GinsGlobal Index Funds

Investment Outlook – October 2011

Global Equities

Following an impressive recovery in October, world equity markets retreated throughout November and much of December. The lack of any clear resolution to the European sovereign debt crisis despite ongoing summits and talk of the ECB providing liquidity has dampened the mood going into 2012. The hoped for Santa Claus rally evaporated shortly after the ECB indicated it would not provide any significant bailout fund. With interest rates at unsustainably high levels on Italian, Greek, Portuguese and Spanish debt, it appear that the ratings agencies are likely to reduce the credit ratings of a host of these countries.

With the UK veto getting much press the net effect is that the Eurozone appears weaker than before. The long term fiscal restraints proposed by Germany for all Eurozone members does little to solve the looming debt crisis. Talk of continued austerity throughout Europe and the UK ensures that the region will likely be ensnared in a recession for much of 2012. The hope of an IMF intervention has also receded for now. It appears the political leaders have no great urgency to ensure a rebooting of the European economy – so unemployment will remain high too – with Spain the highest at over 21%.

The European crisis has put a drag on growth worldwide – simultaneously causing US and Emerging Market countries to lower their growth expectations going into 2012.

Changes in government leadership should begin to bring more fiscal discipline to such countries as Italy, Spain and Greece as we enter 2012.

ECB President Draghi lowering the ECB rate by 0.25% signaled the onset of a possible recession. The likelihood has grown as financial markets turn increasingly bearish on the Eurozone.

Despite Europe, the US economy has been showing signs of life. However it will remain hobbled while its housing and related mortgage financing and construction sectors remain a mess. With 25% of homeowners now owing more on their mortgages than their homes are worth, the prospect of increasing foreclosure filings exist. Some believe that in 2012 we will see a large deluge of repossessions by banks, if the government programs now in place do not adequately save many homeowners from default. Many US banks continue to see their share prices hit recent lows such as Bank of America and Morgan Stanley. They may finally decide they should take all the necessary medicine and write down now as things cannot really get much worse for the stock prices.

On the positive side of the ledger, the likelihood of a double dip recession in the US has definitely evaporated and is unlikely, unless the Eurozone grows into a full blown meltdown. With US Presidential elections now less than a year away, it is unlikely that major legislation will pass in the final year of Obama's office.

With almost half of all unemployed Americans out of work for 6 months or longer – an unheard of statistic in the past 40 years, it is clear that it will take upwards of 5 years to reduce the huge spike in unemployment resulting from the 8 million lost jobs since the 2008 recession.

Given the gloom and doom above, it is not surprising that the Global Equity developed world index (MSCI World) lost 2.4% for the month and is now down 5.5% for the year. By contrast the Eurozone as measured by the MSCI EMU lost 2.4% in Euros for the month and is down 14.7% for the year. Given the retreating Euro currency which has moved from over 1.40 to the dollar to under 1.30 as of mid December, US investors in the Eurozone have lost much more.

The MSCI Emerging Markets Index is down 6.7% for the month and 23.3% for the year in US$ terms. The Global Consumer Staples Index has held up best with a 0.4% month return and a year to date performance (US$) of 6.9%. The US Equity Index lost 0.4% and is flat for the year at 0.5%. (MSCI USA)

The 10 year US Treasury yield sank to 1.8% by mid December - its lowest level in almost 3 months. Another sign of a lack of confidence in the global economy and Treasuries are again seen as a perfectly safe haven. Other safety valves such as gold and natural resources have retreated significantly from earlier in the year. Gold is off about 30% from its earlier highs in 2011.

Global Bond outlook

Unfortunately the recent Eurozone summit in early December did not produce any definitive outcome. Thus resolving the European sovereign debt crisis has been pushed off into 2012 – the markets are not pleased and have shown their displeasure by lowering equity prices and pushing up yields on most Eurozone debt. By contract US Treasury yields are again at record lows of around 1.8%.

With record Italian, Greek and Spanish government bond yields, all three governments have recently fallen along with a change in Ireland and Portugal earlier this year. The demand for further austerity by the Germans means that the EU will essentially remain mired in a recession for much of 2012 with little prospect for any meaningful job growth until 2013-2014.

Fundamentally markets seem to realize that German exporters were the primary beneficiary of the Euro the past 13 years, as a single currency made German goods affordable for the first time from Lisbon to Athens and beyond. Arguably far too many BMWs and Mercedes are being driven in such places than would have been the case under different currencies. While the southern part of Europe cannot devalue their currencies any longer – they are now forced to devalue their standard of living by slashing salaries and pension benefits. Clearly such countries were considerably cheaper for a US tourist to visit prior to the Euro being introduced. No American tourist expected to have to pay similar hotel and restaurant prices in Germany and Athens. However the introduction of the Euro had the effect of making southern Europe a far more expensive place to visit or do business in.

Until the balance gets back to equilibrium, there is little hope of southern Europe enjoying any significant growth. Fundamentally the weaker productivity levels from Germany should ensure a cheaper cost of living – however a single currency had the reverse effect and made German and other expensive imports affordable given the Euro-linked salaries that were now being paid.

We expect a continued weaker Euro relative to the US$ and other leading currencies for now, while Emerging Market currencies and markets will continue to suffer due to capital flight until more certainty returns to global markets.

With US unemployment rate at 25 year highs, wage growth (wage inflation) are non-existent, and US consumers still laboring under way too much debt – it will likely take 5 years for US consumers to repair their balance sheets. Consequently the lack of consumer demand will sadly continue to depress many sectors such as retail and housing, that have a disproportionate share of consumer wealth and drive many spending decisions (so-called ‘wealth effect’).

The Citibank Global Government Bond Index lost 1.5% in November but remains up 5.4% for 2011. Over the past 12 month sit has recorded a 7.3% gain.

The European Government Bond Index lost 2.58% for the month and is now down 0.6% for the year. It is also negative for the 12 month period at -0.9%. US REITs suffered a large reversal in November of -3.9% but remain up 4.5% for 2012. By comparison Eurozone Property stocks lost 6.6% and are now down 17.7% for the year.

Give the weakness in the Eurozone and lack of confidence it was encouraging to see Mario Draghi the new ECB President lower the rate by 0.25% at his first meeting. However it is likely this reflects just how poor the prospects are for Eurozone growth over the next 6 months. The ECB needs to play a more engaged and active role in helping to lower unsustainable bond yields in Europe. By working with the IMF to shore up Eurozone debt market liquidity it can play a significant role in securing the Euros future. Only time will tell.