GinsGlobal Index Funds

Investment Outlook – April 2011

Global Equities

The global equity markets rebounded in April after a weak March. The strong showing was partly due to improved European and US economic data, including the addition of almost 200,000 new jobs in the US for the month.

The market also settled down after the twin stresses of the Japanese tsunami and nuclear fallout, plus the growing Libyan crisis.

The Global Developed world index (MSCI World) gained 4.3% in April and is now up 9.3% for the year to date and 18.3% over the past year. The US market gained 3.0% for the month and is up 9.0% for the year. Non-US developed markets also enjoyed good gains with the MSCI EAFE gaining 5.6% – it is now up 8.4% during 2011 (US$). The Eurozone as measured by the MSCI EMU gained 3.7% in Euros for the month and is up 7.6% for the year to date.

This compares with the MSCI BRIC and MSCI Emerging Market Indexes – both posting far weaker returns as follows (respectively): 0% and 2.8% for the month and for the year to date: 6.5% and 7.6% respectively. Inflationary pressures in emerging markets and the recent price reduction in commodities have put a dampener on emerging market returns during 2011.

The commodity boom hit a major bump during early May with gold, silver and oil all experiencing rapid declines. With volatility spiking, it is likely that emerging market stocks closely linked to resources will remain under pressure for some time. This is also partly due to Chinese demand being reduced through tougher lending standards on the Mainland. Higher bank regulatory requirements translates into fewer loans being made. The free flow of credit has been curtailed in China – the central bank has actively managed this process with regular interventions. It is hoped that this will limit inflationary pressures there.

However many believe that only a revaluation of the Yuan currency against international currencies – will ultimately curtail inflationary pressures. China has only allowed their currency to appreciate marginally against the US dollar – which itself has lost 10-15% against a basket of leading currencies over the past 9 months.

Policy makers in the US are under growing pressure to tackle the twin threats of inflation and continuing US deficits (trade deficits and budget deficits). However the sluggish housing market and continued high unemployment data (9% as of early May), indicate that the Fed is likely very keen to keep rates at their current levels - which is good for the equity market.

The weak US$ continues to assist the US corporate earnings since a growing percentage of large cap earnings are generated abroad. By some estimates, approximately 40% of S&P 500 earnings are generated outside the US. Most analysts expect the Dow to post gains beyond the 12,700 level by year end.

In April and May European economic data was impressive – underpinned by good gains in the French and German economies. The fallout from Portugal and Greece has not impacted the largest European economies. US job gains exceeded 200,000 in May after healthy April data – pointing to rehiring. Such monthly job gains are the highest recorded levels in over 2 years.

The MSCI Pacific Index gained 2.2% in April and is down 0.8% for 2011, largely due to the Japanese crisis. In Yen terms the MSCI Japan index was down 1.7% in April and down 4.5% year to date.

The US REIT Index rebounded almost 6% for the month and is now up 13.0% for the year and 23.1% over 12 months. By comparison the European Listed Property Index gained 2.1% for the month, 6.4% for 2011 to date and 20.2% for the past year (Euros). For the past 12 months this translates into a whopping 36.4% gain in US$ terms

It is clear that the US Fed will likely be the last major central bank to seek to raise interest rates. Despite the lack of a full economic rebound and relatively weaker job growth at this point in the economic cycle than normal – a number of leading Central Banks are seeking to hike interest rates. The Fed appears to be the least worried regarding an inflation threat.

We expect large caps from industrialized countries to enjoy positive performance through the end of the year and outperform small caps and emerging markets.

Global Bond outlook

With Central Banks around the world looking to raise interest rates given the imminent inflationary threat, it is surprising to many that US bond yields have fallen the past month. The yield on the 10yr Treasury fell from around 3.6% down to 3.1% - despite the Fed's QE2 buying spree set to end in June.

The recent reduction in commodity prices may give Central Banks more breathing room and rate rises may take longer to come to fruition. This is particularly true in industrialized countries. Unfortunately higher oil, food and commodity prices have already had a severe impact in developing countries. China's central bank and banking regulator has tightened the credit noose – effectively limiting the flow of credit to medium and large businesses. This is expected to reduce demand for raw materials in the short term and has helped reduce commodity prices around the world. Ultimately the Chinese economy is still on track for a 9% GDP gain, but the hope is to curtail inflationary pressures at the same time.

The growing US budget battle over the debt ceiling (due to be pierced in August) – could lead to a US government shutdown. Cooler heads will likely prevail and raise the debt ceiling limit by an act of Congress. However no long term bargain is expected to be made between the two political parties until after the 2012 presidential elections. Tough decisions are being pushed off in Washington, which continues to undermine sentiment towards the US$. A weaker US$ will help import inflation into the US over time.

The Fed is expected to curtail its QE2 purchasing program of US Treasuries by June which is expected to lead to a rise in US rates. However the Fed itself is in no mood to raise rates with the real estate market remaining vulnerable and posting very weak results for the first four months of the year. Home prices continue to fall across much of the US, as measured by the Case Shiller Price Index.

The ECB and UK Central Bank have missed their inflation targets the past few months and there is growing pressure for rate rises. This will negatively impact their economies and reduce export competitiveness as their currencies will gain in strength.

With little movement expected from the Fed on rates, a weaker US dollar will continue to subsidize US export and corporate earnings.

Once QE2 is stopped the Fed runs the risk that rates will rise in the US as the Fed no longer buys Treasuries. The consensus is that rates will rise later in 2011 as the Fed's buying spree disappears from the bond market – thus driving bond prices down and rates higher – due to less demand.

Despite the rise in oil and inflation threat, the Fed is expected to keep rates at the lower levels for much of 2011, in order to try stimulating the economy as much as possible. With the US

unemployment rate at 25 year highs, wage growth (wage inflation) is nonexistent, US consumers still laboring under way too much debt , it will likely take years for US consumers to repair their balance sheets.

A massive overhang of foreclosed properties exists – some 5 million that are expected to come onto the market over the next 24 months as rates reset. Given the tenuous nature of the residential and commercial real estate markets in the US, the Fed has no desire to make mortgage finance more expensive for prospective borrowers.

Given record inflows into bond mutual funds in the US the past 3 years, many retail investors are now rushing for the bond exits (ahead of rate rises expected towards the end of 2011). This will help fuel interest in the stock market, likely further pushing up equity prices.

The Citibank Global Government Bond Index gained 3.2% in April and is now up 11.2% over the past 12 months. This is in large measure due to the measurement being in US dollars. By comparison the European Government Bond Index was up 0.4% in April and is down 0.9% for the year (Euros).

A sustained global economic recovery remains under threat due to huge structural deficit problems in certain Eurozone countries including the UK, Greece, Spain and Ireland. The threat of inflation exceeding levels of 3% in Europe will compel the ECB to also act in the next few months to raise rates.