

# The FTSE 100 a potential safe haven in Cyprus crisis

Trade Idea

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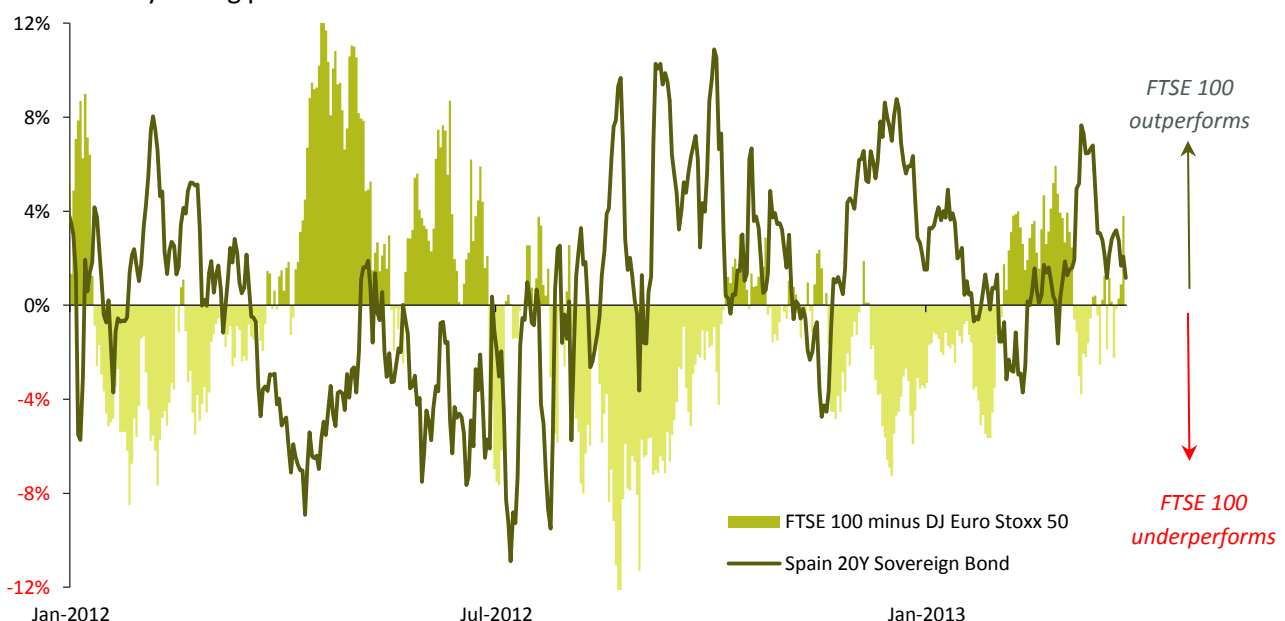


## Summary

- FTSE 100 is the defensive play on 'Cyprus' contagion risk' within European equities
- Investors seeking equity exposure should consider Boost FTSE 100 3x Leverage Daily ETP (3UKL)

## Trading the FTSE 100 on contagion fears

30 day rolling performance in EUR



Source: Boost Research, Bloomberg

In positioning equity exposure defensively against the banking crisis in Cyprus and in a wider context, the potential contagion risks to Europe's weakest links Spain and Italy, the FTSE 100 offers distinct advantages to do just that. Already outperforming the DJ Euro Stoxx 50 by around 5% (~20% annualised) so far this year, the FTSE may do well over days and weeks ahead as the practical implementations, political tensions and economic consequences of the bailout terms unravel and undermine sentiment in Eurozone's stock markets. Investors should consider buying the Boost FTSE 100 3X Leverage Daily ETP, as a result.

The chart shows the mirror image between Spanish government's long bond price performance (our proxy for Cyprus' contagion risk) and the net performance of the FTSE 100 over the DJ Euro Stoxx in EUR terms. Clearly, in the number of episodes where markets feared the worst for Spain and bond prices took a dive (i.e. yields soared), the FTSE 100 outperformed DJ Euro Stoxx, most notably in the April to June period last year and February this year. As markets calmed and confidence returned the FTSE lost momentum and tended to underperform. Hence, as the Cyprus crisis unfolds, UK stocks offer a good degree of shelter against any developments undermining Eurozone

\* Source: Boost, Bloomberg. The prices used for the returns are primary market closing prices from Oct 18th 2012 to March 25th 2013, and are given in the base currency of each index. The returns may rely in part on back-tested prices prior to the inception of some ETPs. Past performance and back-tested performance are not indicators of future performance. Back-tested prices are those which precede Dec 4th 2012 for ETPs referencing the FTSE 100, Dec 7th for the DAX, Dec 10th for EURO STOXX 50, Russell 1000 or NASDAQ-100, and Dec 17th for the commodities.

\*\* Calculated as annualised standard deviation over the past 3 months of daily returns (some of which are based on back-tested prices).

sentiment, not least because the FTSE 100 is sterling denominated.

Unlike continental Europe, the UK market's make up of large cap stocks is generally characterised as lower beta and less cyclical than the Euro Stoxx 50, or for that matter the DAX 30. First, consider the big index heavyweights: the top five names, HSBC, Vodafone, BP, Royal Dutch Shell and Glaxo represent well over 25% of the FTSE 100, most of which are steady dividend paying stocks. While the FTSE 100's dividend yield is currently lower than that of the DJ Euro Stoxx 50, this is as much due to FTSE 100 marked outperformance relative to DJ Euro Stoxx 50 since 2008 as it is due to BP's 2010 oil spill disaster in Mexico. BP's huge litigation costs not only destroyed its disproportionate weighting in the benchmark when it its stock nosedived, it also undermined its traditional large dividend contribution. For instance, in 2009, the year before the Mexico oil spill disaster, BP's weighting in the FTSE 100 was around 9% (as opposed to around 5% now) and paid more than GBP 10bn in cash dividends, a whopping 12% share of all cash dividends paying stocks in the FTSE 100 combined. However, as BP is steadily repositioning itself through asset disposals and strategic alliances with amongst others Russia's oil behemoth Rosneft for instance, its dividend per share is already recovering and according to consensus is expected to grow further out. Second, the make-up of the UK stock market is significantly more defensive than its continental European counterparts, with consumer related stocks overrepresented the index. Once the energy sector, despite its proxy to volatile crude oil prices is included on the back of the recovery of BP's dividend

prospects, the UK stock market is far more defensive than it appears.

However, all these developments should be put into perspective against the huge balance sheet repair challenges facing many of the continental European names, not least across Euro Stoxx bank sector names. Not only Spanish, Italian, and Greek banks' balance sheets are impaired, but many of those in healthier parts of Europe as well, including the Netherlands (SNS Bank), Belgium (Dexia) and Germany (Commerzbank). Their balance sheet deleveraging will take several years to unwind and while some of those banks may not be part of the DJ Euro Stoxx 50, the wider implications for other companies, including those within DJ Euro Stoxx should not be underestimated.

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