GinsGlobal Index Funds

Investment Outlook – November 2010

Global Equities

The global equity markets pulled back slightly during November following significant gains posted in the two months prior.

On November 3rd, the Fed announced that it would buy an additional $600bn US Treasuries over the next eight months. This bond purchase aimed at keeping rates low and stimulating the economy, will ultimately total a $900bn infusion. These extraordinary measures gave the market pause, with many analysts believing that the economy must be weaker than earlier presumed. The poor November US jobs report which showed unemployment edging up to 9.8% appears to have reinforced the Fed's assessment that the economy needs additional stimulus.

During the first weeks of December a tax agreement between Obama and the Republicans has helped to boost the market with the sense that Washington DC can work again without true gridlock occurring. However in the long run these additional tax concession will grow the already mighty US deficit. The hope is that the continued tax concessions and lower payroll tax will provide further stimulus to the US economy over the short term.

While US retail sales have held up well, the lack of job creation is a worrying trend with almost half the unemployed being out of work for 6 months or longer – this is an unprecedented phenomenon in the modern day US labour market.

Continued worries in the Eurozone with the approximately $100bn Irish bailout from the EU and concerns over Spanish, Portuguese and Greece weighed on currency markets. The US dollar in fact gained almost 10% against the Euro the past month.

For October the US market was completely flat (MSCI US Index and S&P 500). For the year to date the S&P 500 is up 7.9% and 9.9% over 12 months. The S&P MidCap 400 and SmallCap 600 posted even more impressive gains for the year to date – racking up gains of 18.9% 17.3% respectively.

Although continued concerns about the US economic recovery helped drive government bond yields to historic lows throughout 2010, by early December yields began to spike as a large bond selloff occurred. In less than 3 weeks, yields have risen more than 60 basis points on the 10yr Treasury Note to around 3.3%. Higher rates will limit economic growth and put a dampener on the US housing market recovery.

Despite difficulties in the Eurozone, the Euro is expected to remain strong relative to the US$. The Fed seems happy to weaken the US$ as it seeks to maximize US economic growth. The broad Eurozone market index lost 4.9% in Euro terms for the month and is now down 2.8% for the year. The MSCI World (All Country) Index lost 2.2% for the month and is up 4.1% for the year.

The impressive rebound in the US REIT and Eurozone real estate indexes suffered a reversal in November. Year to date the US property index is up 22.3% while the Eurozone area is up 3.7% in Euros.

Emerging market equities remain more fully priced than developed markets. US PE ratios on the S&P 500 are at levels of 14 for 2010 and 12.5 for next year which are below long run averages for this market. The S&P Emerging Markets Index posted a loss of 2.6% for the month, but remains up 10.2% for the year to date and 14.4% over the past year. PE ratios for large cap stocks in developed countries (US and Europe) remain cheaper in many cases than their Emerging Market counterparts.

Global Bond outlook

Based on the significant uptick in US government yields the past few weeks, it is clear that the Fed's quantitative easing was already priced into the extremely low yields seen in September and October. The new tax deal agreed in Washington DC has led to growing worries of an unsustainable budget deficit – which has translated into far higher Treasury yields in early December.

It is unclear if the Fed's QE2 bond purchases are having the desired impact. The tax deal will likely have a far greater stimulus effect on the economy, with upper income earners benefiting from continued low tax rates for another two years and the payroll tax being cut by 2%. The average American will save an additional $1,000 in taxes from the payroll tax alone.

While interest rates will remain relatively low well into 2011 – the recent increase in Treasury yields to 3.3% on the 10 year Note point to a larger sell off of US bonds during 2011. The US bond bubble may have finally been pricked in early December as rates head upwards albeit still at historically low levels.

Given record inflows into bond mutual funds in the US the past 2 years, many retail investors will likely be caught by this turn of events next year. It is expected that much of this money will move back into the equity market over the next 2-3 years, helping to fuel demand for US and global equities.

Less demand for long term bonds will likely lead to higher long term yields by mid 2011 – exceeding 3% on the 10yr Treasury.

Meanwhile the difficulties in the Eurozone have led to significantly higher government bond yields in Portugal, Ireland, Spain and Greece. Further bailouts in Europe are expected. The $100bn EU financing to assist Ireland with its bad bank problem is only a temporary measure according to many analysts.

With US unemployment rates at 25 year highs, wage growth non existent, US consumers still laboring under way too much debt – it will likely take years for US consumers to repair their balance sheets.

The Fed will keep rates at these historical levels as long as possible to assist the housing and broader real estate markets.

Given weak corporate lending the Fed has no desire to raise rates – Bernanke is actively encouraging banks to increase their lending books to small business so that these businesses can begin to add to their payrolls and production. 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.

Both the ECB along with the Fed, are expected to keep rates on hold for far longer than earlier expected. Rates have risen across these smaller peripheral Eurozone countries the past 6 weeks, translating into a recent loss in the European Government Bond Index of 2.7% in November and is up just 1.3% for the year.

The Citibank Global Bond Index suffered a big monthly reversal as a result of rising rates – losing 4.8%. For the year to date it is up just 3.4%.

A sustained global economic recovery remains under threat due to huge structural deficit problems in certain Eurozone countries including the UK, Greece, Spain and Ireland. The Irish bailout of their banks and government deficit (reaching a massive 33% of GDP for 2010) – shows that the Eurozone laggards will continue to limit economic growth on the Continent.

It is expected that Asia and leading Emerging markets plus ultimately the US consumer – will all be needed to pull Europe out from its current woes.