GinsGlobal Index Funds

Investment Outlook – June 2011

Global Equities

The global uncertainty pervading markets will not likely be lifted until both European and US political leaders show a readiness to solve their current debt problems. The contagion that has spread form Greece to Portugal, Ireland and recently Italy, shows the Eurozone remains under immediate pressure from investors. Political leaders continue to play catch up and have not shown a desire to get ahead of the lingering debt problems toiling Greece and other weak Eurozone members. Sovereign concerns persist in Europe primarily due to the twin problems of solvency and liquidity. The recent attempt at solving the Greek and Irish problems only deal with liquidity. Eurozone banks remain under-capitalized; which has led to a recent selloff amongst Italian banks for example. With more monetary tightening in store for Europe as inflation rises; this does not bode well for the weaker Eurozone members.

Similarly the ongoing debate regarding the US debt ceiling being lifted is only a short term fix. Long term fiscal policies need to be implemented to set the US on a more healthy fiscal budget over the next 5-10 years. Divisive politics in the US means that most tough choices will be delayed until after the 2012 election. This means the US will likely be in limbo on hard fiscal reforms for another two years. Such uncertainty will likely lead to significantly higher debt costs for the US with interest rates expected to rise over the next 12 months. In the immediate term, Congress and the White House will likely come to a bare bones agreement by August 2nd that staves off any default, but kicks the can down the road another 32 years before any tough budgetary cuts and possible tax raises are dealt with in earnest.

These debt concerns coupled with the US slipping into a soft economic patch recently are increasingly worrying. The incredibly weak May and June job creation figures massively disappointed the market. In addition there are growing real estate concerns that it has entered a double dip in the housing market. Tight credit from the banking community and the lack of housing activity continue to dampen any confidence amongst corporations and consumers. The lack of new job hires shows the concern that the recovery has in fact stalled. It seems the White House realizes this and is keen to strike a grand bargain with Republicans who control Congress, however to no avail. Divided US government is effectively leaving the country in a state of paralysis on any of the tough long term questions of how best to tackle the debt and bring the budget deficit under control.

Given the uncertainty, equity markets should remain under-valued relative to corporate earnings. Despite some good results expected amongst leading corporates, the bad neighborhood syndrome will keep share prices muted. If European leaders and US politicians do show movement on their debt travails, the market may well stage a relief rally later in the year.

Weaker demand in developed countries has been partially offset by significant economic growth in the leading emerging markets. For now, China's economic growth is largely linked to huge amounts of bank lending; much of it on construction and infrastructure projects. Fortunately this growth will not abate for the next few years, and will continue to fuel demand for precious metals and commodities. Gold is benefiting significantly from the political uncertainty in the US and Eurozone, climbing to all time highs of $1600 per oz.

The Global Developed world index (MSCI World) lost 1.6% in June on the back of a 2.1% loss in May. For the year to date, it remains up 5.3%. Similarly the US market lost 1.7% for the month and is up 5.9% for the year.

The Eurozone as measured by the MSCI EMU lost almost 1% in Euros for the month, but is up for the year by 4.1%.

Encouragingly Japan boasted a small rebound of almost 1% in June, but remains down 5.1% for the year in Yen terms.

Global property markets in the US and Europe both suffered losses in June, but remain in positive territory for the year – the US REIT Index is up 10.9% for 2011. The Eurozone is up 6.3% by contrast in listed property stocks.

We continue to maintain that the US Fed will likely be the last major central bank to seek to raise interest rates, given the ongoing weak state of the US consumer. The Fed also appears to be the least worried regarding an inflation threat.

Global Bond outlook

The continuing sovereign debt uncertainty in Europe and the US coupled with weak economic data has led to an equity selloff while certain bonds are seen as a safe haven. The US 10 year Treasury has now seen a reduction in yield from over 3.6% to under 2.9% in less than 3 months, something that has even surprised most bond experts. With QE2 ending at the end of June, most predicted that US bond yields would immediately begin to rise. The exact opposite has occurred, as investors seek a safe haven.

Despite worries over US debt levels, it is clear foreign investors would still bet on the US$ over the Euro – so demand for US Treasuries is continuing to rise in recent weeks.

With the US jobs report reporting anemic growth levels, the lack of aggregate demand in the economy amongst consumer spending is apparent. Consequently no inflationary threat is rarely visible on the immediate horizon. The Fed will continue to keep rates as low as possible, hoping this stimulates a housing recovery at some point. A US debt default would be a huge folly at this point, as it would lead to higher interest rates and kill off any property market recovery. Low interest rates remain a key tactic in the fight to get America back on its feet. Low rates also ensure that the US$ will remain competitive relative to the Euro, yen and other major countries where US exports are headed.

The worrying fact is that despite all the stimulus and policy measures taken by the Fed, the economy remains on the backfoot and suffers from a number of headwinds. This is expected to keep the outlook for the Fed to retain it's current low interest rates through year-end.

Developing countries such as the BRICs are expected to exceed the 5% GDP growth projection, but uncertainty on the Greek bailout and ongoing delays amongst EU members in this regard has not helped markets. Greece ultimately needs structural reform of its debt burden which is approaching 200% of GDP based on projections over the next 5 years. Until private sector banks agree to significant write downs, it sees that the sovereign debt crisis in Europe will not be resolved with any form of finality. The spreading contagion to Italy – Europe's 3rd largest economy which saw bond yields spiking to levels approaching Portugal and Spain, indicates the lack of overall confidence that European leaders have a clear handle on solving the debt crisis.

Currently European banks have avoided taking some of the painful write downs many suspect they will inevitably be required to do. This lack of confidence is showing up in the bond markets, where the only strong functioning European inter-bond market is that supported by the European Central Bank.

With the US presidential election less than 18 months away, political posturing will likely prevent any real breakthrough in the fiscal policies to alleviate the debt burden or budget deficits. US states are also in dire shape particularly, Illinois, California, Pennsylvania and others.

Regarding the US debt ceiling cooler heads will likely prevail at the eleventh hour – given the lack of popularity amongst the US populace. For now it is essentially a pox on both US political parties with neither particularly well liked by voters. President Obama is facing the real prospect of trying to be the first US president to ever be re-elected with an unemployment rate higher than 7.5%. US business is increasingly blaming the White House administration for the massive amount of new regulations and costs being imposed on various sectors of the American economy. Although some of these policies may well be necessary, they have often been implemented in a ham-fisted manner. Few incentives have been created for business to reinvest in the US economy and much of their reinvestment is occurring abroad. This has led to the situation where the majority of unemployed Americans have now not worked for close to 7 months. This is a distressing phenomenon not seen in the US – where typically unemployed workers are rehired in about 3 months. 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 ECB and UK Central Bank have missed their inflation targets the past few months and there is growing pressure for rate rises – the ECB raised rates in early July as expected. Unfortunately higher rates are certainly not welcomed by many of the weaker Eurozone members.

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

With US unemployment rate at 25 year highs, wage growth (wage inflation) is non-existent, US consumers are 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.

The Citibank Global Government Bond Index was flat in June, up jus t0.2%, but is up 4.0% for the year and over 10% 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 down 0.3% in June, but is flat for the year (in Euros).

A sustained global economic recovery remains under threat due to huge structural deficit problems in certain Eurozone countries including the UK, Greece, Portugal, Spain and Ireland. A Greek bailout or restructuring in mid June will help calm the markets. However, only sustained job creation in the US and lower commodity prices will provide the immediate shot in the arm and the confidence that investors are looking for.