GinsGlobal Index Funds

Investment Outlook – March 2013

Global Equities

Global equity markets continued their bullish run in March, with a number of leading indices including the Dow Jones, S&P 500 and FTSE all within striking distance of their all time highs.

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 almost 40% in the past 8 months. In March, the MSCI Japan index gained almost 7.0%. For the 2013 year, the index is up 21.4%.

The overall global equity benchmark (MSCI World) gained 2.3% for the month and is now up 7.7% for year to date. The global consumer staples sector gained 4.3% in March and is now up 19.7% over the past 12 months.

US economic growth figures for the 1st quarter 2013 showed a 2.5% rise which has continued the positive sentiment. The MSCI USA index gained 3.7% in March and is now up an impressive 10.5% in just the past quarter – with the most followed US equity indices expected to shortly surpass their previous 2007 highs.

Despite initial fears of a failed US budget agreement, the market appears to have taken it in its stride. This is perhaps not surprising, given that few US budgets have been passed on time over the past decade. Although the Budget Sequester cuts are deemed unfair and random, US business on balance, is not unhappy with a shrinking government since it is viewed by many as already bloated. Focus in the US Congress has shifted to the all important immigration question, while emotional sentiment increasingly falls on the new hand-gun legislation that is struggling to get passed.

March showed weaker US job growth figures than expected (85,000), which is less than half the numbers reported in the prior three months. 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 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. 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. Clearly Fed watchers expect no upward move on rates by the Fed for some time to come – very likely 2013 will not see any such moves.

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. India's economic growth also continues to disappoint while China is no longer expected to post 10% annual GDP gains and may struggle to get beyond the 7.5% marker in 2013.

The MSCI EMU Index is up just 2.3% for the year (in Euros), while the MSCI Emerging Markets Index lost 1.7% in March and is slightly negative for 2013 (-1.6%). Italy continues to function without a newly elected government and remains in a state of limbo under a caretaker regime. Problems in Spain and Greece persist with the highest unemployment levels seen in those countries in decades. Concerns regarding European banking resurfaced with the problems in Cyprus – it is disorganized and 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. Major structural weaknesses persist, particularly in the peripheral countries such as Portugal, Spain and Greece. Spain remains reluctant to formally ask for a bailout, but massive Spanish unemployment may necessitate IMF/Eurozone assistance later in 2013.

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.

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 sunk to a 4 year low of 1.49 to the US$ during March, but has since recovered to around 1.53. The Euro also sank below $1.30 during March but has since recovered to this level, while the Yen is expected to exceed the 100 level versus the US$ shortly. Emerging markets such as South Africa have seen a dramatic weakening of their currency against the US$ too, with the Rand hovering around the R9.20 to US$1 level.

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 gains of 2.5% in March and is now up 7.0% for 2013. The REIT Index is now up an impressive 11.2% over the past year and almost 52.0% over the past three years. By comparison the European Citigroup BMI Property Index lost 0.4% for the month, but remains flat for the year and is up 14.3% over the past year.

Global Bond outlook

The Federal Reserve continues to purchase $85bn of US bonds monthly. This has helped, in large part, to ensure rates remain extremely low across the board – encouraging capital expenditure projects and US mortgage/real estate lending activity. In particular the US 10 year Note is yielding just 1.7% - well below the 2.1% level it hit just after New Year.

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. Weaker job growth figures posted in March (85,000), while disappointing, has reinforced the view that the Fed won't release its foot from the bond buying pedal until well into 2014 – when the unemployment rate may begin to approach the stated 6.5% level.

With Chairman Bernanke expected to retire at the end of his second term in 2014, more nervousness about Fed policy may rear its head later in the year. The current Fed Vice Chairman Janet Yellen could possibly be chosen to succeed Bernanke as the first female leader of the Fed. She is viewed as placing more emphasis on unemployment than inflation risks, so the likelihood is for current Fed policy to continue well into her tenure. Expect annual Fed bond purchases to remain on track to buy $1 trillion of US government debt over the next 12 months.

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.

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 of the order of 20% - 25%.

Rates across Europe and Emerging Markets are unlikely to rise due to weak economic growth. Many Europeans could benefit form slightly lower rates but the ECB for now seems unlikely to drop rates further. As expected, neither the ECB nor the Bank of England changed their rates in early March. In fact 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.

The Global Government Bond Index fell again in March by 0.3% and is down 2.8% so far in 2013. Over the past year the Index is down 0.7%. By comparison, the European Government Bond Index gained 0.7% for the month and remains marginally up- 0.3% for the year. Over the past 12 months the index is up 7.3% (in Euros).

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.

Weak Eurozone economic numbers ensures that the Zone remained in a recession at the beginning of the year, despite Germany's favorable growth figures and optimism there. Upcoming German elections has led to a balanced budget being announced with very little stimulus. Meanwhile the inconclusive political elections recently in Italy have led to almost two months of uncertainty. A new coalition government will now likely only be formed in May. However this new government will likely remain weak and be unable to tackle many of the tough decisions required to reform Italy's economy.

A weaker Euro relative to the US$ will assist the Eurozone over the next year to generate more exports. However continued problems with Spanish banks means the Zone is not out of the woods yet.

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 is poised to experience a far healthier recovery than Europe in 2013. 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.