Global Markets : Outlook and Review

31 July 2013

Global equity markets enjoyed a very positive month in July. Fears of the Federal Reserve's 'tapering' being withdrawn were put to rest. By the end of July US equity markets had again reached new all time highs. For now it appears that the Fed's Bernanke is in no rush to withdraw from its massive $85bn monthly bond buying program – until more robust economic growth figures and lower unemployment numbers are recorded.

That said, markets are predicting tapering to begin by year end – with a smaller bond buying program in the offing. The consensus appears that until monthly jobs data consistently hits over 200,000 jobs the Fed will continue with its stimulus program in various ways. Recent jobs data including June's figures (195,000) and July (162,000) remains well below this level. Unemployment remains stubbornly at 7.4% - well above Bernanke's 6.5% target level for no further Fed bond buying stimulus (QE3).

The US economy is still leading the rest of the world out of its deep malaise since the 2008 crisis. Sentiment is very much against emerging markets currently with their currencies taking major strain. Year to date the MSCI Emerging Markets index is down almost 10% - but we expect developing markets to slowly recoup such losses after Fed uncertainty is put to rest.

The global equity market rally that stalled in June recovered in July. The MSCI World Index gained 5.3% in July following June's 2.5% retreat. It remains up 14.1% for the year. The benchmark is up a total of 23.2% over the past year. The global Consumer Staples sector gained 4.0% in July, and is now up 15.0% in 2013, and 17.9% over the past 12 months.

The US markets measured by the broader MSCI US Index gained 5.2% in July, after losing 1.4% in June. US equities are now up 19.3% year to date and 24.5% over the past year.
By comparison, Europe posted impressive 6.3% gains (MSCI EMU in Euros), and is up 9.3% for the year and 23.2% over the past 12 months. Interestingly, Europe is trading at 12 times earnings, while the US trades at close to 16 times earnings - as measured by the broader MSCI US Index. The MSCI World Index minus US stocks has a dividend yield of 3.1%. That is almost 50% higher than the 2.1% dividend yield of the S&P 500. Amongst the highest yields can be found in Australia (average of 4.5%), France (3.7%), and the UK (3.6%).
The Japanese rally that ended in May and June - remained stalled in July with the MSCI Japan largely flat for the month (-0.4% in Yen). Nevertheless, for 2013 the Japan market remains up an impressive 33.4% in Yen terms. The market is up 58.7% over the past year (MSCI Japan) as stimulus measures in Japan are exerted to generate 2% inflation, so-called Abenomics. Further structural reforms are expected with Abe's recent victory in a parliamentary election in July.

The MSCI Emerging Markets Index after giving back 6.4% in June rose just 1.1% in July - and is now down 8.6% for the year to date. Over the past 12 months the index achieved just a 2.0% growth rate. With PE ratios trading at low levels of just 10 times earnings and a price to book ratio of 1.5X - Emerging Markets arguably have suffered from excessive investor pessimism and overshot on the downside based on slowdown fears in China and India. Making matters worse has been the weakening of many emerging market currencies including the Brazilian Real, South African rand and Indian Rupee now at an all time low of almost 64 to the US$.

New Chinese leadership and an evolving economy there – based far less on massive infrastructure projects, continues to cause concern. Certainly lower demand now exists throughout most of the Chinese economy – most particularly in mineral and steel imports. The recent lending curbs and tightening up of credit in China are designed to reduce the dependence on state finance and shadow banking. China is moving to a more consumption based model as it weans itself off further massive capital infrastructure projects to fuel it s growth. Recent GDP figures in June indicate China is making the transition fairly smoothly with growth of 7.5% being reported.
The US property market has certainly enjoyed a robust past 12 months, with prices up across the country – on average 10%-12% in residential properties. However there are fears that a big spike in mortgage rates could dramatically reduce housing activity and reduce economic growth prospects. The 10 year Treasury is inching it's way back to 3% which will cause 30 year mortgage rates to spike to their highest levels in years. Despite weak GDP figures the bond market is pricing in steadily increasing yields. Between May and early August, 10yr Treasury Bond have lost almost 10% in value. By contrast Global Government Bonds are off 4.4% for the year – and in fact gained 1.4% in July. European Government bonds are up 0.8% for the year in Euro terms.

In the property space, the US Property Index (REIT) benchmark gained 0.8% and is up 6.5% now year to date. By comparison the European Citigroup BMI Property Index gained 3.8% in July and is up just 2.1% in euro terms for the year.

Rates across the UK, Europe and Emerging Markets are unlikely to rise due to weak economic growth. While lower rates would be helpful, many 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 later this year as it becomes clear that there are no great catastrophes affecting China, India, Brazil or Russia.