

Global Investment Review

November 2009

In the first of our new-look monthly updates, we look back at October and the mixed signals over the health of the recovery. Fundamentals continue to show a steady improvement, with GDP growth in the US suggesting the country has eased out of recession. A pause in the markets throughout October (depending on your point of view) could be interpreted as a consolidation point, a looming correction or simply a brief hiatus in an upward trend. The steady tick up in the VIX index, a measure of the cost of insuring against volatility on the S&P500 however, suggests increasing uncertainty. Investors are increasingly nervous of a correction and will be keenly looking toward upcoming economic data to provide more clarity and set the tone for risk appetite.

The current highly accommodating government policy of ultra low interest rates, which, combined with recent signs of growth, have created a 'sweet-spot' or a perfect mix for risky asset prices. The 'sweet spot' assumption has two elements - economic growth and low interest rates - and therefore two opposing risks. Investors and policymakers alike are increasingly focused on these twin risks.

The following is an extract from a recent Ashburton strategic view discussing the 'sweet spot' and the risks to its sustainability, strength and duration....

Where does Ashburton stand on these issues?

While events have clearly taken a turn for the better since March, there remains considerable uncertainty over the global economic outlook. As such, both risks to the 'sweet spot' argument are legitimate. While a very anaemic economic recovery would arguably be more pernicious from an equity market perspective; tighter monetary policy is the more likely outcome in our view. The strength of China's recovery, the potential for a powerful inventory rebound, the recovery in financial markets and the lagged effects of fiscal and monetary policies yet to come through underpin our optimistic bias regarding the 12-month outlook for global growth.

The Federal Reserve and ECB have begun to outline exit strategies from ultra loose monetary policies and will likely start to tighten in 2010. However, given how far Western economic output is below potential, they are likely to move gradually, mindful of avoiding a shock to interest rate expectations that could destabilise financial markets and put recovery at risk. Donald Kohn, Vice-Chairman of the Federal Reserve, has made this clear:

"The unusual nature of our actions and the uncertainty about when and how they will be unwound suggest an even greater payoff than usual from being as clear as possible in our communications with the public."

The 'sweet spot' will not last forever. Investors have to prepare themselves for a period of either higher interest rates or disappointingly weak growth. This will mean bumps in the road. However, in our view, the general backdrop for financial markets is likely to remain relatively benign for some time to come – a global recovery is underway and monetary policy will remain accommodative.

Ashburton Investment Strategy

While further downside risk is of course possible, in our view the current set-back in global equity markets should be seen as a buying opportunity. We therefore anticipate using the current period of weakness to rebuild equity weightings.

We see risks to short-maturity bonds as investors may start to price in more aggressive interest rate hikes. The steepness of yield curves in US and European bond markets suggest longer maturity bonds offer better value, although we view the latter as less risky and our US treasury holdings are concentrated in inflation-linked bonds currently.

As suggested above, we believe a material rise in commodity prices (especially oil) could create renewed fears of inflation and induce central banks to raise interest rates earlier. High commodity prices therefore pose a risk to both equity and bond markets.

Our currency views are little changed. On a medium-term view, we believe Asian currencies offer the greatest opportunity for significant gains. Among the four majors, Sterling and the US Dollar offer the greatest value from a medium-term perspective but loose monetary policy remains a headwind for both in the short-run.

(Source: Ashburton November 2009)

Key Global Market Indicators

	1D	5D	1M	6M	12M	YTD
	%	%	%	%	%	%
Equities (local CCY)						
MSCI World Local	1.0	-0.2	1.7	15.7	8.6	17.1
S&P 500 INDEX	1.9	0.0	1.1	16.0	17.9	18.1
DJ EURO STOXX €Pr	-0.6	1.4	-3.1	14.2	11.5	16.8
FTSE 100 INDEX	-0.5	1.1	-0.7	16.0	19.4	15.0
FTSE/JSE AFRICA TOP40 IX	-0.7	-2.2	3.3	17.8	27.2	19.0
TOPIX INDEX (TOKYO)	-0.1	-0.9	0.3	3.2	-3.9	1.7
HANG SENG INDEX	1.6	0.4	4.9	29.7	58.3	51.7
MSCI All Country Asia Ex Japan	-0.6	0.5	1.2	23.1	48.4	53.0
MSCI EM Latin America Local	1.2	1.6	3.0	23.2	52.6	51.4
MSCI Emerging Markets Eastern	2.8	-1.4	6.2	28.1	23.6	57.8
Bonds (local CCY)						
Citigroup WGBI All Maturities	-0.1	-0.4	-0.9	1.3	5.5	0.7
iBoxx USD Corporates Total Ret	-0.1	-0.2	-0.1	15.0	23.9	15.4
Iboxx Euro Corporate 25 Total	-0.1	0.0	0.5	7.0	17.5	12.7
FX (v USD)						
EURO SPOT	0.0	1.0	1.0	11.5	16.9	6.4
BRITISH POUND SPOT	-0.2	0.6	4.0	9.4	5.9	13.4
JAPANESE YEN SPOT	0.9	0.2	-1.2	9.3	8.7	0.8
NORWEGIAN KRONE SPOT	-0.1	0.7	0.1	14.7	21.4	22.3
AUSTRALIAN DOLLAR SPOT	0.6	1.8	2.9	22.4	37.6	30.3
Commodities						
S&P GSCI Commodities Index	-1.5	0.9	8.2	26.5	19.6	43.5
Bloomberg Base Metals 3-Month	-0.7	0.2	6.0	32.7	40.0	71.0
COPPER FUTURE Dec09	-0.5	-0.5	5.7	34.8	66.6	104.4
GOLD SPOT \$/OZ	0.4	4.7	5.0	20.1	49.3	24.1

*Data Source: Bloomberg as at 6th November 2009