Global capital markets:
outlook 2015 to 2016

With global equity indices recently hitting new highs across the US, Europe and Asia, valuations are becoming more stretched. However, with yields remaining at historic lows, there is little competition for investment monies. Bond investing at this stage remains a low-return strategy with considerable risks attached to it, with US and other interest rates set to rise over the next few years.

A US rate hike is expected by October this year. However, hikes will likely be in very small increments of 25 bps, and it will take many years to return to a historically 'normal' interest rate level. With the 10-year Treasury hovering around two per cent and equivalent German government bond rates at almost a quarter of this rate, investors have few alternatives beyond equities.

The European Central Bank's $60 billion quantitative easing programme has helped push up European equity markets by almost 20 per cent year to date (in Euros). The weaker Euro is a boost for corporates in the Eurozone as the raging US dollar makes US exports less competitive. European Central Bank President Mario Draghi has confirmed his willingness to maintain quantitative easing until inflation approximates two per cent. Consequently, we expect further gains in European equities in 2015 to 2016. We expect global economic growth to gradually accelerate in 2015 and 2016, helped by the Eurozone finally pulling more of its weight.

The US economy remains the most robust despite a weaker than expected first quarter GDP figure, which was affected by bad winter weather. Jobless claims and the unemployment rate are both at almost decade lows. The shale oil and gas revolution in the US has helped power the economy, accounting for almost 25 per cent of all US capital expenditure currently. While lower oil prices driven by the Saudis will slow this momentum, oil at $50 per barrel is effectively a sizable tax break for a US economy dominated by consumer spending.

Since GDP growth remains muted, the Fed has no desire to harm the housing market, which remains one of the leading engines of US economic activity. Consequently, an increase in interest rates will be done with significant caution. Fed chairman Janet Yellen has paid much attention to the state of the labour market and is keenly aware that housing is the main asset held by working Americans.

Instability remains in Russia, Iraq, Syria and the Ukraine, which could rattle markets later this year. Despite a recent bailout extension, Greece and international creditors remain at odds. Should Greece continue to fight further austerity initiatives, it will become a larger default risk.

Brazil and Russia remain in recession. However, on balance, emerging markets continue to outpace developed markets, and China (comprising 12 per cent of the global economy) is expected to grow by at least 6.7 per cent this year. China's stock market has bounced back from very low levels seen earlier in the year. The major pessimism previously apparent in China is now largely removed from its stock market, which remains mainly closed to outsiders.

Between March and the end of April, the broad MSCI Emerging Markets Index gained almost 15 per cent from its recent lows. However, emerging markets still have some way to go to make up for their lack of gains experienced during 2013-2014. So we expect further gains as global economic growth rises, which should help many emerging market exporters. The threat of higher US interest rates and a possible outflow of portfolio assets back into US bonds and treasuries will put a lid on excessive emerging market gains. However, with relatively low valuations, the developing world remains a good bet for equity exposure.

Although there is the possibility of a correction in US equities, the consensus for now is for the market to slowly grind higher, albeit with increased volatility due to the higher valuations now experienced.

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