GinsGlobal Index Funds

Investment Outlook – October 2010

Global Equities

Following a record rebound in September, October continued to show solid gains across most equity classes. An expected pull back has occurred in November with the market requiring a breather, given these past two months of stellar performances.

For October the US market was up 3.9% (MSCI US Index) with the Dow approaching its post crash highs of 11,300 level. For the year to date the broad US market is now up 7.6%.

Although US economic and employment data remained weak, the earnings season has shown large cap companies to be performing well and meeting expectations. The weaker US Dollar which has recently lost 10-20% of its value versus such currencies as the Euro, Yen and Pound – has helped to fuel US exports and bumped up US$ based earnings after converting for foreign based sales.

Continued concerns about the US economic recovery has helped drive government bond yields lower in October with the 10 year Treasury Bond yielding just 2.4%, a 30 year low. The Feds quantitative easing was clearly already priced in – subsequent to the Fed's announcement, the yields have in fact moved higher approaching the 2.8% level. With billions of dollars sitting in bond funds and on the equity sidelines, any consensus on anti-bonds and pro- equity could lead to a significant demand for equities and help fuel a further stock-market recovery.

Following the US mid-term elections which delivered a large rebuke to President Obama's economic and health policy platforms, investment markets are happier with a divided Washington. With the Republicans regaining the House of Representatives, business confidence has risen – the view is, that at least a gridlocked Washington will not pass any more defining regulatory overhauls or further tax increases. The Republican success is seen as a positive by business.

The likelihood of a double dip recession in the US is extremely low, but growth is likely to be very weak for the duration of 2010 and 2011. The risk of deflation is beginning to recede but at the same time inflation is barely visible. The latest October figures have CPI at the slowest annual increase in over two decades. The expectation is for the Fed to leave rates on hold for far longer than previously expected. We could be in this holding pattern on rates for another 18-24 months.

The US jobless recovery will continue to put a damper on any housing or real estate recovery. Despite record low mortgage rates, excess inventory build up remains high, and credit financing is low. Currently US banks have a record amount of money parked at the Fed which they have not lent out.

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. A strong Euro and weak Eurozone GDP growth will further constrain any Fed tightening that may have been predicted. The broad Eurozone market index gained 3.7% in Euro terms in October and was up 2.2% for the year. Non US markets overall measured by the MSCI EAFE showed a 3.6% monthly gain and 2.3% gain for the year. (US$ terms)

We remain more bullish relative to the US stock-market as compared to the Eurozone given the US$ weakness and expectation of Fed assistance re quantitative easing – which will suppress any interest rate rises for the foreseeable future.

The MSCI World (All Country) Index gained 3.7% for the month and is up 6.4% for the year.

The impressive rebound in the US REIT Index continued with an October gain of 4.6% - year to date the gain is approximately 23%. By comparison the European real estate index gained 3.4% in October and is slightly above 14% for the year.

Emerging market equities remain more fully priced than developed markets. The concern exists that the booming commodity market and exports will taper off as the developed world continues to deleverage and consumer demand remains weak, for a much longer period than previously expected. 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

The Fed's quantitative easing was priced into the extremely low yields seen on Treasuries the past 5-6 months. Ironically since the announcement was made in November to purchase upwards to $700bn of bonds via the Fed – yields have risen to their highest levels in many months – above 2.7% on the 10yr Treasury.

While interest rates will remain low well into 2011 – there is evidence of a bond bubble brewing as rates may begin to turn during 2011. Given record inflows into bond mutual funds in the US the past two 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.

Continued weak economic data in the US during October means that little evidence of inflation exists, so it is unlikely that the Fed will raise short term rates through much of 2011. However less demand for long term bonds will likely lead to higher long term yields by mid 2011 – exceeding 3% on the 10yr Treasury.

Jobless claims fortunately may have reached a plateau, thanks in a large part to the government stimulus plans and the Fed preventing rates from rising.

With wages static or moving backwards and consumer demand lethargic, this appears to be the far greater immediate threat faced by the US economy over the next 12 months. A weaker US$ and the Fed priming the pump will inevitably help create a measure of inflation – the Fed's historical unofficial target has been in the range of 2%-3%. Bernanke's implicit goal is to get inflation back to these levels form a very low 0.5% currently.

With US unemployment rates at 25 year highs, wage growth nonexistent and 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 low 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. The sovereign debt crisis playing itself out in the Eurozone is far from over – the recent Euro 750bn government bailout has still not fully appeased markets, particularly re Spain, Ireland, Portugal and even Greece. 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 0.5% in October , but is up 4.1% for the year.

The Citibank Global Bond Index gained 1.4% for October given the expectation of low rates persisting. For the year to date it is up an impressive 8.5%. Over the past 3 months it has returned a total of 5.8%.

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