

Stock Market Review



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The January stock market barometer

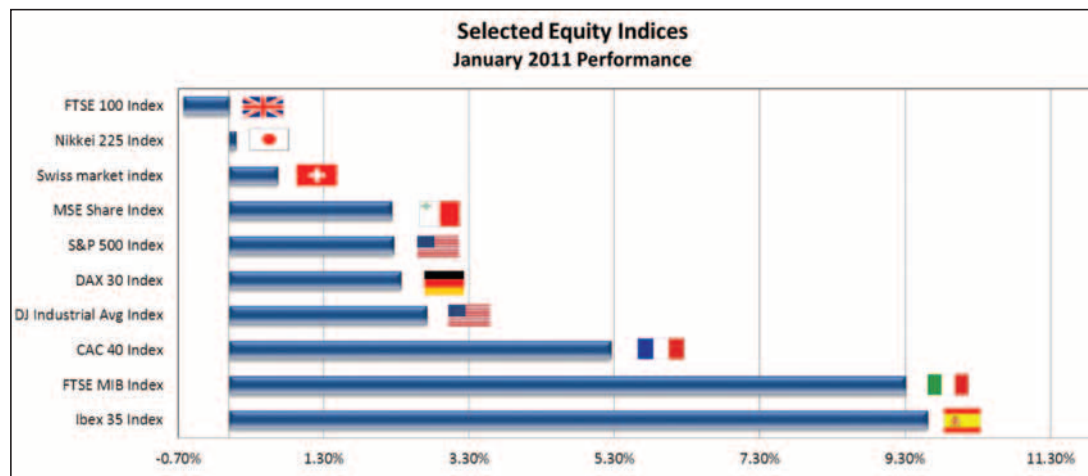
In recent weeks, many international financial commentators wrote about the January stock market barometer. Statistical studies conducted in the US suggest that stock market returns in January are a precursor of returns over the next 11 months of the year. There are three main studies quoted by such commentators. These have been based on evidence as follows: (i) the returns achieved on the first trading day of the year; (ii) the movement during the first five trading days of January and (iii) the returns during the entire month of January.

Since 1973, a big advance on the first trading day of January in the Standard & Poor's 500 Index in the US has been a strong signal that shares will post robust gains for the rest of the year. Other researchers have extended their studies to the first five trading days of the year and empirical evidence suggests that from the last 36 times that the first five days closed higher, in 31 times the full-year performance was similarly positive giving an accuracy rate of 86.1 per cent.

Some other researchers preferred to base their studies on the entire month of January and extended their evidence to 1896 when the Dow Jones Index was initially computed. The evidence from 1896 until 2010 suggests that a positive January led to a yearly positive movement for the Index in 72 per cent of the times. However the barometer was not accurate in 2010 as the Dow Jones Index started the year down 3.5 per cent but recovered strongly to close the year up 11 per cent.

These January stock market indicators led to a conventional market wisdom that "As goes January, so goes the year".

Does the January barometer also apply locally? We analysed the performance of the MSE Share Index since its inception in December 1995 therefore analysing the past 15 years. In 80 per cent of the cases, a positive performance in the index for the month of January led to a positive performance for the year. This barometer did not function for only three years (1997, 2006 and 2009). In 2010, the MSE Share Index closed 9.3 per cent higher after a very strong start to the year as the share prices of HSBC Bank Malta plc, Bank of Valletta plc, Malta International Airport plc and Maltapost plc rallied.



So what's in store for 2011? International equity markets continued to edge higher for most of the month of January with the Dow Jones 100 Index in the US surpassing the 12,000 points level for the first time since mid-2008 on increasing evidence of an improving economic outlook and stronger corporate earnings from some of the blue-chip companies. During the first few weeks of the year, European equity markets also maintained their upturn with the UK's FTSE 100 up 2.65 per cent.

The Dow Jones in the US gained 3.6 per cent. However, the political tensions in Tunisia and Egypt towards the end of the month hit investor sentiment causing a sell-off in global equity markets. This trimmed the gains registered during January to +2.7 per cent for the Dow Jones while the FTSE closed the month 0.6 per cent lower. Meanwhile France's CAC 40 Index climbed 5.3 per cent higher with Germany's DAX up 2.4 per cent. Surprisingly the best performing equity markets in Europe during the month of January were Spain's IBEX 35 (+9.8 per cent) and Italy's FTSE MIB (+9.1 per cent).

Locally, the MSE Share Index also started off the year on a positive note and shares have continued to outperform bonds. Although the first week saw a decline of 2.3 per cent in the Share Index, this was strongly reversed during the second week of the year with a strong upturn of 4.8 per cent. Overall the MSE Share Index closed the first month of 2011 with a gain of 2.24 per cent compared to a decline of 0.88 per cent in the Rizzo Farrugia MGS Index tracking the performance of Malta Government Stocks. The upturn in the equity market was mainly due to the outper-

formance by Malta International Airport plc (+10.2 per cent) and HSBC Bank Malta plc (+7.5 per cent). The other positive performers were Simonds Farsons Cisk plc, Lombard Bank Malta plc, Island Hotels Group Holdings plc, FimBank plc and International Hotel Investments plc. Maltapost closed the month unchanged but hit a new all-time high of €1.01 on high trading activity in the company's shares following the announcement of the September 2010 full-year results and the dividend declaration.

With HSBC performing positively ahead of the announcement of their 2010 full-year financial performance, the share price of Bank of Valletta plc was off to a weak start (-3.3 per cent) as the positive momentum in the run-up to the bonus share issue was halted after the allotment of the new shares on increasing levels of supply in the market. The two worst performers during the month of January were Plaza Centres plc (-11.2 per cent) and RS2 Software plc (-6.3 per cent).

On the bond market, Malta Government Stock prices declined in line with the upward trend in eurozone yields as market commentators increasingly speculate on the timing of the start of interest rate hikes in the eurozone, the UK and also the US. Last week it was revealed that some members of the Bank of England's Monetary Policy Council voted in favour of a 25 basis point rate hike as inflation hit an eight-month high of 3.7 per cent in December. However following the January MPC meeting, the UK economy unexpectedly contracted by 0.5 per cent during the final quarter of 2010 leading to further debates on the timing of

the first rate hike especially as the Governor of the Bank of England Mervyn King claimed that inflation may hit the five per cent level in the coming months.

In the eurozone, Germany's economy continued to outperform other nations and despite the difficulties being faced by the periphery countries of Greece, Spain, Portugal and Ireland, some analysts still favour a slight increase in interest rates by the end of 2011 in view of the inflationary outlook.

Although the January barometer could provide some useful insight on the expected market performance for the coming year, the trading strategy for an investor should always be based on his risk profile and overall investment objectives.

With no new corporate bond issues in Malta expected during the first quarter of the year, and with inadequate levels of supply in the secondary market on lack of an active market making mechanism, investors who have a general preference towards fixed interest securities have an increasingly difficult task of finding suitable investments.

In this context, equities could attract increased demand from investors who could possibly also consider increasing their equity allocation with a long-term objective in mind. Investors' preference will likely be skewed towards those companies offering a sustainable and attractive dividend yield. As such, the upcoming publication of the 2010 financial statements by the larger publicly listed companies will be closely watched by investors to gauge the sustainability of a company's dividend and the likelihood of improved dividend payments in future years.

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