Investment Outlook – November 2009

Global Equities

Following a pause in October after an impressive six month recovery, markets again enjoyed significant gains in November. The MSCI World Index returned 4.1% in November and is now up 27.7% for the year.

By most measures including P/E ratios – the easy money has now been made on the recovery. However over a 3 year period the global equity index is down some 15.8% still.

November saw the US unemployment rate of 10.2% fall back to just 10.0%. However as job seekers reenter the market looking for jobs in the recovery the Fed does not expect unemployment to drop much below 10%. It is expected that it will take at least 4-5 years for unemployment levels to retreat back to pre crisis levels.

The market has priced in a modest recovery now that the recession is officially over, with the posting of a 3.5% GDP growth rate for the 3rd quarter. Fourth quarter growth is expected to look similarly good given the benefit of the holiday season consumer spending binge.

Clearly the ongoing weaker US$ is also playing a major role in the US market's resurgence –given that more than half of the earnings from US companies in the S&P 500 originate from abroad. Thus a weaker dollar helps US exports and results in currency gains (boosting foreign earnings) - directly affecting the bottom line.

The S&P 500 is expected to exceed the 1200 levels before year end. The broader US measure – MSCI US Index gained 5.9% for November and is up 24.8% for the year. Non US stocks as measured by the MSDCI ESAFE index gained 1.8% for the month and are up 26.0% for 2009.

The Pacific region saw a flat monthly return, but remains up 19.7% for the year.

A continued bullish outlook for the commodity market is expected to boost emerging markets leading indices over the next 6-12 months. Consequently emerging market currencies are expected to outperform the US$ and Euro.

By comparison the MSCI EMU (Eurozone) gained 3.1% in US$ terms for the month and is now up 25.9% for the year. The US REIT market posted an impressive gain of 6.9% for the month and is up 20.1% for the year.

The Japanese market lost 6.4% for the month but is up 1.3% over the past year (in Yen).

It is clear the US financial system will continue to see failed banks and the real estate meltdown will persist for another 12-18 months – when prices are expected to bottom out. Over 150 smaller US banks are expected to have been closed by year end. To date this year, the number is 130.

Global Bond outlook

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.)

With little inflation risk – the consensus is that the Fed is unlikely to do any tightening until mid 2010 at the earliest. However the Fed is expected to begin withdrawing support from the bond and mortgage markets in early 2010 – which will likely begin to raise long term interest rates by mid year.

Currently the Fed Fund rate is 0.25% which has helped boost bank profits this year. Large banks are still hoarding much of their cash and have dramatically reduced commercial property lending. The lack of lending means that Main Street USA will not likely begin any significant job hiring until late 2010.

November proved a positive month for the bond market – with the global government bond benchmark gaining 3.2% - it is now up 8.0% for the year (Citi Government Bond Index). By comparison the European bond market is up 5.1% in euros for the year and 0.7% for the past month (European Government Bond Index).

Australia's central bank again raised rates in early December. Possibly other commodity based economies may follow suit in early 2010 including Canada and South Africa.

The Fed has to still convince the market that it is not going to let inflation loose, therefore Bernanke is likely to simply remove the Fed's own spending and enlarged balance sheet purchases and related interventions beginning in early 2010. Removal of these quantitative easing measures will negatively impact the housing market so any reduction is expected to be gradual.

A 2nd wave of US foreclosures is only now beginning to hit, as further layoffs affect the market. Currently 1 in 5 US home owners are now 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.