ECONOMIC & MARKET OVERVIEW

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For Professional Clients only

ALL EYES ON THE US AS INTEREST RATES TAKE CENTRE STAGE

The FTSE All-World local currency index rose 1.0% in May, bringing 12-month performance to 13.8%. The FTSE World Asia Pacific Index was the strongest region for the second month running, adding 1.5%, equating to a 12-month return of 25.0%. The FTSE All-World Middle East and Africa Index was the worst performing region overall, declining 5% in May.

On a global sector view, healthcare stocks returned the most over the month (3.5%), followed by technology stocks (2.2%). Oil and gas gave up the most ground, falling 4.6%.

TO HIKE OR NOT TO HIKE?

The timing of a possible US interest rate hike once again took centre stage in May, with economic data coming under the usual close scrutiny as a result. In any event, May's figures offered something of a mixed bag. Revised Q1 GDP figures showed a 0.7% deterioration in growth, partly due to weaker consumer spending. This was offset by payroll data for May showing the US economy added 280,000 jobs over the month, well ahead of Bloomberg expectations of a 226,000 gain.

In markets, the Nasdaq suffered a mini correction as investors took stock of tech valuations. Twitter, LinkedIn, Alibaba and Yelp all briefly suffered, with Twitter at one point falling some 26%, before recovering lost ground by the end of the month.

The world of mergers and acquisitions (M&A) shrugged off the mixed messages, however, with US deals in May smashing records set during both the dotcom and debt booms. The overall value of deals in US-bound M&A came to US$243bn in May. That compares with US$226bn in May 2007 and US$213bn in January 2000, the previous biggest and second biggest months respectively.

In a zeitgeisty move, US semiconductor maker Avago acquired sector peer Broadcom for US$37 billion, making for the largest ever acquisition in the semiconductor industry. Cable operator Charter Communications' US$79bn deal to acquire Time Warner Cable hit a similar 'sign of the times' note.

US equities finished the month 1.3% higher, equating to an 11.7% return over 12 months.

EUROPE: GREXIT REDUX

In the Eurozone it was déjà vu all over again as the Greek debt crisis rumbled on with still no conclusion in sight. Mid-month, the country came close to defaulting on a €750m International Monetary Fund repayment but scraped by using emergency funds. Prime Minister Alexis Tsipras and his leftist Syriza party have until the end of June to agree a new reform deal. Despite the lack of progress, markets appeared to have factored in a positive resolution to the crisis: Greek equities posted Europe's strongest returns in May, gaining 4.9% in euro terms.

Elsewhere in the eurozone, profit-taking was the name of the game as Germany equities fell, losing 0.2% for the month. French equities were slightly stronger, gaining 0.7%. Stockmarkets in both countries have made strong gains over 12 months, with German shares adding 15.8% and French shares 15.2% in that time.

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In the UK, a surprise victory for the ruling Conservative party in May's general election saw a sharp rally in Sterling and equities. Investors had been concerned over the prospect of a hung parliament but the Conservatives ended up with 331 seats, a majority.

BNY MELLON

Nonetheless, UK economic data disappointed. First quarter GDP growth remained unchanged at 0.3%, despite expectations of an upwards revision, making for the slowest rate of growth since 2012. The UK manufacturing sector was also weak, with the purchasing managers' index achieving only a small rebound from its lacklustre reading in April. Meanwhile, the UK officially slipped into deflation for the first time in more than half a century. UK equities gained 0.9% in May, equating to a 12-month return of 6.2% in local currency terms.

Russian equities were the worst overall performers in Europe in May, losing 5.8% as ongoing sanctions, the conflict in the Ukraine and the prospect of a new cold war chilled investor sentiment.

CHINA'S SLOW-MOTION SLOWDOWN

In Asia, China's exports fell for a third month running in May, while imports slumped the most in three months, underscoring sluggish domestic demand. In a bid to boost spending, the People's Bank of China cut its benchmark interest rate by a quarter-point to 5.1%, its third cut in six months, while also lowering its deposit rate by the same amount to 2.25%.

Towards the end of the month, Chinese equities finally lost some of their exuberance after recent record-breaking highs, shaking off some 3.4% over the month. The 12-month return on Chinese equities came in at 39.9%.

Elsewhere in Asia, Japanese equities were the standout performer in May, gaining 5.2%. Over 12 months they have gained 42.8%, the most of any of the world's major global economies. Investors took courage from a rise in exports to the US and a smaller-than-expected current account deficit.

Employment figures for April were also encouraging: at 3.3% the unemployment rate was at its lowest since 1997. Less encouraging were figures showing a fall in household spending in April while inflation dropped once more to zero.

COMMODITIES: VOLATILITY REIGNS

Gold initially hit a three-month high in May at US$1,225 an ounce, as investors reacted to weaker US economic data and the prospect of interest rates staying lower for longer. Nonetheless, the rally proved to be short-lived with the precious metal falling back to close the month only marginally ahead of its starting point of US$1,190 an ounce.

Volatility was also apparent in oil pricing as West Texas Intermediate (a benchmark for the industry) oscillated above and below US$60 a barrel in response to news flow around supply and demand. Again, the end-of-May closing price – US$60.30 – represented only marginal progress from the month's opening price.

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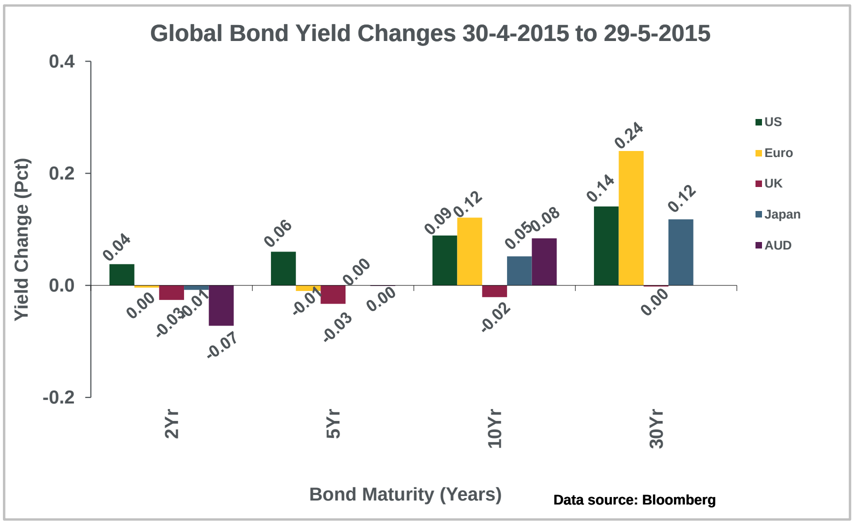
In other commodities, cocoa (5.13%), soybean (4.82%) and silver (3.37%) were the best performers, while nickel (-9.62%), aluminium (-9.10%) and sugar (-8.92%) were the main laggards.

In currencies, the US dollar was the strongest gainer among a basket of major currencies as positive economic data towards the end of the month built momentum behind expectations of a September rate rise. The Japanese yen (-3.8%), the Brazilian real (-5.2%) and the New Zealand dollar (-6.7%) were the weakest currencies overall in the month. The latter fell on weaker-than-expected dairy prices as well as speculation around the prospect of a rate cut in coming months.

BOND MARKETS' BUMPY RIDE

Volatility extended beyond commodities and into bond markets which experienced a month of gyrations culminating in a sell-off of long-term Japanese, German and US debt.



Long-dated eurobonds experienced the largest sell-off overall, as 10-year Bund yields gained 12 basis points, while those for 30-year Bunds gained 24 basis points, equating to returns of -0.9% and -3.6% respectively.

US Treasuries were similarly affected: while yields on 2-year and 5-year dated instruments largely trod water in May, yields on 10-year dated bonds gained nine basis points, while those on 30-year bonds gained 14 basis points, equating to a -0.4% and -1.7% return respectively. The same trend was apparent in Japan where yields on 10-year bonds climbed five basis points while those on 30-year bonds gained 12 basis points, equating to a -0.4% and -1.7% return respectively.

The Financial Times cited a number of factors to explain the bumpy ride in bond markets. One theory suggested market participants were now unwinding positions that had been driven by fears of deflation. A second suggested fears over poor bond market liquidity were a trigger for the sell-off.

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BNY メロン・アセット・マネジメント・ジャパン株式会社
BNY Mellon Asset Management Japan Limited

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〔加入協会〕一般社団法人　投資信託協会
　　　　　　一般社団法人　日本投資顧問業協会