GinsGlobal Index Funds

Investment Outlook – April 2013

Global Equities

Global equity markets hardly stopped for breath in April, and continued the impressive bull run since the start of the year. Positive US economic data on real estate, manufacturing and employment helped push the S&P 50, Dow Jones and Russell 2000 to all time highs.

The UK's FTSE 100 index is within striking distance of its all time high, while Japanese markets have shattered a variety of records in Yen terms this year. Despite weak economic data emanating form Europe and growing debate over austerity measures throughout the Eurozone, bulls remain in the ascendancy.

Measures in Japan to generate 2% inflation, so-called Abenomics, has seen the Japanese equity market rise 48.8% over the past 12 months. For the month, the MSCI Japan gained 12.7%; and year to date the index is up 36.8%.

The overall global equity benchmark (MSCI World) gained 3.2% following last month's gain of 2.3%. The benchmark is up a total of 11.1% for the year to date. The global consumer staples sector gained 3.1% in April and is now up 22.9% over the past 12 months.

US economic growth figures for the 1st quarter 2013 GDP reflected a 2.5% rise which has continued the positive sentiment. The MSCI USA index gained 1.9% in April following a 3.7% gain in March. This benchmark, broader than the S&P 500 is now up 12.6% year to date and 16.1% over the past 12 months.

With the core large cap and small cap US equity indices now surpassing their previous 2007 highs, some expect the rally to fade. However into May the economic data continues to show improving sentiment. The US confidence index hit its 5 year high in May, while unemployment figures in badly hit states such as California, reflect significant improvement – California's rate dropping by almost 1% month on month. Positive sentiment abounds in the real estate sector, which is helping to mop up unemployed workers in the West and Southeastern US – areas previously ravaged by the economic slowdown.

The earlier fears of a failed US budget agreement, have not led to any major concerns amongst investors. May private sector executives are in fact pleased that government spending has been reigned in. The US market has clearly taken the Sequester and the threat of any Debt limit fallout in its stride. It is clear that the Obama administration is somewhat weakened by recent IRS, Libya and related scandals, so it is in no mood to force a government shutdown.

Focus in the US Congress has shifted away from economic matters to domestic political agendas, covering the all important immigration question and the new hand-gun legislation that is struggling to get passed.

April showed significant US job growth figures (165,000 new jobs) while total unemployment reached its lowest level in over four years at 7.5%. With the Fed clearly stating it would suppress interest rates and continue its $85bn a month bond buying binge until unemployment fell back to the 6.5% level – market watchers believe equity markets will continue to enjoy a Fed induced tailwind. US equity investors are far more nervous of the Fed turning off its bond buying, which will hurt the real estate, construction markets, Capex spending and bond buyers.

Housing and construction activity across most US states has shown a marked pick up in growth, with the bottom of the real estate market now well behind the US.

Inflation is ultimately expected to follow the dramatic growth in US money supply (i.e. $1 trillion Fed infusion this year alone) – translating into higher interest rates over the next few years. However the demand remains less than stellar, so Bernanke and company are not expected to take their foot off the bond buying pedal until late 2013 or early 2014.

On a 10 year government bond, a capital loss of upwards of 25% could be realized if the 10 year Treasury were to go from 2% to 4%. Currently, rates on the 10yr bond have bottomed out around 1.7% by mid April. The Bond bull run seems over with the 10yr Treasury hitting 2.2% in May.

By comparison, Emerging Markets and the Eurozone continue to lag US equities. This is not too surprising given economic weakness in such commodity laden countries as Brazil, Russia and South Africa. Emerging market currencies remain under significant pressure with the South African rand amongst the worst currency performer in 2013. India's economic growth also continues to disappoint while a new reality is setting in for China – no longer can the world expect double digit annual GDP gains. Currently China is struggling to get beyond the 7.5% growth level this year.

The MSCI EMU Index is up just 5.3% for the year 2013 (in Euros), while the MSCI Emerging Markets Index is down almost 1% over the same period. Austerity measure across the Eurozone and the UK continue to play out and affect many emerging markets that rely heavily on Eurozone consumption. Italy finally secured a functioning coalition government which is seeking to draw back the austerity measures announced by the previous acting Prime Minister Monti.

Sadly, problems in Spain and Greece persist with the highest unemployment levels seen in those countries in decades. Spain remains reluctant to formally ask for a bailout, but massive Spanish unemployment may necessitate IMF/Eurozone assistance later in 2013.

Concerns regarding European banking resurfaced with the problems in Cyprus. Until such time as a more centralized Eurozone regulator and deposit insurance mechanism is instituted; arguably there remains a two speed Europe in financial services too.

The last minute banking bailout last month (confiscating deposits above 100,000 Euros) – continues to send shivers down the spine of other bank depositors based in weak peripheral Eurozone member countries.

Given ongoing Euro-wide austerity measure in the UK and Germany, expectations remain muted for positive job data and GDP growth over the next 12-18 months. The world is depending on the US to lead the economic recovery which may result in a US GDP growth rate of between 2.5%-3% for 2013. Until the German elections are behind us later this year, it is unlikely Chancellor Merkel will make any significant moves to assist fellow European countries.

Positive US data relative to Eurozone fears, has lead to a strengthening in the US$ relative to both developed and emerging markets. The British Pound and Euro remain under pressure while the Yen as expected pierced the 100 level versus the US$.

Volatility levels as measured by the VIX 'fear index' remain near record lows over the past five years – touching less than 13 recently. Clearly if earnings disappoint globally, we could see a pullback in the equity rally, but for now the bulls are dominating.

In the property space, the US Property Index (REIT) benchmark posted impressive gains of 6.9% in April and is now up 14.4% for 2013. The REIT Index is now up an impressive 17.4% over the past year and almost 60% over the past three years. By comparison, the European Citigroup BMI Property Index gained 5.8% for the month, and is up 25.9% over the past year.

Global Bond outlook

Continued positive US economic data is unlikely to see the Fed step off the gas anytime soon. Unemployment remains at a historical high level of 7.5% - although well down from almost 10% at the height of the financial crisis. Recent statements from the Fed and Chairman Bernanke indicate that the fed's bond buying binge is likely to remain in place through 2013. This $85bn of monthly purchases will help to keep bond prices high and the rates low.

This has helped, in large part, to fuel a real estate resurgence given 30 year fixed mortgage rates still sitting below 4%. Massive bond issuance by the likes of Apple and other corporates are also expected to continue given the cheap cost of capital.

The bond bull run is likely over, however given that 10yr rates recently touched as low as 1.6% are now back up to 2.2%.

While US economic news remains positive it is not 'hot' enough to stop Fed meddling in the bond markets. Markets have taken heart with this goldilocks 'not too hot' scenario and are pleased with continued large scale Fed bond buying - well into 2014. Lower rates are definitely seen as a huge stimulus and boon to more capital projects occurring in 2013 and significant construction spending and a more vibrant real estate sector.

Stronger job growth figures posted in April (165,000), while positive are below expectation during this stage of the recovery. Until employment data is consistently above 200,000 jobs monthly there is little hope that the unemployment rate with fall sharply to the noted 6.5% level required by Bernanke.

Consequently, it is not surprising that the so-called risk-on has led to a substantial equity rally leaving the bond markets in their wake. With European austerity and weak growth in emerging markets continue, inflows of portfolio investment into the US will likely underpin a bullish equity market and relatively low sustained Treasury rates.

US yields remain artificially low given this stage of the economic and inflation cycle. By mid 2014 many analysts expect the US bond rally to finally recede with investors likely to take a beating on their bond holdings in the next few years as rates rise substantially. Currently, the US 10 year Treasury yields 2% and has traded in a very tight range the past year. An increase in yields to 3.5%-4% could cause capital losses in the order of 20% - 25%.

Rates across Europe and Emerging Markets are unlikely to rise due to weak economic growth. In fact lower rates would be helpful, but many Central Banks are caught in the vice between possible inflation issues should their currencies weaken further due to lower rates. Such concerns exist across a number of Emerging Markets countries including South Africa and Brazil.

Given England's weak growth prospects and the continued severe austerity measures, higher inflation targeting is effectively helping to weaken the Pound. It now trades at its weakest levels against the US$ in over 4 years and the Euro in over 3 years.

Emerging Markets with weaker currencies in 2013 may enjoy greater export growth so they may also be less keen to raise rates. Many observers in Europe and Emerging Markets are benefiting from the stronger US dollar. China, meanwhile, has shown positive signs of a recovery and is staving off any real estate bubble for now. We predict that China will surprise on the upside in 2013 in economic growth terms, and manage to show healthy GDP figures in the 7.5% range.

The Global Government Bond Index gained 1.1% in April , but remains down by 1.7% for 2013. By comparison, the European Government Bond Index gained 2.6% for the month and remains marginally up 2.9% for the year. Over the past 12 months the index is up 10.3% (in Euros). Clearly talk of the potential break-up of the Eurozone is long gone.

It is unlikely that US bond yields will drop from current levels. Once the Fed pulls back its giant bond buying program – US rates are expected to head considerably higher. Many believe yields

will slowly begin to rise at the long end of the curve as demand for bonds gradually decreases and economic recovery becomes more pervasive across the US.

The rotation out of bonds is slowly underway according to many analysts, which will help fuel the equity rally. The weekly inflow into equity mutual funds in the US has been the highest it has seen in over five years and has dwarfed any bond inflows.

The US remains the poster child for economic recovery and is experiencing a far healthier recovery than Europe. The lack of severe austerity measures coupled with easy Fed money has boosted the US recovery. By comparison, UK and Eurozone policymakers seem to be stuck in severe austerity policy mode – significantly limiting economic growth.

The hope is that demand in the US economy will help absorb renewed exports from Emerging Markets such as China, Brazil as well as the Eurozone.