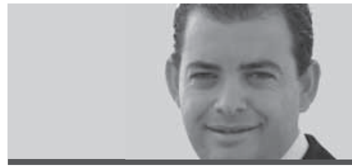
Stock Market Review



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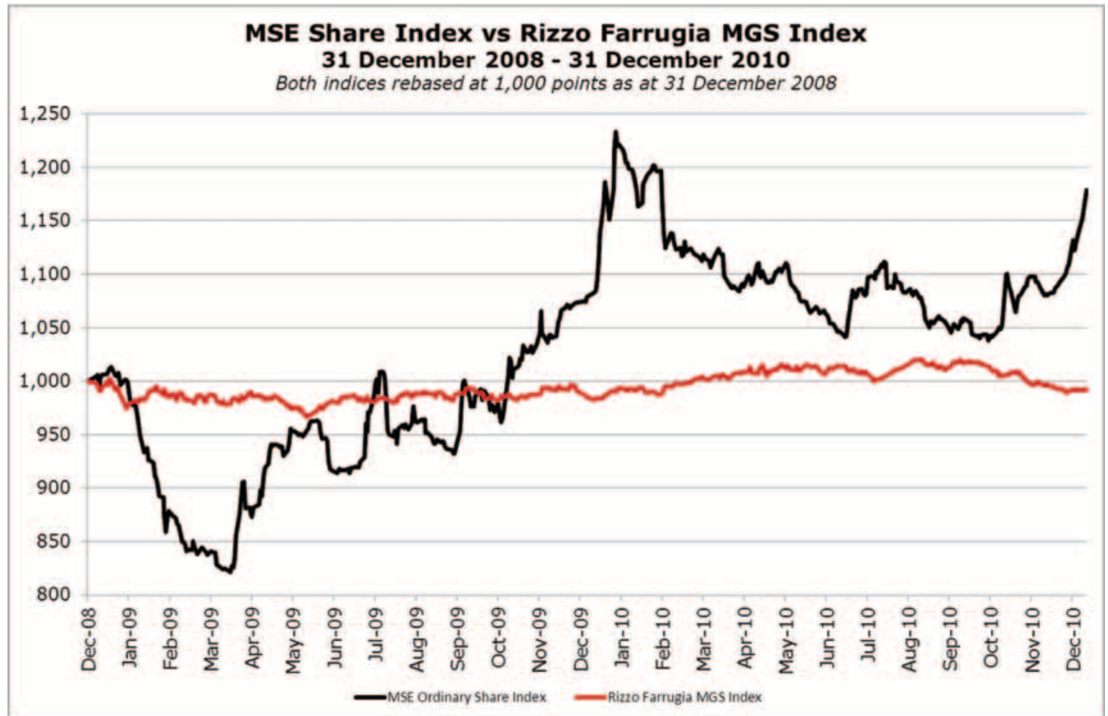
# Shares outperform bonds in 2010




With 2010 behind us and investors beginning to focus on themes likely to impact the market in 2011, a review of the main developments that affected the equity and bond markets over the past 12 months may prove useful.

The local equity market measured by the MSE Share Index closed in positive territory for the second successive year. Although the index gained 9.3 per cent during 2010, it was a volatile year. During the first three weeks of 2010, a sudden rally in the share price of the two large banks helped the MSE Share Index approach the 4,000 points level for the first time since September 2008. However following this initial New Year euphoria, the local equity market drifted to below 3,400 points in June and following a slight recovery during August and September, the Index dipped again to touch a 2010 low of 3,330 points in mid-October.

The announcement by Bank of Valletta plc at the end of October of higher profitability and dividends over 2009 helped the equity market return to positive territory for the year. Meanwhile a recovery in the share prices in December of the other two large caps (HSBC Bank Malta plc and International Hotel Investments plc) helped the Index close the year with a more respectable performance of 9.3 per cent. While the three large caps were the main focus during the final quarter of the year, the top performers of 2010 were Maltapost plc (+42.9 per cent), Malta International Airport plc (+38.3 per cent) and Middlesea Insurance plc (+26.2 per cent).

The "Santa Rally" was also evident in the major international equity markets with the UK's FTSE 100 Index rising by 6.7 per cent during the final month of 2010 and even temporarily surpassing the 6,000-point level for the first time since June 2008. Likewise, the US and other European stockmarkets posted their biggest December gains in a decade. Malta's equity market, however, underperformed the major equity markets. The S&P 500 Index in the US closed the year 12.8 per cent higher with the German DAX advancing by 16.1 per cent. While these are the markets that most investors follow closely, few are those who may be aware that the best performing markets in 2010 were Sri Lanka (+97.7 per cent) and Argentina (+79.4 per cent).

2010 will probably be best remembered as the year of one of the biggest corporate disasters in history, as oil giant BP plc came "very close to going onto the rocks" in the words of the new CEO. Moreover, for most of the year the main talking point was the sovereign debt crisis in the eurozone and the prospect of Europe's single currency being forced into a break-up. In May, Greece had no option but to accept a €110 billion loan from the EU and the IMF, and Ireland was rescued by a loan package of €85 billion in November. The eurozone jitters continued as speculators then turned to Spain and Portugal which was downgraded twice by credit rating agencies during the year.

The sovereign debt crisis left a big negative impact on the equity markets of some of the eurozone nations. In fact the world's worst performing stockmarkets were Greece (-35.6 per cent), Spain (-17.4 per cent), Italy (-13.2 per cent), and Portugal (-10.3 per cent).

Talk of the eurozone crisis also left its mark on the bond markets with the benchmark 10-year eurozone yield initially dropping to a multi-year low of 2.11 per cent in August and recovering strongly to end the year at 2.97 per cent. The rebound in yields materialised as the economic outlook improved in the US and Germany (although concerns remain on the high level of unemployment in various parts of the world) and on growing fears on the state of sovereign public finances and the prospect that Germany may need to purchase increased levels of debt of the eurozone peripheral nations which are finding it increasingly difficult to borrow on the international markets.

Locally, the bond market mirrored the developments of the German benchmark. As indicated by the recently launched Rizzo Farrugia MGS Index, the overall movement in Malta Government Stock prices was an increase of 0.7 per cent with the resultant effect of local shares outperforming bonds for the second successive year. The Treasury raised a total of €580 million during the year with the main focus from investors surrounding the launch of the 20-year paper. In fact, for the first time in a long number of years, demand from retail investors exceeded the amount on offer leaving no paper for take-up by institutional investors. During the November issue, demand from retail investors for the 2030 stock amounted to an extraordinary €93.6 million.

In the local corporate bond market, 2010 continued on the same trend as the previous year with total issues amounting to just below €300 million as a number of companies refinanced their debt and new companies, including Grand Harbour Marina plc, Izola Bank plc, Premier Capital plc and Mediterranean Bank plc tapped the bond market for the first time. Most issues were greeted with enthusiasm on sustained demand from retail investors for fixed-interest rate securities.

Although the sovereign debt crisis took centre stage on numerous occasions during the past year, the eurozone periphery nations challenge for refinancing maturing bonds will again be a key theme in the first half of 2011 as the focus has now turned onto Spain and Portugal while Greece and Ireland must continue to prove that the severe austerity measures being taken will start to deliver the desired benefits.

2011 can also see the start of interest rate hikes across the globe. While the timing and extent of such increases in interest rates are still widely debated, the Confederation of British Industry in the UK expects interest rates to rise six-fold to three per cent over the next two years. Furthermore, despite the trouble in the eurozone, the ECB is also likely to start a programme of rate hikes late in 2011.

With inflation and interest rates expected to start creeping up, investors are likely to increase exposure to equities, in particular blue-chip firms which offer attractive dividends and the potential for capital growth over the years. In the UK, the FTSE is expected to increase well past the 6,000 points level in 2011 with the most optimistic analysts expecting a 15 per cent increase to just below the all-time high of December 1999.

Some contrarians are tipping the US rather than the UK as the market poised for strong growth in 2011. Although most analysts are downbeat on the prospects for the American economy and unemployment is still close to 10 per cent, recent economic data has been encouraging and valuations of US companies are not too demanding with an average price to earnings ratio of 17 compared to an average of 20 times earnings since 1990.

With shares expected to outperform bonds again in 2011 as expectations of interest rate hikes gather momentum, further losses in sovereign bonds are likely and 'dividend plays' will once again be a key factor for investors over the coming months. This was also in evidence locally as the two top performing equities of the year (MIA and MaltaPost) rank among the highest dividend yielders on the market.

As a recent article in The Economist pointed out, "2011 could be a year of more, and bigger, sovereign-debt shocks".

"The top performers of 2010 were Maltapost plc, Malta International Airport plc and Middlesea Insurance plc."

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