# Global Markets : Outlook and Review

30 September 2013

Global equity and bond markets rebounded in September and by mid October a number of global equity markets began hitting all time highs. In particular the S&P 500 hit levels of 1754, while the Dow approached 15,500 levels and the FTSE hit the 6700 range. Global equities as measured by the MSCI World index gained 5.0% in September and for the year are up 17.3%. US markets have led the pack gaining 19.7% year to date after gaining 3.3% for the month. European equities are up 17.2% for the year in US$ terms (MSCI EMU). The stronger Euro has helped power these returns as the Euro:US$ rate approaches 1.40 again.

While the US government shutdown led to some volatility early in October, once it became clear the US Congress would agree to raise the debt ceiling, global markets recovered strongly. The delayed Fed tapering helped boost markets throughout much of September.

With the US$ clearly the world's reserve currency, this has allowed the US to continue to borrow at record low rates. The Fed tapering is set to only begin in earnest in 2014 and to remain somewhat modest in the first half of the year. This is partially due to the politically sensitive handover from Bernanke to Yellen in early 2014. Yellen will be the first Democrat to hold the Chairmanship in almost three decades since Volker tamed inflation.

More concerning for Fed watchers are the weak September job figures of just 148,000 reported in the US – well below the 207,000 net new job gains posted for the 1st quarter and the average 182,000 job gains seen in the 2nd quarter. While the unemployment rate has dropped to 7.2% from the prior month's level of 7.3% this is almost entirely due to fewer job seekers in the US. Increasingly many Americans are giving up looking for work which has pushed the percentage of employed Americans to its lowest levels in decades (slightly above 60%). Despite this, the US economy continues to lead the rest of the developed world out of its deep malaise since the 2008 crisis. US real estate prices continue to show double digit growth as compared with 2012 prices - across most states. Household formation has revived, helping to boost demand for homes and spurning residential construction. Housing starts are now approaching 1 million starts a year – last seen prior to the 2008 financial crisis.

The economic outlook for developed markets has been slightly downgraded by the IMF to around 2.5% for 2013, but is expected to accelerate in 2014 to above 3%. Good news for global equity and bond markets is that global inflation trends remain largely benign due to mostly a sideways trend in oil prices predicted throughout 2014.

Over the past month, Emerging Markets have staged a healthy rally off their earlier year lows. At close to 9.5 times estimated 12-month earnings (PE ratio), valuations across emerging markets are relatively low, although earnings revisions have been negative. An eventual rise in US yields due to the tapering by the Fed will likely put further pressure on depreciating emerging market currencies that harbor both a large current account deficit and fiscal deficits. But export oriented players based in emerging markets will likely see a boost to their bottom line due to the currency effect. This is particularly true in India with offshoring powerhouses Tata Consulting Services and Infosys.

New economic growth figures in China and Latin America point to a steady rebound in activity which should boost prospects for large cap stocks comprising the MSCI Emerging Markets Index. We expect this index to outperform a good deal of the developed world over the next 2-3 years.

Emerging Market indices enjoyed a robust gain of 6.5% in September (MSCI EM) and are now flat for the past year. Particularly impressive has been gains in such sector indices as Consumer Staples globally (MSCI Consumer Staples) – posting again of 14.4% year to date with a3.2% jump for the month.

Recent European economic data shows encouraging GDP gains in the UK and Germany. The recent German election result will likely empower Merkel,( it is hoped) - to play a more activist role in Europe; specifically helping policymakers come to agreements on a centralized banking supervisory system and deposit insurance regime.

The Japanese rally that stalled in August rebounded in September – with the MSCI Japan gaining 8.4%. For 2013 the Japan market is now up an impressive 41.1% in Yen terms or 23.3% in US$. So-called Abenomics is delivering long overdue structural reforms including boosting inflation to around 2%. The implementation of a long overdue consumption tax will also boost Japan's fiscal standing.

The 10 year Treasury is currently hovering around the 2.6% level well below the near 3.0% rate seen earlier in the year. As Fed tapering approaches (early 2014) we expect yields to rise once again and approach 3%.

Lower rates in September helped push the Global Government Bond Index up by 2.0%. Year to date the index is down by 2.9%. By comparison the stronger Euro helped boost returns in US$ for those investing in the European Government Bond Index – which reported a 0.8% gain in Euros. This translated into an impressive US$ gain of almost 9%.

In the property space, the US Property Index (REIT) benchmark recovered 3.2% after falling in August by 6.9%. The index is only marginally positive for the year at 2.3%. Similarly, the European Citigroup BMI Property Index gained 5.3% for the month in Euros – and is now up 3.4% for the year and 14.7% over the past 12 months. (in Euros).

Rates across the UK, Europe and Emerging Markets are unlikely to rise due to weak economic growth. The British Pound has shown considerable strength which is a worrying sign for the Bank of England. With little worry of inflation, it seems lower interest rates will remain with the leading world economies, well into 2014. Emerging markets central banks are caught in the vice between possible inflation issues should their currencies weaken further due to lower rates. We are looking for Emerging Markets to begin to retrace their previous highs over the next six months as it becomes clear that there are no great catastrophes affecting China, India, Brazil or Russia.

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