STANLIB

the art and science of investing

Market Focus

12 month view, updated monthly

August 2011

	Economic Growth	Equities	Bonds (Total Return)	Interest Rates	Currency	Current Affairs
USA	→ The economy is growing below trend and clearly flirting with recession. We don't expect a double-dip recession but will continue to closely monitor the key economic data. Analysts have revised down their growth forecast for 2011 to 1.8% from 2.5%.	↑ The Fed's low interest rate policy continues to assist equities. A cloud will probably remain over stock markets until the global economy shows more evidence of recovering from its soft patch and the European issues settle down.	→ Contrary to most expectations, bond yields have yet again fallen quite sharply. Bond Markets probably fully priced at these levels. Yields could rise if the economy stabilises or improves. US Credit Rating downgraded by S&P from AAA to AA+ has had no effect here.	→ Federal Reserve announced that the US would keep its short-term interest rates at 0%-0.25% for the next 2 years. This was a clever move as it immediately caused medium-to-long-term rates to decline all over.	↓ With the low rates for longer and speculation of QE 3, the dollar could remain weaker for longer, but this is by no means assured. Expect volatility in the short term.	▪ US Federal Reserve Bank of Chicago National Activity Index was much better than expected in July but still below trend. Suggests that the US economy is not in recession, but growing below trend.
Eurozone	↓ European consumer confidence fell sharply. At the same time, the preliminary euro area PMI data was less gloomy than expected in August. Overall, the latest data is consistent with weak euro area growth in H2 and will not help dissipate fears about a renewed recession (not our baseline scenario).	↑ The worst decline came from Germany's stock market - down 27% at its worst from its recent high just 4 months ago...22% in 10 days. A cloud will probably remain over stock markets until the global economy shows more evidence of recovering from its soft patch and the European issues settle down.	→ Bond market developments in the Euro-area have been a little more encouraging since early August; with the exception of Greece. Bond yields in Greece remain exceptionally high, but yields in Ireland, Portugal, Italy and Spain have all moved noticeably lower, helped by ECB intervention (buying bonds).	→ The official European rate was raised in June for the 2nd time to 1.50% because of the 100% inflation mandate. The next move might be a cut, in light of the weak growth numbers and the European debt crisis. Latest inflation is 2.5%.	↑ Recent high volatility/ European problems have made calling the near future tricky. On balance we see the euro gaining versus the dollar and pound over the next 6-12 months, but the debt issues cast more uncertainty on this view.	▪ The Euro-area is facing a number of major economic, social and political challenges. At the heart of the problem, national debt levels are extremely high, while economic growth rates remain depressed, having not recovered enough from the Great Recession in 2008/2009.
UK	↓ The IMF cut its forecast for UK growth for the 3rd time in a year to 1.75% from 2.1% because of the bold front-end loaded austerity cuts and their effect on consumer spending. Consumer confidence did not fall as much as expected in July.	↑ Austerity measures imply that the UK may continue to underperform as the year progresses. A cloud will probably remain over stock markets until the global economy shows more evidence of recovering from its soft patch and the European issues settle down.	→ Government's austerity measures to restore the budget balance, even at the expense of short term economic growth, are supportive of bonds. Bond Markets probably fully priced at these levels. Yields could rise if the economy stabilises or improves.	↑ Despite higher inflation numbers, the UK has so far resisted the urge to raise interest rates because of the austerity measures. Lower oil prices should help their cause.	↑ The pound should continue to strengthen against a weaker dollar over the next 12 months, but our conviction is relatively low on this call, meaning the risks are higher than usual.	▪ Buying a home is now more affordable than at any time in the past 12 years. Lower house prices and reduced mortgage rates have resulted in a substantial improvement in housing affordability.
Japan	→ The Japanese economy is rebounding quite sharply, with production expected back to normal by end Sept. JP Morgan is forecasting 6.2% GDP growth in 2nd half of 2011 (-3.2% in 1st half).	→ Despite uncertainties and unknowns, value is considered good. The only question is the story of the past 22 year when the Japanese stock market has disappointed again and again…and again.	→ Japanese 10 yr bond yields almost hit 1.4% in February and are now back under 1.1%, following the trend of other developed bond markets.	→ Rates to remain rock bottom despite recovery underway in economy from tsunami.	→ Yen remains strong, hurting the export driven economy.	▪ Moody's cut Japan's sovereign rating by one notch to Aa3 which takes in three notches below AAA. The announcement barely impacts on the market given that rating downgrades and negative outlooks for Japan have been around for some time.
Emerging Markets (Average)	↑ Growth outlook remains stronger for Emerging Economies than Developed Economies. Inflation and global growth deceleration is broad based and has been hurting Emerging Economies. China's economy is undergoing a business cycle slowdown, driven by monetary and credit tightening as well as an exports slump.	↑ After taking a 19.7% knock to early August, the MSCI Emerging Markets Index is back at October 2009 levels and looks cheap at 10 times earnings of the next 12 months, especially after Brazil's interest rate cut. Brazil's share price (of the index) to book value is back at its 2008 lows.	→ Most bond markets have strengthened a bit (lower yields) over the past month, in line with the developed markets. The average emerging market bond yield is currently 4.5%, about 3% lower than the 10 year SA government bond yield.	→ China, Brazil and India have consistently been raising interest rates, on the back of higher inflation. Some suspect China has hiked for the last time, while Brazil unexpectedly cut for the first time in a while from 12.5% to 12% this week.	→ Emerging Market currencies weakened in August vs. the US dollar. Swings in risk appetite to remain a key driver. Upward pressure on Asian currencies should persist over time. Commodity currencies firm.	▪ Chinese authorities are walking an uncomfortable tight-rope between inflation and growth; The fine balance between sustained job-creating growth necessary for political legitimacy, and the need to deal with rising living costs.
SA	→ Acknowledging that manufacturing, construction and mining have recently been weak, STANLIB has cut its growth forecast for SA for 2011 from 3.6% to 3.3%. VAT receipts are down year-on-year so far in 2011 versus 2010, when they rose strongly.	↑ The JSE fell 14% from its high in Feb to its low in August. After recovering back over 30,000 in early September, it is still down 4.5% for 2011 (excluding divs). If economies keep growing (avoid recession), then the JSE offers value at this level. STANLIB remains neutral on SA equities, reflecting a cautious approach.	→ Bonds have surprised most commentators, with yields continuing to decline (pushing prices/ values up), even lower than 2010 lows. Foreigners remain big buyers (R48bn YTD) as yields continue to look attractive. The SA bond market has become somewhat of a high yield market for offshore investors.	→ There is a 40% chance of a rate cut in SA. STANLIB forecasts rates to stay flat well into 2012.	→ The rand is likely to remain vulnerable to risk aversion over the coming months. It appears as if the rand has decoupled with the bond market. Lately the bond market has been strengthening in the face of a weakening rand.	▪ Inflation higher than expected in July at 5.3%y/y. Expect CPI inflation to breach 6% in late 2011 or early 2012. Current upward trend in inflation reduces the chances of a cut in domestic interest rates.

Direction

↑ Trending Upwards/Strengthening

→ Trending Sideways/Remaining at constant levels

↓ Trending Downwards/Weakening

Impact on Market

■ Positive

■ Neutral

■ Negative

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