Stock Market Review

Bullish predictions for 2013

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In recent weeks many international financial commentators highlighted their key investment themes and predictions for 2013. It may be surprising that the vast majority are expecting equity markets to perform positively again in the coming 12 months despite the strong performance in 2012. A leading US investment bank, JP Morgan Asset Management, claimed that 2013 could be the first "post-crisis year for markets".

A survey of seven leading banks in the UK reveals an average prediction for the FTSE100 for 2013 of 6,428 points, representing an increase of nine per cent from the 2012 year-end level. A separate survey paints a more bullish picture with 14 per cent of fund managers in the UK expecting the FTSE100 to close the year between 6,500 and 7,000 points. In the US, Goldman Sachs expects the S&P500 Index to advance by 12 per cent with Merrill Lynch also claiming that the S&P500 will rise to a new all-time high, representing an increase of 10 per cent from the 2012 year-end level.

These upbeat prospects are driven by an expectation of an improved global economic performance in 2013 and by the fact that some of the risks that drove significant headwinds in 2012 are now less concerning for markets than they were a year ago. In fact, possibly the truly remarkable aspect of 2012 is that none of the expected 'disaster scenarios' actually materialised. Europe seems to be riding out the storm relatively well and there was no 'eurogeddon' or 'Grexit', or the much-awaited hard landing in the Chinese or other emerging market economies.

While in recent months many had speculated on the future of the euro, the survival of the single currency is now no longer an issue. Meanwhile, the austerity drag on growth is being counteracted by stimulus measures from central banks also helping inflows into riskier assets such as shares.

Although there is widespread consensus on a positive year for equities in 2013, it does not mean the crisis is over. It is merely an indication that expectations for the major equity correction predicted for 2012 have receded as some of the risks related to the disorderly break-up of the single currency seem to have been removed. Naturally, there are still risks that one needs to take into consideration. The protracted negotiations on the US fiscal cliff showed the negative market reaction to renewed uncertainty. Although 2013 should provide further evidence that the eurozone crisis is indeed easing, concerns are likely to re-surface during the course of the year which could again temporarily dampen sentiment.

A key element of 2013 will be the level of consumer confidence and spending patterns as signs of weakness will impact the performance of many global companies. Moreover, other key risks for 2013 include a weakening economic performance in France, election risks in Italy, Japan's high level of indebtedness as well as conflicts in certain parts of the Middle East which remain unsolved and which could result in another spike in the oil price inhibiting the global economic recovery.

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Another factor behind the positive sentiment for 2013 is that many global companies have strong balance sheets, high levels of cash and adopted various cost cutting measures in recent years.

Analysing the key investment themes for the New Year and the outlook for various asset classes (bonds, shares, cash and commodities) is important to determine one's appropriate asset allocation, i.e. the segregation of an investor's portfolio between different types of financial assets.

Equities seem to be the preferred asset class for 2013 by the large majority of investment banks supported by attractive valuations especially relative to bonds. The average dividend yield on equities across the eurozone exceeds the 10-year yield on German Government bonds as this declined to record levels in 2012.

Although investors can find a number of preferred shares or 'top equity picks' for the New Year by various financial commentators, given the wide variety of equities available across international markets, it would be very difficult for retail investors to solely rely on such 'stock picking' to obtain their desired international equity exposure. Exchange traded funds would be the more advisable method. For example, the iShares FTSE100 would be an ideal investment to gain exposure to the UK stockmarket as it is widely expected to continue rising in 2013. Likewise, the iShares S&P500 Index tracks all the components of the S&P500 obtaining an excellent exposure to the broad US market.

Shares are the favoured asset class for 2013 not only in view of expectations of stronger economic growth and key risks subsiding but also as interest rates are expected to remain low. A low interest rate scenario supports an increased equity allocation especially towards companies producing attractive and sustainable dividends.

In view of the historic low interest rate scenario, many commentators are advising a reduced allocation to bonds as there seems to be widespread consensus that many international bond prices (especially sovereigns) have risen too high and bond yields should start to rise towards pre-crisis levels. Some analysts are also predicting that 2013 will be the year when the bull market in government bonds starts to deflate. Although interest rates are expected to stay low until 2015, it may be advisable for some investors to reduce bond exposures especially those with longer dated issues as a rise in secondary market bond yields over the course of 2013 (even moderately) is sufficient to result in negative returns for sovereign bonds. However, despite the volatility in bond prices expected during 2013, a core allocation to bonds is vital especially for investors seeking stable income from their portfolio.

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Gold has also been widely tipped to have a positive year in 2013 with analysts claiming that the price of gold could rise above $2,000 per ounce compared to the current level of below $1,700.

Developments across the international financial markets will inevitably also impact sentiment across the local market. The general election taking place on March 9 could also influence short-term investor behavior. However, some specific developments at various companies should characterise the market's overall performance in 2013. Two companies in particular are widely expected to announce another record financial performance. Recent announcements from both Malta International Airport plc and Simonds Farsons Cisk plc provide clear indications in this respect and shareholders should be pleased on developments across both companies.

The three IT companies are also expected to report more positive financials and the share prices of Crimsonwing plc and RS2 Software plc have started to reflect this as both equities strongly outperformed in 2012 and maintained this trend in the New Year. On the other hand, the share price of 6pm Holdings plc was flat last year but the company is already indicating that they will be recommending the payment of a dividend to shareholders as well as a bonus share issue.

One of the more imminent developments for the year is likely to take place in the early part following the Extraordinary General Meeting of FimBank plc convened for January 31. Burgan Bank of Kuwait and United Gulf Bank of Bahrain have made a joint offer to acquire a majority shareholding of FimBank in three separate stages. Maltapost plc is also likely to be among the companies hitting the headlines as its majority shareholder Lombard Bank Malta plc issued a public announcement on 25 October stating its intention to increase its shareholding in the postal operator to not more than 74.5 per cent.

Following the wide fluctuations in the share price of Go plc in recent months, local investors will also be focusing on the upcoming developments within this company. Go has yet to confirm whether it will be investing further funds into the Greek company Forthnet, while the 2012 financial performance of the group should show a return to an overall profitable position with some shareholders possible expecting the much-awaited return of a dividend.

Among the larger caps, the two major banks are always the ones that have most influence on investor sentiment given the widespread shareholder base of both institutions. The local economic performance and in particular developments within the real estate and construction industries are key determinants on the level of impairments at these banks going forward as highlighted once again by the Central Bank in the Financial Stability Report. Meanwhile, shareholders of International Hotel Investments plc are looking towards 2013 as the year in which the company should reward them with a cash dividend as the Group expects to conclude the sale of the London apartments.

2013 is expected to be another interesting but, as always, also a challenging year. However, as was evident in recent years, whatever market cycle develops, attractive opportunities for investors always present themselves in some form or other.