showed sentiment at its lowest ebb since April 2009. New Zealand’s currency, the kiwi dollar, fell to its lowest level in six months against the US dollar after Standard & Poor’s followed Fitch Ratings in cutting the country’s credit rating, adding to
concern that borrowing costs will increase. Explaining the reason for the cut, Fitch cited New Zealand’s high level of external debt and its persistent current account deficit.

**Emerging markets – Plunging market indices dash investors’ decoupling hopes**

Until earlier this year, some investors had hoped that emerging markets could “decouple” from their developed-market peers should share prices in the West fall. Those hopes, however, have proven to be illusory. Amid signs of a global economic slowdown – and the threat of a second financial crisis focused on the eurozone’s banking sector – September’s flight to safety witnessed the wholesale dumping of risk assets such as emerging-market equities. As a result, it was another extremely weak month for emerging markets; the MSCI Emerging Markets index fell by 10.7%. As markets fell, September saw a sharp divergence in monetary policy between two of the ‘BRIC’ economies. The Brazilian central bank responded to fears of a global slowdown by unexpectedly cutting interest rates by 50 basis points. At 7.2%, inflation remains a worry, but policymakers were guided by fears that a global slowdown might hurt the domestic economy. Despite the rate cut, the Brazilian market remained under pressure. In contrast, the Reserve Bank of India raised interest rates again as part of its efforts to tackle inflation, hiking rates by 25 basis points to 8.25%. There was some good news, however. Share prices in Turkey surged after Standard & Poor’s raised the country’s sovereign-debt rating to investment grade. In response, the stock market enjoyed its biggest one-day gain since last May.

**Government bonds – Continued risk aversion supports Treasuries over credit**

Major government bond markets remained in demand in September. Investors continued to be concerned about the ongoing debt crisis in Greece, with its potentially devastating repercussions, as well as the gloomy economic outlook across much of the western world. Greek bonds plummeted as investors priced in the growing prospect of a default. Despite a generally strong performance in Treasury markets, we saw downward moves in the long end of the US yield curve after the Fed’s efforts to increase the maturity of its Treasury portfolio. UK gilts performed well; long-dated bonds were the best-performing sector, while short-dated bonds lagged for the third consecutive month. Most economic surveys in the UK remained disappointing – and GDP growth suffered further downgrades. However, this month’s data provided occasional positive surprises too: the Rightmove house price survey rose in September, with asking prices up 0.7% month on month. Mortgage lending also rose by 6% in August. With economic data underwhelming, minutes from the latest Bank of England meeting showed most policymakers saw a stronger case for quantitative easing. Index-linked gilts performed in line with conventional gilts.

**Corporate bonds – Credit spreads widen further as sentiment deteriorates**

Meanwhile, corporate bond markets remained weak in September, continuing their sell-off from last month. Credit markets remained caught up in the broad-based shift out of equities into government debt. Indeed, deteriorating news on European debt and global growth led to an acceleration of the widening of credit spreads in September. As a result of the weak market, new issues were few and far between. Those able to refinance were typically safer issuers, such as utility company Scottish & Southern Energy, which this month broke a six-week drought in European corporate bond issuance. Several French non-financial borrowers followed – some investors claimed that the stresses suffered by the French banks are behind the surge of issuance in the non-cash credit market. The European high yield market was also closed for much of the month. There were only two opportunistic issues, with BB-rated bonds from strong German issuers Fresenius Medical Care and HeidelbergCement. Despite the weak tone, the outlook for defaults among high-yield issuers remains good. Moody's reported that global high-yield defaults had actually fallen to 1.8% in August, from 1.9% in July, despite the recent market turbulence. The European default rate was even lower and remained unchanged at 1.1% in August.

**Emerging-market bonds – Investors finally take profits from emerging markets**

Demand for emerging market bonds fell sharply in September, the asset class having performed much better than expected in recent months as other riskier assets saw price falls. This month, the weaker picture in Western economies forced investors to consider the impact on emerging markets – while their domestic economies may be more resilient than those in
the indebted West, many are exporters and therefore exposed to Western demand, which is expected to fall heavily. Indeed, late in September, the Brazilian central bank cut its growth forecast to less than half of last year’s, blaming in part the slowing global economy. Meanwhile, in China, the HSBC China PMI for September remained below the dividing line indicating growth and contraction.