Global Investment Review

February 2010

The markets rallied strongly in late 2009 as liquidity driven momentum continued to push stocks higher. Despite this, 2010 got off to a somewhat unsettled start, as fears of overheating in China grew, fiscal concerns increased and global financial reforms gathered pace. A new year also brought with it renewed focus on the sustainability of the global recovery. At what point will the Governments start to remove support? As one commentator questioned '…when the life-support is switched off, will there be a pulse?' We take a look at some of the events of January….

Increasingly hawkish newsflow regarding inflation expectations has created widespread speculation at the timing of interest rate rises and has undoubtedly unsettled the markets. Despite this, the Federal Reserve and other global central banks continued to re-assure investors that monetary policy is not about to change until they are sure the recovery will not be jeopardised. So why then, from the middle of January onwards, amidst improving fundamentals (culminating in the long-awaited return of strong US GDP growth figures - data that supports a consolidated recovery), did global equity indices and commodity markets in particular lurch downwards?

This sell-off (or profit-taking) was triggered by a number of events. Perhaps the most significant of these were reports that China was considering immediate and significant monetary tightening to avoid their economy overheating. The story was somewhat exaggerated. The Chinese actually demonstrated a deft hand at implementing monetary strategy, by merely draining excess liquidity whilst emphasising a policy shift from "managing crisis" to "managing recovery".

A secondary trigger was the announcement from President Obama on Banking reform. He has certainly come out swinging and this time he's taking on a very popular target - the bankers. A re-imposition of Glass Steagall type legislation will be very unpopular with Wall Street and therefore very well received by the other 99% of the population. It will no doubt be enthusiastically followed in Europe. However, whilst President Obama's policy proposals may be populist in nature and do not fully consider the impact on the willingness of banks to provide credit, which is so crucial for the recovery, it is highly likely that they will be watered down once the government begins to focus on details and implementation.

The final cause for investor concern lay in the possibility of various sovereign defaults, such as in Greece. Albeit a relatively small economy, the situation there is dire. Although the threat may be adjudged as containable, the risk of contagion to other 'club-med' countries in similar circumstances can not be underestimated. Containment is imperative, a Greek default on its own, whilst a serious event, would be unlikely to have a lasting impact on the global stage where an increasingly legitimate 'recovery' is playing out.

These three concerns undoubtedly present significant headwinds for markets to battle against. However, each should be a fairly manageable risk in its own right and they are somewhat disconnected from one another. Even the sum of all three does not appear sufficient to de-rail the recovery.

Looking at the outstanding positives, equity fundamentals remain intact and are still cheap on a relative basis. There are also no clear signs (from any of the major players) that substantive monetary policy tightening will begin any time soon. And with economic fundamentals continuing to improve, such as the recent 5.7% growth in US GDP, there are many more reasons to feel optimistic.

The following is an extract from a recent Ashburton strategic view discussing the current sell-off in the markets and the potential buying opportunities that lie ahead….

Ashburton Investment Strategy

The almost indiscriminate selling of risk assets on the back of recent worries is likely to present a buying opportunity before long, although it is impossible to identify when exactly. Global equities are trading on undemanding valuations and profits growth is likely to be strong in 2010. Moreover, despite the fears, there is little to suggest global growth is going to roll over imminently. We believe these factors will be supportive of higher global equity prices over the coming months, although markets will be volatile.

However, given a riskier environment and heightened policy uncertainty, a diversified portfolio is deemed important currently. We maintain exposure to long-dated government bonds in the core euro-area (especially since draconian fiscal tightening and weak growth should limit inflationary pressures and the need for interest rate hikes) and long-dated inflation-linked bonds in the US. We also have some modest exposure to corporate and emerging market bonds. We believe exposure to Asian currencies such as the Korean won and Indian rupee is attractive on a long-term view. Indeed, as recent headlines demonstrate, we believe at some point the market is going to realise that many Asian countries have less inherent risk than their developed counterparts.

(Source: Ashburton February 2009)

Key Global Market Indicators

January 2010

			Currency returns		
Asset Class/Region	**Index**	**Currency**	**Jan 2010**	**3 Months**	**2009**
Equities					
United States	S&P 500 NR	USD	-3.6	4.0	25.6
United Kingdom	FTSE All Share TR	GBP	-3.6	3.6	30.1
Continental Europe	MSCI Europe ex UK NR EUR	EUR	-3.4	3.2	28.4
Japan	Topix TR	JPY	-0.7	0.7	7.6
Global	MSCI World NR USD	USD	-4.1	1.6	30.0
Global emerging markets	MSCI EM (Emerging Markets) NR USD	USD	-5.6	2.4	78.5
Bonds					
US Treasuries	JP Morgan United States GBI TR	USD	1.6	0.3	-3.8
US Treasuries (inflation protected)	Barclays Capital U.S. Govt Inflation Linked TR USD	USD	1.6	2.1	10.5
US Corporate (investment grade)	Barclays Capital U.S. Corp Investment Grade TR	USD	1.6	2.3	18.7
US High yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	1.3	5.7	58.8
UK Gilts	JP Morgan United Kingdom GBI TR (daily)	GBP	0.6	-1.1	-1.0
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilt TR	GBP	2.3	2.1	11.1
Euro Government Bonds	Citigroup EMU GBI TR	EUR	0.4	0.3	4.3
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.6	2.5	15.7
Euro High yield	BofA Merrill Lynch Euro HY 3% Constrained TR	EUR	3.4	5.7	76.3
Japanese Government	JP Morgan Japan GBI TR	JPY	0.0	0.9	0.9
Global Government bonds	JP Morgan Global GBI TR	USD	0.5	-1.4	1.9
Global Bonds	Citigroup WorldBIG TR USD	USD	0.2	-1.3	5.8
Global Convertible bonds	UBS Global Convertible Bond USD	USD	-1.2	3.5	41.4
Global emerging market bonds	JP Morgan EMBI+	USD	-0.1	1.1	25.9
Property					
US Property securities	MSCI US REIT NR	USD	-5.4	7.9	26.3
UK Property securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	-7.0	-3.8	14.9
Europe ex UK Property securities	FTSE EPRA/NAREIT Developed Europe ex UK TR	EUR	0.0	0.7	40.2
Asia Property securities	FTSE EPRA/NAREIT Developed Asia TR	USD	-6.8	-6.2	43.4
Global Property securities	FTSE EPRA/NAREIT Developed CR	USD	-5.9	-1.3	31.8
Currencies					
Euro		USD	-3.1	-5.8	3.2
UK Pound Sterling		USD	-0.8	-2.8	12.3
Japanese Yen		USD	2.7	-0.1	-2.6
Australian Dollar		USD	-1.2	-1.6	29.0
South African Rand		USD	-2.4	3.7	25.5
Commodities & Alternatives					
Commodities	RICI TR	USD	-7.9	-3.3	26.2
Agricultural Commodities	RICI Agriculture TR	USD	-7.6	-1.7	6.4
Oil	ICE Crude Oil CR	USD	-6.3	-5.4	96.9
Gold	Gold index	USD	-4.1	3.6	30.6
Funds of hedge funds	Credit Suisse/Tremont Hedge Fund USD	USD	0.0	3.0	18.6

Source: Lipper Hindsight