

Stock Market Review

Equity markets suffer after volatile 2011



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In a year that was dominated by unrest in the Middle East, a devastating earthquake in Japan and the sovereign debt crisis in the eurozone, for the first time since 2008, equity markets closed in negative territory with the exception of the US Dow Jones Industrial Average.

The S&P 500 which is a broader index composed of 500 companies in the US closed the year fractionally lower. Despite significant volatility in 2011, the movement during the past twelve months was the smallest annual change in the history of this index.

The equity market in the US outperformed all other major markets. In the UK, the FTSE 100 closed the year 5.6 per cent lower at 5,572.28 points. In the previous two years, this UK index had risen by 22 per cent in 2009 and nine per cent in 2010 as shares in London recovered from the 31 per cent slump in 2008 as the bankruptcy of the US investment bank Lehman Brothers in September 2008 had brought the global financial system on the brink of collapse. This led to a significant downturn across all major equity markets.

The equity markets in continental Europe fared much worse than in the UK with Germany's DAX dropping 14.7 per cent and France's CAC40 losing 17 per cent as both countries are likely to bear the major part of the bail-out costs for the Southern European nations.

Countries mostly affected by the eurozone sovereign debt crisis which spread to Italy and Spain during the second half of the year suffered significant declines in their equity markets. In fact, the Spanish benchmark index, the IBEX35, dropped 13.1 per cent and Italy's FTSE MIB shed 25.2 per cent during the past twelve months. The worst performing market within the eurozone was Greece with its index comprising the 20 largest companies listed on the

Athens Stock Exchange declining by 60 per cent.

The markets in Asia also performed negatively in 2011 initially as a result of the earthquake in Japan and later as the eurozone crisis damaged global growth and as concerns over Chinese economic growth prospects continued to dampen sentiment. Japan's NIKKEI 225 Index shed 17.3 per cent closing at its lowest year-end level since 1982, whilst Hong Kong's Hang Seng Index dropped 20 per cent in 2011 and China's Shanghai Composite shed 22 per cent.

Stockmarkets in the Arab World also declined following the historic developments across the region. The equity market in Tunisia only dropped eight per cent following a relatively peaceful transition from the previous regime led by President Ben Ali. On the other hand, the market in Egypt slid 50 per cent as the transition following the ousting of President Hosni Mubarak proved to be significantly harder and troublesome amid increased political uncertainty.

Although all markets suffered losses during 2011, the start of the year had offered bright prospects with equities rising rapidly during the first few months of the year. In the US, the S&P 500 had traded up to almost a three year high by April while in the UK the FTSE 100 had advanced to above 6,100 points by May. However, these upturns were quickly reversed in the summer months after the US lost its 'AAA' credit rating and the eurozone crisis escalated causing a sell-off across equity markets. Most markets entered bear market territory with the S&P 500 in the US tumbling by 20 per cent by the first week of October from its April high and the FTSE 100 dropping below 4,900 points also in October.

Locally, the MSE Share Index skidded 18.2 per cent during the last 12 months to 3,094.799 points, mainly due to the double-digit declines in the three largest capitalised companies. Similar to the trends across international markets, the equity market in Malta had recovered somewhat following the 2008 decline after advancing by 7.9 per cent in 2009 and climbing by a further 9.3 per cent in 2010. Although volumes across the equity market increased by 4.1 per cent to €37.5 million, these are still significantly below the levels achieved in 2008 and prior years. After a very active start to the year when €15.1 million worth of trades

passed through the equity market in Q1, volumes declined rapidly in subsequent months.

Undoubtedly, the political uprising in Libya dented local investor sentiment to a large extent in February and March 2011 and triggered a sell-off in the share price of International Hotel Investments plc and also across the bond prices of the Corinthia Group due to their investments in the country. Although the third largest capitalised company on the MSE recovered some of these declines in line with the improved operational performance reported by the IHI Group at its Tripoli Hotel and its European properties, IHI's equity still ended 2011 with a loss of 10.7 per cent. Meanwhile, the bond prices all regained their par value after dropping below 80 per cent in some instances.

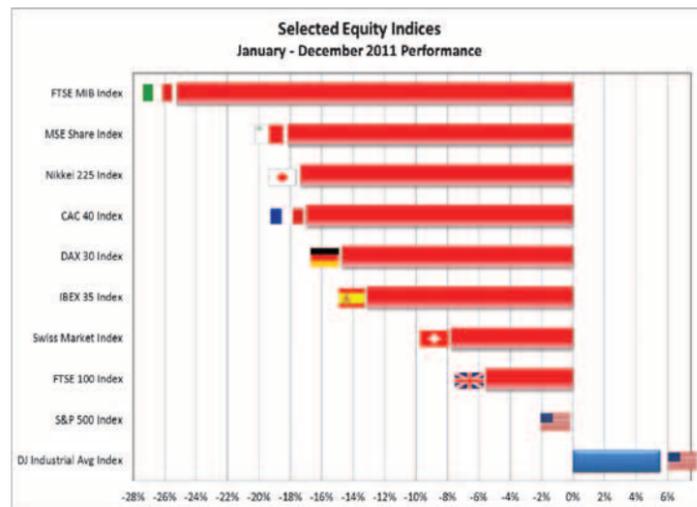
The two largest caps suffered steeper losses with the share price of HSBC Bank Malta plc shedding 20.8 per cent and Bank of Valletta plc sliding by 22.2 per cent in the past 12 months. The local banking sector seems to have been affected mostly by the escalating eurozone crisis while BoV's equity was also significantly impacted by the ongoing saga of the La Valette Multi Manager Property Fund.

Bond markets also had a volatile 2011. The Rizzo Farrugia MGS Index which tracks the movements of the indicative bid prices of Malta Government Stocks declined by 0.4 per cent to 988.877 points. During the first six months of 2011, the

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MGS Index declined by 1.91 per cent reflecting the sharp increase in eurozone benchmark yields (from 2.968 per cent as at December 30, 2010 to 3.51 per cent) as a result of the ECB raising interest rates by 50 basis points to 1.50 per cent. However, the decline in the MGS Index was almost completely reversed during the summer months with yields dropping to end the year at around 1.83 per cent as the eurozone sovereign debt crisis took center stage pushing investors towards the 'safe haven' sovereign paper of Germany. Yields remained volatile during the final quarter of the year on developments across the eurozone and as the European Central Bank reversed the interest rate rises announced earlier on in the year.

While German Government bonds performed positively, yields of the troubled eurozone countries reached record levels with the most concerning being those of the third and fourth largest economies of Italy and Spain. As both these economies seemed to be also in danger of needing a bailout, the yields on their bonds approached the critical seven per cent level in November. Despite the ECB's bond buying programme and Italy's €33 billion package of spending cuts and tax hikes, Italy's 10-year yields still closed the year above the seven per cent level with Spanish yields easing below the six per cent level.

Across the local bond market, there were limited new investment opportunities for retail investors during 2011 and this led to a significant decline in activity even on the secondary market. During the past 12 months, a total of €34.2 million worth of corporate bonds

were exchanged representing a 26 per cent decline from the previous year reflecting the lack of new issuance as well as the limited two-way market in most corporate bonds. On the other hand, activity on the secondary market for Malta Government Stocks soared by 45.7 per cent to €406 million in part reflecting also the strong demand by retail investors for the various new Malta Government Stock issues throughout the year.

In the foreign exchange markets, currencies also had a volatile year. The euro suffered in recent months as investors shifted to currencies normally regarded as safe havens. The US dollar rallied sharply in the final quarter of the year with the euro dropping to a 15-month low against the US dollar of \$1.2856 and to an 11-year low against the Japanese Yen of below JPY100. A major development in the foreign exchange market was the intervention by the Swiss National Bank in September to dampen the franc's appreciation in order to limit the damage to the country's export sector.

The eurozone sovereign debt crisis is likely to remain at the forefront of market movements at least during the first part of 2012. In fact, in the next few weeks, the international credit rating agency Standard & Poors is expected to decide whether to downgrade the 15 eurozone countries including Germany and France after these were placed on "credit watch negative". Moreover, the bond redemptions amounting to €100 billion facing the Italian government in the first quarter will affect the performance of the eurozone bond markets in the coming months and may also impact sentiment across the global equity markets.

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