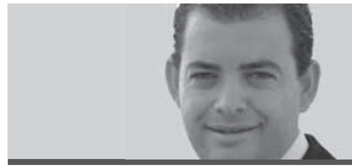
Stock Market Review



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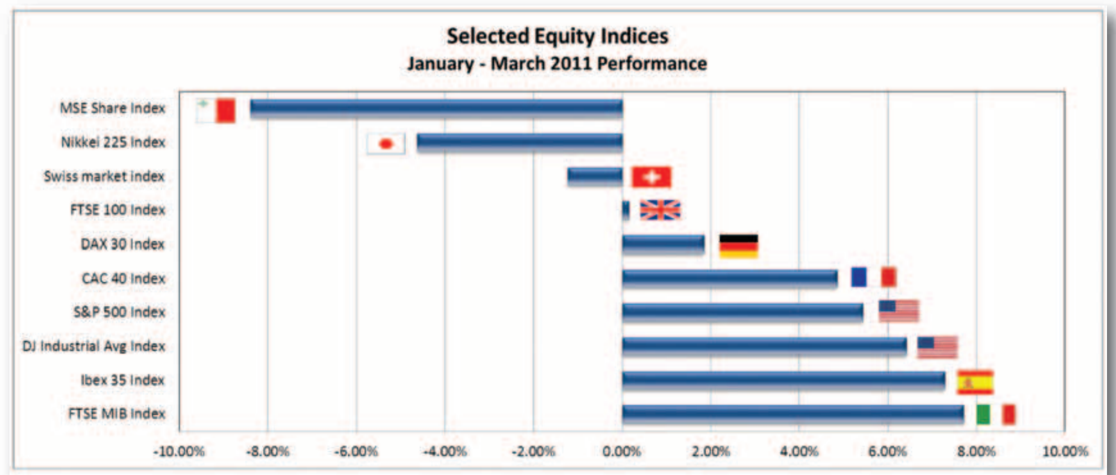
Local shares strongly underperform in Q1

Since higher inflationary expectations is bad news for bonds, investors are retaining their exposure to equities

During the first quarter of 2011 all major international stockmarkets were impacted by two unexpected events which occurred in quick succession – the escalating crisis in the Arab world which quickly spread to Libya and the devastating natural disasters in Japan, the world's third largest economy. Although these left their mark on the performance of most equity markets in recent weeks, the majority of the indices in developed markets still closed higher on optimism of improving corporate and economic fundamentals. Surprisingly, the Italian and Spanish markets performed best with gains in excess of seven per cent.



The performance of the Japanese market (as measured by the Nikkei 225) was also surprising. Despite the steep decline of over 16 per cent in the aftermath of the devastating earthquake and tsunami, the Nikkei ended the quarter only 4.6 per cent lower.

Locally, the Libya crisis had a more severe negative effect on the securities market than the natural disasters in Japan. However, other factors also seem to have played their part in the performance of shares listed on the Malta Stock Exchange which forced the Share Index to decline by 8.4 per cent to a four-month low of 3,463.776 points. In fact, the MSE Share Index continued to decline during the first week of April while international equity markets recovered to trade at their highest levels in three years.

Sentiment towards BoV was dented by the unexpected downgrade by the international credit rating agency which occurred in the midst of the media hype surrounding the fate of the La Valette Multi-Manager Property Fund. BoV's share price suffered in the weeks following the rating downgrade while the reduced dividend payout by HSBC Bank Malta plc also played a part in the decline of both large banking equities which closed the quarter 9.5 per cent lower. Another determining factor was the unexpected sharp reduction in Go plc's dividend which forced the equity to tumble by over 22 per cent in recent weeks to a fresh two year low.

2011 started on a reassuring note with trading activity rising in the local equity market to €12.2 million during the first two months mainly on sizeable volumes passing through the market in the shares of BoV, HSBC and International Hotel Investments plc. However, local and international events which occurred in quick succession by the third week of February left a significant negative impact on investor sentiment and trading volumes. Activity shrunk to just €3 million during March with the majority of trades again in BoV and HSBC although some heavy volumes in Lombard Bank Malta plc following the publication of their 2010 financial statements were seen.

Lombard's equity was the second best performer during the first three months of the year as the renewed appetite for Lombard shares helped the price to close the quarter 7.1 per cent higher at €3 after touching a high of €3.075 in the run-up to the dividend entitlement. The strong demand for Lombard's equity materialised after the Bank announced on March 10 a 12.9 per cent increase in group profit after tax to €8.3 million for the year ended December 31 2010. Lombard's subsidiary, Maltapost plc, ranked again as the top performer with a gain of a further 10.1 per cent following the 42.9 per cent increase in its share price during 2010. Among the other positive performers were Malta International Airport plc (+6.6 per cent), Plaza Centres plc (+6.5 per cent) and Simonds Farsons Cisk plc (+5.9 per cent). Plaza and Farsons have since reversed these gains last week.

The performance of the bond market was also negative during the first quarter of 2011. On the one hand, the unfolding developments in Libya led to a sharp decline in the bond prices of companies having an exposure to the region. Naturally, bonds issued by the Corinthia Group and its subsidiaries were the ones mostly impacted. All bonds issued by Corinthia Finance plc, International Hotel Investments plc and Mediterranean Investments Holding plc dropped below par with the price of the MIH bonds falling to as low as 80 per cent. The bonds issued by FimBank plc also declined in value while overall trading volumes in corporate bonds also faltered as investors awaited further news from the unfolding events in Libya.

On the other hand, Malta Government Stock movements were negatively affected by developments related to the sovereign debt crises in the eurozone and expectations of future rate hikes by the European Central Bank. Despite renewed concerns on the finances of some of the periphery nations, expectations of a rate hike by the European Central Bank forced prices to decline rapidly during March. This was very evident in the performance of the Rizzo Farrugia MGS Index which dropped by 1.9% during the first quarter to a 21-month low.

As was highly anticipated, no new corporate bonds were issued during the first three months of the year. The Treasury of Malta was the only issuer in recent weeks as it launched the first MGS offering for 2011. Strong demand was evident once again for the MGS issues in February with the Treasury receiving a total of 6,052 applications for the two new Malta Government Stocks for a value exceeding €326 million. The maximum allowed amount of €200 million was allotted with a larger percentage in the new six year paper as opposed to the longer-dated 19-year stock.

Currencies were also volatile during the quarter, with many investors rightly surprised at the strengthening of the euro. Europe's single currency, which was seen as a potential failure only months ago, advanced by 6.5 per cent against the US dollar and 2.3 per cent against sterling during the first quarter of 2011. In June 2010 the euro had dropped to a four-year low against the USD of US$1.1877, but it has since appreciated by over 21 per cent to touch the US$1.44 level last week.

Concerns on the eurozone's currency have faded in recent months despite the strongly negative performance of Portuguese bonds indicating the possibility of a potential default and regulators claiming that four Irish banks need to raise €24 billion. However, the improving German economic performance and the anticipation of higher interest rates by the European Central Bank at last week's meeting outweighed the negative factors and helped the euro gather strength. In fact, the 0.25 percentage point increase to 1.25 per cent materialised last week and surveys of international economists indicate that similar rate hikes are likely to take place in July and October pushing rates up to 1.75 per cent.

In recent weeks, many international commentators have tried to explain the reasons for the surprising positive performance of global equity markets despite the "wall of worry". This term is used to describe a market upturn in the face of a series of concerns, notably the tragedy in Japan, the debt crisis in Europe, the unrest in the Middle East and its impact on oil prices and inflation.

A well-respected columnist in the UK argued that inflation seems to be the biggest worry for investors. In fact, the ECB defended its rate hike decision by claiming that inflation risks remain high. Since higher inflationary expectations is bad news for bonds, investors are retaining their exposure to equities. The columnist concludes "it's not because it's the best place to put their cash, it's just better than all the other options".

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