JOHN RAISIN FINANCIAL SERVICES LIMITED

Independent Advisors Report

Market Background 2013-14

The financial year 1 April 2013 to 31 March 2014 was, like 2012-13, another year in which the Central Banks played a major role. The year began with a dramatic announcement on 4 April 2013 by Haruhiko Kuroda the Governor of the Bank of Japan of a radical policy of monetary easing whereby the bank aimed to double the amount of money in circulation to reach 2% inflation in two years. In December 2013 after six months of market speculation the US Federal Reserve announced a tightening of its extremely loose monetary policy with a $10 billion taper in January 2014 of its monthly $85 billion worth of Quantitative Easing.

The announcement by the Bank of Japan on 4 April 2013 combined with intended fiscal and structural reforms by the Japanese Government represented a concerted effort (known as "Abenomics" after the Japanese Prime Minister Shinzo Abe) to end 15 years of deflation and general economic malaise through growth orientated policies. Following the announcement by the Bank of Japan of its huge Quantitative Easing programme the Nikkei 225 equity index increased by 31% between 1 April and 31December 2013. There was a significant fall in the index between January and March 2014 however the index ended the financial year 20% up. Despite questions about the likely long term success of "Abenomics" 2013-14 saw annual consumer price inflation rise to1.6% by March 2014 a remarkable figure in the context of recent Japanese economic history.

2013-14 was a clearly positive year for US equities, despite the fact that on conventional measures such as (Robert Shiller's) cyclically adjusted price/earnings ratio (CAPE) they appeared overpriced. The S&P 500 began the year on 1 April 2013 at 1569 and ended 19% higher at 1872 on 31 March 2014.

Despite some downward corrections during the year the S&P index reached new record highs during the year. This indicates that despite market concerns surrounding the "tapering" (reduction) in the US Federal Reserve's $85 billion per month Quantitative Easing programme and consequently a slower pace of monetary easing these were more than offset by other factors including improved sentiment resulting from continuing reductions in unemployment (which was 6.7% in March 2014 compared to 7.6% a year earlier), continuing house price increases (the Case Shiller House Price indices indicated increases of over 10% during the year), strong corporate earnings/balance sheets with pre-tax corporate profits at record highs, and the fact that the Federal Reserve indicated continued support for the Federal Funds (Base Rate) to remain at virtually zero. The Ukrainian crisis including the annexation of Crimea by Russia in March 2014 failed to halt the upward trend of the S&P 500.

Speculation and announcements regarding the future of Quantitative Easing were major features of the year. On 19 June 2013 Ben Bernankie the Chairman of the US Federal Reserve set out the case for "tapering" (reducing) its monthly $85 billion Quantitative Easing programme if the US economy grew as predicted. The immediate effect was a fall in the S&P 500 Index the following day, its biggest single day decline since November 2011 a fall of 2.5%. This fall had however been fully recovered by 5 July 2013. However, stock markets across the world reacted adversely to Mr Bernankie's statement with Emerging Markets in particular suffering notable declines.

There was some expectation that the September 2013 meeting of the Federal Reserve Open Market Committee would see an announcement that "tapering" would begin. However on 18 September the Committee stated that it had decided that it required more evidence that improvements in economic activity and employment would be sustained before adjusting the pace of asset purchases.

However following further improvements in economic activity and reductions in unemployment the Federal Reserve announced on 18 December 2013 that it would "taper" its monthly Quantitative Easing programme by $10 billion from January 2014. This represented a decision by the Federal Reserve that it no longer needed to do ever more to facilitate economic recovery not an end to its highly simulative monetary policy. Indeed at the same time as announcing the beginning of the "taper" the Federal Reserve strengthened its forward guidance on policy emphasising that it would keep interest rates close to zero "well past" when US unemployment fell below 6.5% and said it wanted to see inflation heading back up towards its 2% target before the first rate rise. Consequently the S&P 500 achieved a (then) record high of 1,810 on 18 December 2013. Further "tapering" of $10 billion per month were approved by the Federal Reserve at both its January and March 2014 meetings.

In February 2014 Ben Bernankie stepped down after eight momentous years as Chairman of the US Federal Reserve and was succeeded by Janet Yellen. Mrs Yellen indicated her support for a continuation of the existing policy approach of the Federal Reserve in a speech in Chicago on 31 March 2014 stating extraordinary policy was "still needed and will be for some time to come."

2013-14 was another difficult year for Emerging Markets. The prospect and then announcement of "tapering" by the US Federal Reserve was a major issue for Emerging Market economies which had seen large capital inflows as a result of the Unites States Federal Reserve policy of Quantitative Easing. Tapering by the Federal Reserve also implied a stronger United States economy and ultimately higher United States interest rates all of which would potentially entice investors towards the United States and away from Emerging Markets.

Concerns over tapering by the Federal Reserve together with deteriorating fundamentals such as high inflation (for example in India and South Africa), weakening growth, large current account deficits and economic slowdown in China resulted in significant selling off in emerging market currencies. Morgan Stanley identified a so called “fragile five” of Brazil, India, Indonesia, South Africa and Turkey. There were interest rate rises in a number of Emerging Market countries including India, South Africa and Turkey in an attempt by their Central Banks to improve economic stability. Over the financial year the FTSE All-World Emerging Markets index fell by 13.5%.

The promise by Mario Draghi President of the European Central Bank (ECB) in July 2012 to do “whatever it takes” continued to have positive effects in 2013-14.The prospect of a Eurozone crisis, which seemed so likely in 2011-12, clearly receded even further as demonstrated by further significant falls in Greek, Portuguese, Irish, Italian and Spanish 10 Year Government Bond yields between 1 April 2013 and 31 March 2014. For example the Greek 10 Year Yield fell from 12.48% to 6.57% while the Italian fell from 4.78% to 3.31%. Mr Draghi emphasised continued loose ECB monetary policy in July 2013 stating that key ECB rates were expected “to remain at present or lower levels for an extended period of time.”

2013-14 saw growth rather than contraction across the Eurozone economy, with Gross Domestic Product expanding by approximately 1% over the financial year, and strong purchasing of European shares by US investors. Eurozone stocks had a clearly positive year with the FTSE All-World Eurobloc Index advancing 18%.

The generally positive trend in the Eurozone was however mitigated by several factors. There was continued weakness in lending by the Eurozone banking sector and continued high unemployment in the peripheral Eurozone countries with Greece and Spain still experiencing levels well in excess of 20%. In particular there were growing concerns regarding a trend towards possible deflation with core Eurozone inflation below 1% for the last five months of the financial year. By March 2014 Eurozone Consumer Price inflation was a mere 0.7%. In January 2014 Mario Draghi stated that the Eurozone economy remained “fragile” and strongly emphasised that the ECB “will maintain an accommodative stance of monetary policy for as long as necessary.”

2013-14 was positive for the UK economy. There was broad based growth across manufacturing, services and construction. By February 2014 output in the UK services sector was reported to have reached levels last seen before 2008-2009. In March 2014 the Office for National Statistics reported unemployment was 6.8% compared to 7.8% a year earlier. The FTSE All Share index advanced by 5.2% over the financial year.

On 1 July 2013 Mark Carney took over from Sir Mervyn King as Governor of the Bank of England. In August 2013 the Bank of England introduced "forward guidance" into UK monetary policy indicating that a fall in unemployment to 7% would be a key indicator for an increase in Bank Rate from its present 0.5% the level held since 2009. However in January 2014 it was announced that unemployment had fallen to 7.1% in November 2013. This resulted in a rapid change in policy with the Bank of England announcing in February 2014 that it would abandon its policy of linking interest rate policy to unemployment.

2013-14 saw losses for holders of the "safe haven" government bonds. However despite the "taper" US Government 10 Year Bonds ended the 2013-14 financial year with a yield of 2.75% only 0.9% up over the financial year influenced at least in part by the Federal Reserve's continued commitment to ultra low interest rates. The UK 10 year benchmark increased over the year by 0.98% from 1.78% to 2.76%. However the German 10 year benchmark increased by only 0.29% from 1.29% to 1.58%.

Indeed the growing yield spread between UK and German Government Bonds and US and German Government Bonds was a clear feature of 2013-14 with the "spread" or difference reaching levels not seen since before the financial crisis which began in 2007. A significant factor in this trend is likely to have been developing differences in Central Bank policy and economic trends and expectations during 2013-14.

The Eurozone experienced very low inflation and weak growth and the ECB remained open to further monetary easing as demonstrated by its reductions in its main interest rate in May and November 2013. In contrast the US enjoyed broadly clearly positive economic indicators and the US Federal Reserve moved, albeit tentatively, towards tightening exceptionally loose monetary policy. UK economic performance was also clearly positive and the Bank of England was also anticipated to potentially begin monetary tightening in the foreseeable future.

John Raisin
Independent Advisor
29 July 2014