Global Markets : Outlook and Review

31 May 2014

The number of new U.S. jobs created last month slowed a bit after a big gain in April, but the brisk pace of hiring supports expectations of a spring revival in the economy. The U.S. created 217,000 nonfarm jobs in May and hiring has now topped 200,000 for four straight months, the first time that's happened in almost 15 years. The robust increase in hiring in May follows a slightly revised 282,000 gain in new jobs in April, 203,000 in March and 222,000 in February.

The U.S. has now recovered the 8.7 million jobs lost after the 2007-2009 downturn, but it took more than six years to surpass the nation's prior peak of 138.25 million workers. Not since the Great Depression in the 1930s has it taken so long to recover all the jobs lost from a recession.

The unemployment rate held steady at 6.3%, although this masks a far higher rate of under-employment. There is still a considerable amount of slack in the economy. As of May, 23.5 million Americans either want a job, or want to work full-time but can't because of the weak economy. This "army of the unemployed" is down nearly 5 million from the peak of 30.4 million four years ago, but it's up 7.5 million from the pre-recession level of 16 million.

That means the "real" unemployment rate is about 14.5%, compared with a low of around 10% just before the recession hit. This includes all the people who are looking for work, plus those who aren't looking but say they want a job, plus those who are working part-time but want a full-time job.

For the Federal Reserve, the slack in the economy is the most important number in the May jobs report. It means the Fed will keep interest rates extremely low for a long time as wannabe workers slowly return to work.

But simply recovering to the earlier employment peak says little about the health of the U.S. labor market, given population and potential labor-force growth in the more than six intervening years. In this time, the U.S. civilian population increased by nearly 14.5 million people, although the labor force grew by just 1.7 million new jobs.

In early June the ECB cut its key policy rates and indicated it was preparing for purchases in the asset backed securities market. At the heart of the ECB's package is the refinancing scheme to spur business growth – the Euro 400bn in cheap fixed-rate loans. Unlike earlier plans it is directly linked to banks' lending out more to credit starved smaller businesses. Further plans are expected to be unveiled. The historic decision to cut interest rates below zero on the money banks deposit with the ECB, should also finally help spur credit growth. ECB President Draghi is clearly also seeking to weaken the Euro relative to the US to not only ensure more exports from the Eurozone, but also importing more inflation, as the threat of deflation continues. Ultimately the ECB may be forced to unleash Quantitative Easing (QE) with sizable purchases of government bonds.

It is clear stocks have benefitted from the stronger economic data which should support robust earnings growth throughout the rest of the year. While global interest rates are likely to stay low, increasingly the Central Bank divide. The ECB provided further monetary easing with lower rates, along with the Bank of Japan that continues with its very aggressive asset purchase program. Liquidity from these two banks will help support global equity markets throughout the year, while the US dollar is likely to strengthen due to a weaker Euro.

US equity markets during June hit all-time highs. US sectors such as financials and real estate remain top performers for the past few months. US Equity markets are up over 22% year on year, slightly beating out the Global Developed market benchmark (MSCI World) which returned approximately 17%. The Dow is expected to hit the 17,000 level during the US summer while the S&P 500 is likely to break through the 2000 level this year too.

While US valuations are relatively high compared with the past two years, with PEs averaging around 19 on the S&P 500 - it is not seen as excessive for such a low interest rate environment.

Emerging markets as an overall group remain out of favor, although India, South Africa and Mexico have posted recent highs too.

Low 10 year US Treasury yields below 2.5% continue to surprise investors. Both the Global Government Bond and European Government bond markets have shown positive returns for the year to date in the range of 4%. However the recent good economic and job report news is likely to put pressure on bonds going forward.

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