GinsGlobal Index Funds

# Investment Outlook – January 2010

## Global Equities

Following a robust recovery in global equity markets during the final 9 months of 2009, the beginning of 2010 saw increased volatility amid growing uncertainty regarding the Euro and the expected worldwide economic recovery.

The MSCI World Index lost 4.1% in January, the MSCI EAFE (non US industrialized markets) fell 4.4% and the Eurozone itself fell by 4.7% (in Euros) or 6.7% in US$. The growing risk of sovereign default in the Eurozone grabbed investors attention when Greece reported that its previous deficit numbers were severely misleading and it had under-reported how large their budget deficit was. The Greek effect has led to detailed reviews of other large deficit running countries in the Eurozone, particularly Spain, Portugal, Ireland and Italy, which are also huge concerns too.

Eurozone economic growth is expected to be far slower now than any US or Asian recovery and structural unemployment is growing across Europe. The lack of an easy way to resolve the sovereign debt crises has been shown by the lack of EU resolve to sort out the Greek situation expeditiously. This may be satisfactory, however when dealing with a relatively small member of the EU, but such solutions are inappropriate for the likes of Spain or Italy.

In the US, despite a good $4^{th}$ quarter GDP growth figure of over 5%, analysts believe that the country will record economic growth of between just 3.5%-4% for 2010. Coming off a very low base and with very little likelihood of bringing unemployment rates below the 9% level – there is little room for comfort. By any measure, the US led recovery will consequently be a jobless recovery at best, as the over leverage US consumer continues to adjust his/her spending habits and the absence of new growth industries are not going to be able to fuel renewed demand. This is unlike the recovery of 2001, when real estate demand fed by low rates buoyed the US economy, creating millions of new jobs related to construction, mortgage financing etc.

It is expected that it will take at least 4-5 years for unemployment levels to retreat back to the pre crisis levels of 5%-6%.

Although US companies on the S&P 500 have mostly beaten market expectations regarding their earnings, much of this is on the back of once off expenditure cuts. Top line growth remains anemic at best.

The Pacific region saw a 1.4% loss for the month (US$) – when excluding Japan, the region in fact lost 6.8% for the period.

The nervousness and sell of in mid-late January subsided by mid February, with both the Hang Seng recovering above 20,000 and the Nikkei returned to 10,100 levels.

The US REIT (listed property) market posted a negative 5.7% return for January, following an equally impressive 2009 total return of 28.5%.

It is clear that the US financial system will continue to see failed banks and the real estate meltdown (specifically commercial properties) persist for another 12-18 months – when prices are expected to bottom out. Approximately 140 smaller US banks were liquidated or taken over during 2009 – a record over the past 2 decades.

## Global Bond outlook

Although the Fed raised the US discount rate at which it lends money to banks by 0.25%, it is not expected to begin any general interest rate hikes for another 3-6 months at the very earliest. Most experts expect only a nominal 0.25%-0.50% rate hike by the end of the year. The stronger US$ relative to the Euro and British Pound is now a concern, as it will harm export recoveries.

The Fed also has no desire to make mortgage finance more expensive for prospective homeowners – thus the Fed's support of the mortgage markets through the purchase of mortgage securities while being dramatically reduced, will not evaporate as some analysts suggest.

The Fed holds large swathes of US bond market securities to prop up the mortgage and corporate bond markets. Given the weak economic recovery expected and problems particularly in the real estate industry the Fed will not likely unload its holdings as fast as some predict. Nevertheless at a minimum, the lack of Fed buying power will lead to increased US mortgage rates and rates at the long end of the yield curve.

The Federal Reserve remains hawkish on raising interest rates anytime soon – most recent Fed statements indicate that the risk of inflation is viewed as very minor, considering that some 10 million jobs have been lost in the US over the past 2.5 years. (This figure includes the need to generate 100,000 new jobs a month simply to keep pace with the number of new job seekers.)

Higher US bond yields are expected as the Yield curve steepens further by year end. It is possible that the 10 year Treasury rate currently at 3.75% approximately may exceed 5.5% by year end.

January proved a flat month for the bond market – with the global government bond benchmark gaining just 0.1% although it is up 7.3% over the past 12 months.

By comparison the European government bond market gained a marginal 0.4% in Euros for the period and is up 6.0% over 1 year.

In the Eurozone, rate hikes are no longer seen as an option given the fallout over sovereign debt risk. The ECB has continued to push back the target date of any further hikes until well into the latterr half of the year.

A 2$^{nd}$ wave of US foreclosures is only now beginning to hit as further layoffs affect the market. Currently 1 in 5 US home owners are behind on their mortgage payments or are affected by negative home equity. Persistent high unemployment rates will continue to dampen any real estate recovery well into late 2010. Unemployment losses are expected to peak by mid 2010.

A sustained global economic recovery remains under threat due to the strong euro and huge deficit problems in certain Eurozone countries including the UK, Greece, Spain and Ireland. The US is expected to recover far quicker then the Eurozone. It is hoped that Asia will outdo both of the old world economic regions.