Market Comments

July 2, 2009

After posting exceptionally strong gains in April and May as fears of economic Armageddon faded, global equity markets experienced more choppy trading conditions in June and declined modestly. Many of the strongest financial market trends of recent months such as rising bond yields and commodity prices also were reversed in June, with resource-sensitive markets like Russia experiencing sharp corrections after posting stellar gains earlier this year. But despite the slight setback in June, global equity markets realized significant gains in the second quarter of 2009 which left most broad equity indices in positive territory for the year to date.

Economic data released during the month was inconclusive in settling the "green shoots versus yellow weeds" debate about global growth prospects. The U.S. economy continued to struggle, with initial unemployment claims data pointing toward continuation of unacceptably high job losses. In contrast, data from some Asian nations showed a strong rebound in output in recent months with Japan posting an annual rate gain in industrial output of nearly 70% for the three months to May. To the extent that some of the violence of the downturn following Lehman's collapse was due to inventory dynamics, it is not surprising to see some of the most striking reversals coming from manufacturing-oriented Asian nations. But the question still lingers about whether an inventory-led growth recovery can be sustained if end-user demand in the U.S. and Europe remains anemic.

We remain optimistic that the global recovery will stay on track and that the risk to consensus forecasts is to the upside. Since the crisis originated in money and credit markets, we have been closely following the Bloomberg Financial Conditions Index which gave early and reliable signals as to the severity of the global economic downturn following Lehman's collapse. That index continued to improve in June and has now experienced a V-shaped recovery of nearly 10 standard deviations from its post-Lehman low of last October. Our own statistical work shows that such dramatic improvement in that index would be consistent with much stronger growth in the U.S. this year than currently called for in consensus forecasts, which would be very good news for America's trading partners as well. In addition the internal action of equity markets this year, which has been led by sectors like materials, information technology, and consumer discretionary, is consistent with a reasonably buoyant global economic recovery. In short, we believe that unprecedented policy measures are likely to bring about unprecedented economic outcomes. And that suggests that risks to global growth, corporate profits, and equity markets remain to the upside over the balance of 2009.