Global Markets : Outlook and Review

31 May 2015

During May, U.S. non-farm payrolls gained 280,000, the largest rise since December. Payrolls for the prior two months were also revised up 32,000. Despite these increases the overall unemployment rate rose slightly to 5.5% - a positive sign that more Americans are looking for work.

In total the US has now added over a million jobs in 2015. While this all points to a likely Fed rate increase before year-end (September possibly) – since wage growth remains anaemic, at just 2.3% on an annualized basis - the Fed is under little pressure to raise rates currently. Ultimately there are a number of Fed members keen to get interest rates away from the zero level they have effectively been locked in at for the past six and a half years.

Inflation is unlikely to pass the 2% mark this year, below the Fed's target. The level of wage growth the Fed is seeking is closer to 3.5%. This means there remains much slack in the US economy and it is clearly far from full employment. Interestingly the broader U6 measure of unemployment remains at an elevated level of 10.8% and includes discouraged and marginal workers.

The benchmark 10-year U.S. Treasury yield has begun moving higher surpassing 2.4% for the first time in months. Historically low rates have boosted the real estate market where 30 year mortgage (fixed) rates hover around 4%. First time home buyers and those will low credit scores continue to struggle getting onto the US property ladder while those with access to credit benefit from rising prices.

Increasingly a number of large US cities mirror markets such as London and Paris where locals are pushed to the margins of house affordability, as foreign buyers push up prices. In California Chinese buys are now a major influence in many upmarket suburbs – often paying cash for their homes.

US merger and acquisition activity has surged with a number of larger media, telecoms, IT and communications deals being announced over the past few months. While

The demand for US dollars continues apace - the dollar recently hit a 13-year high against the yen and continues to crush many emerging market currencies. The weakness in crude and commodity prices has helped boost US consumer spending and savings, while helping to drive down the inflation numbers. The dollar remains in bullish territory and with the likely Fed move – it will remain strong albeit with more short-term volatility.

The US is seeking fast track approval for a variety of trade deals including with Japan (part of the aggressive Trans Pacific Partnership). This will enhance US exports and ensure that the US businesses increasingly pivot towards the Asia-Pacific region.

The US stock market has traded in a narrow band the past few months. With 12-month trailing PE ratios at high levels (S&P 500 at 21, Dow Jones Industrial Average at 16 and Nasdaq at 23) – there is clearly more upside potential for European and Emerging Market valuations that currently trade at significant discounts to the US market. The Greek drama remains a concern as it continues to be pushed out. Ultimately the amount of money required to restore Greek confidence is small and many believe it will be resolved through a combination of IMF and EU financing.

The ECB has agreed to push forward some of its Quantitative Easing related asset purchases – ahead of the summer slowdown. This is intended to help limit any volatility in bond or currency markets during the European summer.

Despite worries that China is slowing down – the shift to a consumer led economy and away from giant infrastructure led growth is a net positive form many US and European businesses. Consequently we remain bullish on China. The IMF's recent vote of confidence in the Chinese Renminbi currency and allowing it to effectively become one of the four main currencies used by the IMF – points ot a stronger RMB over the next few years. While free convertability is some way off, moves to open a new free trade/currency zone in Shanghai and new – far greater access by foreigners to purchase domestic Chinese stocks – indicate a loosening of exchange controls.

Negative political issues in Brazil and Russia and have pushed those markets to historically low valuations with significant upside if they regain investors favor.

On the investment front Calpers the largest US pension fund is cutting way back on the number of fund managers it uses after withdrawing from the hedge fund space recently too. This is likely on the back of increasingly negative performance data showing that the vast majority of European and US fund managers consistently underperform their respective index benchmarks over the past 1, 3, 5 and 10 year periods. This is true of both equity and fixed income (bond) fund managers.