GinsGlobal Index Funds

Investment Outlook – December 2011

Global Equities

Equity markets staged an impressive recovery in the final six weeks of 2012 and have continued their upward trajectory throughout January. Most leading equity benchmarks are now at their six month highs, thanks in part to the good news filtering out of the US. Unemployment in the US slipped to 8.6% from well above 9%, while there was a sharp drop in weekly claims for unemployment insurance and encouraging manufacturing data.

Although it is now clear that the US avoided the double dip recession that some forecasters were worried about, the real unemployment rate in the US remains closer to the 16-17% level when taking into account workers who have not returned to the workforce and temporary employees who prefer a full time job. None of these workers are counted in the current unemployment statistics.

Meanwhile US housing remains under pressure with the majority of US cities still reflecting decreasing home prices. Ultimately the difficulty in obtaining a new mortgage and credit will hamstring the sector for a number of years, as bank lending remains tight. With many Americans currently unable to refinance their homes and take advantage of the historic low interest rates, it is clear that parts of the residential housing market remain dysfunctional. Commercial real estate seems to be on track to have a faster recovery. The listed property sector in the US posted gains of 9.4% for the year (REIT Index) as opposed to the broad equity market being completely flat (S&P 500 -0.2%) – the broader MSCI US Index gained 0.9% for the month and closed up 1.4% for the year.

By comparison European Equity and Emerging Market stocks had a dismal 2011 losing 14.9% and 24.2% respectively. Overall the MSCI World Index measuring developed markets closed down 5.5% for the year and was flat for December.

Europe remains the number one concern on most global investor's minds, after China seems to being heading for a soft landing – posting good 8.9% GDP growth figures last month. The lack of any clear resolution to the European sovereign debt crisis despite ongoing summits and talk of the ECB providing liquidity, has dampened the mood going into 2012. However recent debt auctions by Spain and Italy have seemed to buoy the market, while large sovereign debt purchases by the ECB has helped sentiment. It remains true that certain Eurozone banks such as Commerzbank remain under capitalized, and along with Unicredito and other large Italian banks are making much use of the ECB's Euro500mn credit facility. Without such a facility, it is unlikely that Italian banks would have secured the necessary funding to operate in the current environment.

With gold again above $1600 an ounce and oil above $100 – it is clear there remains global nervousness despite the recent equity market rally – which has seen the Dow touch 12,700 and roar past the 1300 mark on the S&P 500. One gauge of trepidation is the Baltic Dry Goods Index which records the cost of shipping commodities (mostly coal, iron, grain etc). Recent data indicate shrinkage in world trade and this equates to the global economic slowdown. The Index stands at the same level it was at in 2009 with no pick up.

While we don't see a hard landing in China, the authorities have a tough task balancing the need for growth with inflation and a property bubble. Most analysts agree that a property bubble has already burst in China at the top end – but it was well managed by the authorities who limited credit some time ago. While US listed property markets gained almost 10%, in the Eurozone listed property stocks retreated by 16.8%.

While the outlook remains uncertain for Europe in 2012, with a definite recession already taking hold in the region, the US appears to have begun working its way out of its worst economic slump in decades. Over the past quarter, an average of 150,000 new jobs were created monthly with December peaking at over 200,000.

Global Bond outlook

The performance of US Treasuries in 2011 stumped even the most seasoned bond investors. Many predicted rates would rise towards the 3% level, whereas the 10yr Treasury closed out the year with rates hovering around 1.9% and touching 1.7% a few months ago.

The Global Government Bond index gained 0.9% for December and closed up 6.4% for 2011. By comparison, the European Government Bond Index gained an impressive 4.0% for the month and closed up 3.4% for the year. This impressive European bond performance in December reflected some positive actions taken by both the ECB, the government of Italy as well as the good response from sovereign debt auctions held in the past few weeks.

The ECB's Euro 500mn lending facility for Eurozone banks has been largely taken up by Italian banks plus Commerzbank, the weakest of the German banks. In effect the ECB has also become a lender of last resort pumping in hundreds of millions of Euros into the sovereign bond market sustaining demand for the recent auctions.

With German economic performance showing robust health and maintaining its AAA rating – observers increasingly believe the Eurozone crisis can muddle along well into 2012 and there is no imminent danger of a Lehman like event occurring that could freeze up capital markets,

Despite the imminent danger in Europe being averted for now, it is clear that simple austerity measures will not allow Greece or the other peripheral countries to grow their way out of their solvency problems. It is clear that Greece will require their bondholders to take an increasingly large haircut (i.e. a default) in order to write down its level of debt; otherwise social unrest will limit any further draconian measures that cut further into the Greek economy. Already youth unemployment is approaching 30%, while Spanish general unemployment is now at 23%.

Europe needs to grow its way out of its liquidity and solvency problems – an infusion by the ECB and IMF along with a global economic recovery will help do wonders helped by a weaker Euro relative to the US$ and Pound.

In the US with housing remaining under pressure no interest rate increases are expected for another year – as already indicated by the Fed. The implied aim is to keep long rates as close to current levels as possible to help spur refinancings and new affordable mortgages at 30yr rates hovering around 4%. Unfortunately many US homeowners simply no longer have the credit necessary to qualify for these new low rate mortgages.

With US unemployment rate at 25 year highs, wage growth (wage inflation) are nonexistent, US consumers are still laboring under way too much debt – it will likely take another 4-5 years for US consumers to repair their balance sheets. Unemployment levels are not expected to decline to pre 2008 levels for at least four years from now.