Market Comments

April 1, 2010

After a rocky start, global equity markets posted healthy gains in the first quarter of 2010, with the MSCI World Index up 3.2% in U.S. dollar terms while the MSCI Emerging Markets Index rose 2.4%. Those indexes rose by 6.2% and 8.1% respectively in March, erasing losses that had been posted earlier in the year as investors worried about Chinese monetary tightening, a fiscal crisis in Greece, and uncertainty over U.S. growth and economic policy prospects.

Economic data from around the world has lent increasing support to the view that the global economy is entering a period of self-sustaining growth. Severe winter weather in much of the northern hemisphere had contributed to a modest downshift in economic momentum around the turn of the year, but data from the U.S., Europe, and Japan all suggest that economic activity recovered nicely in March. Timely business surveys for both Europe and Japan appear consistent with 2% real GDP growth in those areas, while U.S. first quarter growth looks likely to come in above a 3% annualized rate as jobless claims have continued to trend down, while auto sales are expected to reach a 12 million unit pace. Financial conditions have improved during the quarter, with the Bloomberg Financial Conditions Index having risen to its highest level since mid-2007 as stock prices continued to rally while corporate borrowing spreads have narrowed.

The apparent shift to synchronized domestic demand growth in the U.S., Europe, and Japan is coinciding with a strong expansion in the emerging economies, suggesting that a broad-based global economic recovery is now underway. Further confirmation of this will be necessary from labor market data from all of these areas, but the combination of strong recoveries in manufacturing sectors, impressive recoveries in corporate profits, and signs of life in service industries all bode well for a recovery in job growth in coming quarters.

Risk assets received a boost in March from an agreement by European officials on a Greek support mechanism with IMF involvement, although the onus will remain on Greece to convince market participants that its fiscal reform plans are serious. And, at the same time European leaders came up with a plan for Greece the Dubai government stepped in unexpectedly with an additional commitment of $9.5 billion for Dubai World, whose financial difficulties had emerged as another flash point for global credit markets.

The multi-speed nature of the global economic recovery means that many key emerging market nations have fully recovered pre-recession activity levels and may be facing increasing inflation pressures in coming quarters. In contrast, core inflation readings in most developed nations continue to ease in response to high unemployment and spare industrial capacity. Not surprisingly, central banks in emerging market nations are expected to tighten monetary policy ahead of their counterparts in the developed nations. Already, India, Malaysia, and Israel have initiated rate-tightening cycles, with Brazil and China expected to follow soon. In contrast, the Fed and the ECB are still probably many months away from monetary tightening while the Bank of Japan is under increased political pressure to fight deflation through quantitative easing. Overall, global monetary policy can still be considered very much pro-growth while the global economy is on the cusp of achieving self-sustaining growth.