Market Comments

May 1, 2009

Global equity markets enjoyed strong returns for the second consecutive month in April, with the MSCI World Index rising by 11.2% and the MSCI Emerging Markets Index by 16.6%. Although trailing economic data from the first quarter generally continued to be grim, market participants have been encouraged by supportive government policy measures and evidence from around the world that the pace of economic contraction is abating.

There is little doubt now that last September's policy decision to let Lehman Brothers fail was the catalyst for a global collapse of financial intermediation that has triggered the most severe global recession in the post war period. Official forecasts generally project global GDP growth in 2009 to be between negative 1% to negative 3%, followed by a weak recovery in 2010. Past financial crises have frequently been followed by weak recoveries due to battered investor confidence and the headwinds created by financial deleveraging, and most official forecasts expect such forces to weigh heavily on economic growth prospects in the post-crisis period. That said, official forecasts were behind the curve as the downturn intensified and could turn out to be too cautious in view of the unprecedented policy measures that have been marshalled to restore global growth. Much will depend on how global inventory cycles develop in coming months, since the very violence of the production downturn in the past two quarters could lead to a scramble to refill inventory pipelines in coming months as final demand stabilizes. Reports from industries in the Far East suggest that such a scramble may be underway currently. For example, Japan's government estimates that industrial production posted monthly gains of 4% and 6% respectively in March and April after having registered a stunning decline from a year ago of nearly 35% in the first quarter. China has also seen a significant recovery in business sentiment, with the key purchasing managers' index having been above the "boom or bust" level of 50 for two consecutive months in March and April.

The U.S. Fed has helped support the global equity recovery by announcing unprecedented credit easing and quantitative easing measures that are expected to boost its balance sheet to nearly 29% of GDP later this year from about 7% a year ago. The UK has announced quantitative easing measures that are nearly as aggressive, while other central banks like the Swiss National Bank have also embraced quantitative easing while others have pushed interest rates to record low levels and are considering more radical measures as well. Governments have also announced fiscal stimulus measures expected to contribute nearly 2% of GDP toward global growth in 2009, led by America's $787 billion package and China's $586 billion package. In addition, the G20 nations have tripled the IMF's resources to $750 billion, while authorizing SDR (currency) issuance of $250 billion, bringing the total commitment toward a more pre-emptive support program for developing nations to $1 trillion. Finally, governments continue to focus on restoring confidence to the financial sector with an emphasis on capital injections or asset protection programs. With the IMF having estimated that total loan losses globally could exceed $4 trillion, the challenges remain daunting, but recent measures appear to be restoring some degree of confidence in the financial sector with the MSCI World Financial Sector posting a gain of 22% in April. It remains to be seen whether the rally in global equity markets of nearly 30% since early March represents a false dawn, but it seems clear that policymakers around the world will remain intently focused on restoring global growth. Aside from wild cards like Swine flu, the main risk to further equity market recovery would appear to be that of political bickering that impedes further financial sector stabilization efforts. Despite the rally, equities remain attractively valued relative to fixed income, with global equities trading close to 12.5 times expected earnings over the next twelve months.