# GinsGlobal Investment Outlook – September 2012

## Global Equity

By the end of September, global equity markets had approached four year highs across most developed markets. The rally which began in June has been sustained by aggressive actions undertaken by both the European Central Bank (ECB) and most recently the US Fed through its QE3 which have both buoyed markets.

Given the continued weak job growth figures in the US, the Fed boldly decided to embark on a third round of Quantitative Easing (QE3). This follows on the heels of QE1 in November 2008 and QE2 in August 2010 and more recently Operation Twist. The announcement of a new $40bn a month purchasing program of US mortgage backed securities is intended to stimulate demand for equities and boost the value of housing stock in the US.

Pumping this level of new money into the economy has boosted real assets (gold) and devalued the US dollar against the Euro - the dollar has lost almost 10% of its value against the Euro in the past two months.

By late September the S&P 500 had posted a 16% gain for the year, followed by a 13% gain in the global developed markets equity index, the MSCI World. By comparison emerging markets have gained 12% for 2012 (MSCI Emerging Markets Index), constrained somewhat by China's falling stock market – now at its lowest point since the crisis of 2008.

The developed world outside the US has only gained 7% for the year as measured by the MSCI EAFE Index, while the Asia-Pacific region has gained just 5.2% for the same period. However when excluding Japan from the Index the region has posted impressive gains of 13.4% year to date and 19.3% over the past year – almost double the MSCI EAFE one year growth rate.

The ECB actions while offering unlimited bailout funds for such peripheral Euro nations as Greece, Spain and Portugal – has helped to reduce long term yields on sovereign debt and effectively bought the Zone more time by putting a temporary band aid on the festering wound. However the governments of these nations have to formally request bailout funds so further delays are expected in Europe since requesting funds from the ECB is seen an unpalatable by many electorates in the peripheral parts of the Eurozone. Spain in particular is seen as the next key dyke in the wall of the Eurozone. How much longer can Spain hold out before requesting a full bailout? German Chancellor Merkel meanwhile seems to have recently pushed back on a Eurozone bailout for Spanish and other insolvent banks – emphasizing that the sovereign governments of Ireland, Greece and Spain should lead any bailout of their own banks.

Bernanke and his Central Bank colleagues in Europe have temporarily succeeded in creating a positive wealth effect boosting equity markets. However by mid October concerns of weak corporate earnings and the US fiscal cliff began to weigh on investor sentiment.

With the US poised for a fiscal cliff at the end of 2012, due to $1 trillion of public spending cuts taking effect and various looming tax increases – the Fed felt compelled to act now despite the intense political season the country finds itself in. The fiscal cliff could knock off close to 3% of US GDP growth next year, so any Fed stimulus program will help. Most experts believe that an 11th hour compromise will be fashioned by the Republicans and Democrats but not before the US credit rating is again put in the line of fire and sentiment grows negative as the deadline grows ever closer. It is likely the US will have a split government between the legislature (Congress) and the presidency after the Presidential election in November. Markets generally like a split vote.

It seems the mid year rally may have finally run out of steam by October with markets trending lower by mid October. Impressive year to date movements across the Eurozone (Eurostoxx 50 up 12.5% in Euros) and such markets as Germany (Dax up 25% in local terms) and France's CAC 40 up 13%, lead many to believe that the rally will run out of steam shortly. With all the recent Central Bank moves now fully priced in, it is hard to see where another leg to the impressive equity rally may come from. For now investors should remain cautious and feel content with riding the equity market gains, but should be willing to take some money off the table and pocket certain gains.

Outside of equities – the US property markets continues to stabilize although some States remain incredibly fragile such as California, Arizona and Nevada. The US REIT index is up 32% over the past 12 months and the European Property Index up 15.5% (Citigroup BMI Property Eurozone Index).

**Global Bond**

The recent dramatic Central Bank moves led by the ECB and Fed temporarily helped reduce long term sovereign and corporate rates in addition to mortgage rates across the developed world. Since any inflationary fears remained muted, central bankers have felt empowered to make dramatic gestures to ensure the world's leading economies do not fall back into a recession. With a growing number of Eurozone members already in recession and austerity programs set to continue in a wide variety of Zone countries, the ECB's move seems particularly well timed to assist its peripheral members with little hope of solving their immediate problems.

Austerity measure across Spain, Portugal, Ireland, Greece and the UK have taken their toll thrusting much of Europe back into a recession earlier this year. However the UK is now posting encouraging signs of exiting its deepest double dip recession slump for many decades.

Spain may well require a bailout along with Greece, and government moves by both these countries could yet disrupt equity market confidence as we head into the final closing months of the year. Given the impending fiscal cliff in the US budgetary negotiations, it is likely that we may have seen the top of the equity rally as of September. By mid October developed markets have already retreated by 3%-4% off their September highs.

It is hoped that the ECB's strong defense of the Euro will buy the region enough time to begin to heal the weakest of its economies as economies begin to restructure on a firmer fiscal footing going forward.

The Debt to GDP ratio need not be zero in peripheral Eurozone member countries. Increasingly a level of between 3%-5% is felt sustainable and will help poorer Eurozone members begin to grow. Much of the draconian austerity measures being announced will not help the Zone rebound due to massive layoffs and salary cuts. It remains clear that the global investment banking model no longer works, as continued massive layoffs at global banks dominates the financial scene. Recent appointments at both Barclays and Citibank indicate a back to basics form of banking strategy and a move away form the hedge fund, proprietary trading model which caused so many recent problems.

A weaker Euro would be helpful for exports from the region, but with the US itself in a fiscal mess, a weak US$ policy will likely remain - thanks to the Fed increasingly priming the printing presses. US policy makers are happy to see a Euro appreciate almost 10% against the US$ during the past month.

It seems likely that the US economy is most likely to emerge stronger than Europe for some time to come – benefiting from growing exports and manufacturing, due to the weaker US$ and real wages in the US continuing to fall for the middle class. The divide between rich and poor in the US has arguably never been greater as the middle class see its standard of living fall further. However with high unemployment, US corporates are able to rehire workers at lower wages and with far less benefits – making the US far leaner and meaner to take on the global economy than it was prior to the Great Recession of 2008-2009.

The Citigroup World Government Bond Index is up just 3.4% for 2012, while the European Government Bond Index is up 7.4% over the same period (in Euros).