INVESTMENT NEWS

MONTHLY NEWS BULLETIN
FROM THE INVESTMENT AND RISK TEAM

6 January 2014

MONTHLY UPDATE

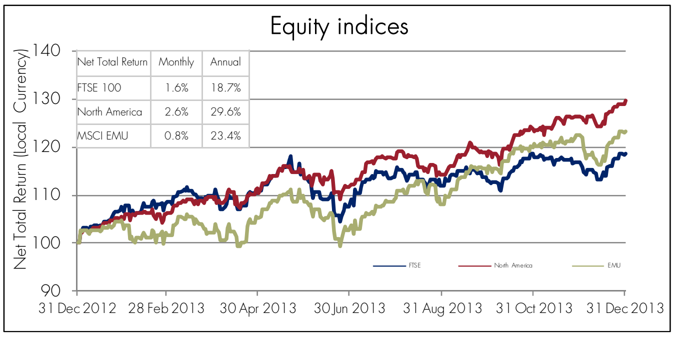
Overview

December brought a number of positive UK data releases with unemployment falling to 7.4% (its lowest level since 2009), CPI inflation continuing to decrease to 2.1% and manufacturing output rising. The US also saw positive announcements with an annualised rate of growth of 3.6% in Q3 and healthy November retail sales.

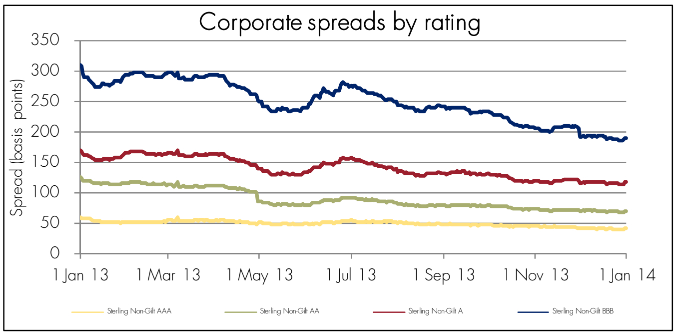
With conditions improving, the Federal Reserve announced that they would finally start 'tapering' their monetary stimulus in January, reducing purchases of bonds by $10bn to $75bn each month. However, they stressed that they expected to keep interest rates at exceptionally low levels, extending their forward guidance. Despite some surprise about the timing, equity markets responded positively to the announcement with US indices closing at record levels.

With improving economic conditions and expectations that interest rates may now rise sooner than had been previously expected, nominal yields rose with 10 year gilts breaking through the 3% level.

Equity markets continued to rise during December



Credit spreads decreased very slightly over the month

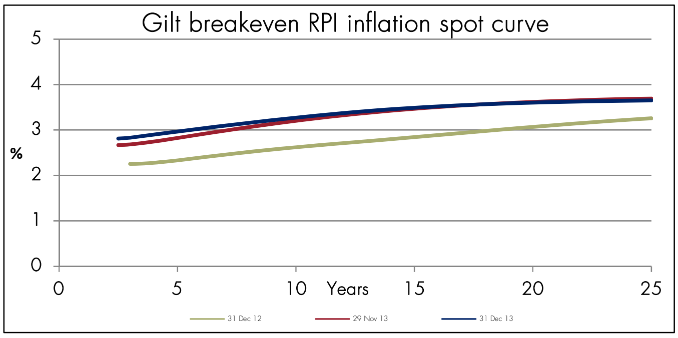


LATEST ECONOMIC NUMBERS

Current base rate	0.5%
Quantitative easing level	£375bn
CPI increase Nov (%y/y)	2.1%
Halifax house prices Nov (%m/m)	1.1%
IPD TR property index Nov (%m/m)	1.5%
PPF 7800 funding ratio end Nov	95.0%
VIX (volatility) index	13.7
$/£ exchange rate	1.65

Numbers as at the end of month unless stated

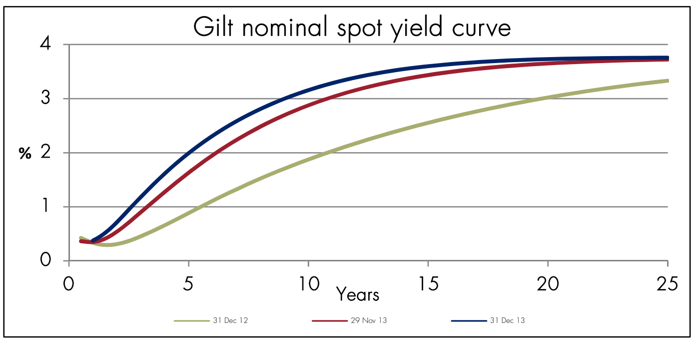
Breakeven inflation increased marginally this month



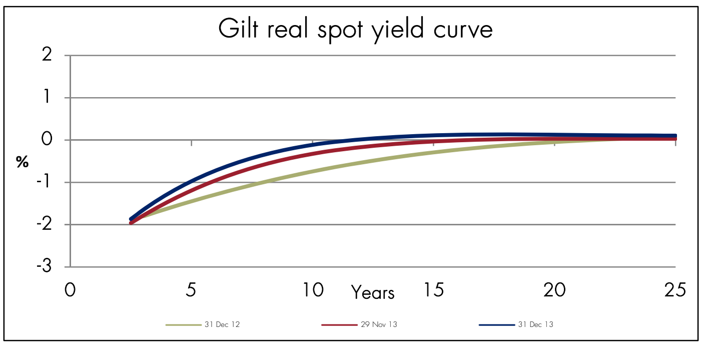
CALENDAR OF EVENTS AND DATA RELEASES

MPC interest rate announcement	9th Jan
RPI / CPI	14th Jan
Labour Market Statistics	22nd Jan
Minutes of MPC meeting	22nd Jan
UK GDP	28th Jan

Nominal yields have increased slightly this month



Real yields increased slightly this month



All chart data sourced to Bank of England, Merrill Lynch, Financial Times, MSCI & Standard and Poor.

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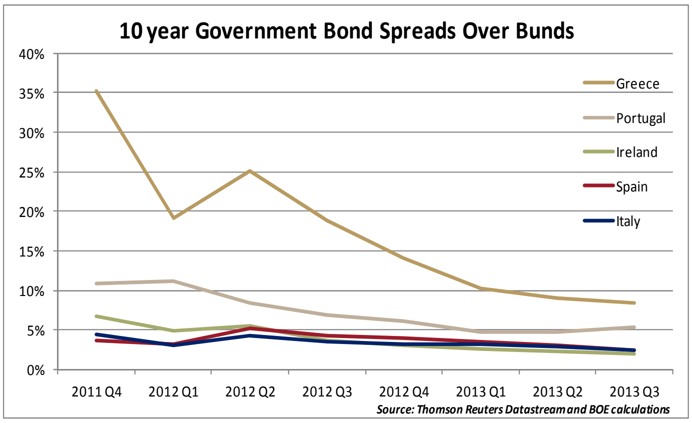
2013 year end review

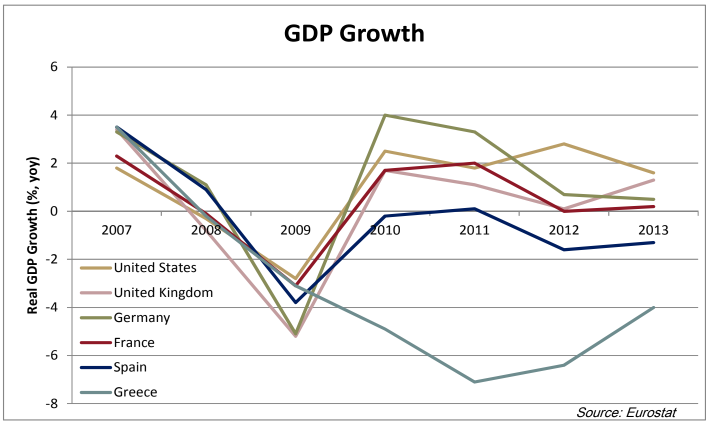
2013 saw the UK economic recovery increase in pace. Whilst growth in most developed countries remains slow compared to long-run averages, there were signs of improvement in many areas. UK growth was stronger than most forecasters expected and unemployment fell in the UK, US and the eurozone - with the eurozone experiencing its first fall in unemployment since 2011. With sentiment improving, risky assets performed well with equities providing returns of around 20%. However conditions, whilst improving, can still not be viewed as positive across the board. Unemployment in Spain and Greece still stands at around 25%, and in the UK, improved performance in London and the South-East masks weaker conditions elsewhere. With the UK's growth largely driven by increased consumer spending, some commentators remain nervous about the sustainability of this growth given the lack of business investment. This year announcements by the US Fed have played a key role in market movements and this is likely to continue as investors closely watch any news about the future levels of quantitative easing.

Perceived tail risks decline



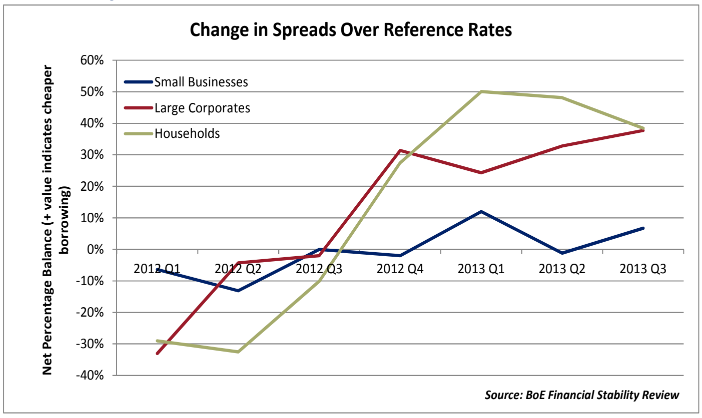
The perceived tail risks to the eurozone decreased this year with the spreads on bonds issued by countries such as Greece and Spain continuing to fall. Measures of expectations of broader financial instability also decreased and the US shutdown did not appear to have a significant impact on investment markets.

GDP is still contracting in some eurozone countries



There continued to be a two speed economy in the eurozone with the economies of Greece and Spain continuing to contract while Germany continued to grow. With inflation under target, the European Central Bank cut their main refinancing rate to a record low of 0.25% in order to try to avoid the risk of disinflation.

Borrowing conditions for households eased



Households have seen borrowing become more affordable and more available. Together with strong house price increases (particularly in London) this has led the Bank of England to curtail the Funding for Lending Scheme and focus it only towards business lending where credit conditions are not so favourable.

Average UK forecasts

	2013	2014
GDP growth	1.4	2.5
CPI inflation	2.3	2.4
RPI inflation	2.7	3.0
Claimant unemployment	1.35m	1.22m
Current account	-£57.2bn	-£48.4bn
PSNB	£100.3bn	£88.4bn

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury December 2013

Both GDP growth and employment figures have exceeded forecasts during the course of 2013 and CPI has fallen back towards the Bank of England's 2% target. Forecasters expect that economic conditions will continue to improve in 2014.

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