

Investment Outlook – February 2009

Global Equities

February proved to be another crushing defeat for the market as sentiment turned even more negative than exhibited in January. February economic data shows declines across all industrialized nations along with a record 651,000 loss of US jobs, reiterating the dire straits that the US economy and its major trading partners are in.

US unemployment is now expected to reach 10% within the next 12 months – as earlier expectations had been for perhaps a maximum 8% unemployment rate. The delayed US stimulus package that was passed in mid February will likely only stem the bleeding of government and state employment rolls. The US has now lost over 4.1 million jobs since the credit and financial crisis hit some 18 months ago.

Retail bankruptcies are beginning to gather more pace in the US amongst well established electronics and clothing stores such as Circuit City and Linen 'n Things. Layoffs continue across all sectors, except health care and government.

The lack of a globally coordinated fiscal stimulus alongside a well coordinated US bank rescue plan has heightened fears that no early economic recovery or market rebound can be expected.

We believe it is vital to have a well diversified portfolio that is defensive in nature – with a larger exposure to non equities until the volatility in markets is reduced. Nevertheless this is bargain hunting time in the leading equity markets and for investors with a medium to long term outlook this is surely a tremendous buying opportunity over the next 5 years and perhaps phasing your money in would be a better option.

The MSCI World Index lost 10.2% for the month following the 8.8% fall in January, while the Eurozone lost 10.9% (in Euros). The US lost 10.4% in February following a similar double digit loss the prior month, as measured by the broad MSCI US Index. The MSCI World reported a decline of 18.1% for the year so far in US\$ terms.

Japan lost 4.5% in Yen terms as its economy sputtered to its worst export figures in decades. The Nikkei is currently at 25 year lows.

Increasing worries over real estate write downs, lack of bank liquidity and esoteric financial instruments have created fear in the markets. The S&P 500 is now at levels last seen 12 years ago.

It is clear the US financial system will continue to see more failed banks and the real estate meltdown will persist for another 12-18 months – when prices are expected to bottom out. Housing prices have already fallen approximately 20-25% across most US markets –but further declines are still expected.

Global Bond outlook

US rates on treasuries are at historical lows and many believe it is the next bubble to burst as confidence slowly returns to the equity market later in the year.

Coordinated rate cuts by the leading central banks has led to quantitative easing by the US Federal Reserve and UK Central Bank – effectively pumping billions of currency into their economies. Thus inflationary fears have started to rise and the threat of deflation appears to be receding.

Rates can only go up which could cause significant declines in US government bonds prices. As such we suggest being underweight in the government bond sector.

Spreads on corporate, high yield and municipal bonds over governments are now also at historical highs. The fallout from Eastern Europe means that the Swiss Franc and other currencies may be forced to devalue their currencies – including such exporters as China, South Korea and Brazil who have seen their exports fall off a cliff. IMF bailouts of Eastern European countries will help shore up Western European banking groups who have heavy exposure to the region.

However commodity based currencies such as the Canadian, Australia and South African currencies will remain under pressure until signs of global demand rebound.

The European Government Bond Index gained 0.7% for the month (euros) but is up 5.8% for the past year. The World Government Bond retreated again in February – losing 3.0% following a loss of 4.3% in January. The strong US dollar has mitigated against any significant returns in this index.

Consumer spending across the globe is expected to dry up and unemployment across the world will rise to levels last seen since the early 1970s. There is a growing fear that government bailouts will not have the desired dramatic impact and it will take considerable time to work through the system – with mid 2010 now being the date where economies may show some relatively decent signs of growth.