Market Comments

February 2, 2012

Global equity markets experienced a strong rally in January as better economic data coincided with supportive policy stances from key central banks. As market participants embraced riskier assets, emerging market equities led the way along with more cyclically driven sectors like materials, financials, consumer discretionary, and industrials. For the month, the MSCI World Index delivered a positive total return of 5.0% while the MSCI Emerging Markets Index posted an even more impressive total return of 11.3%. All twenty-one emerging market index countries posted gains in January, while emerging market currencies also registered strong gains against the U.S. dollar. The January gains followed a recovery in equity markets in the fourth quarter that left the World and Emerging Markets indexes up by nearly 16% and 20% respectively from their lows posted in early October last year.

Although Europe appears to have entered a recession, the rest of the world continues to grow and has generally provided positive economic news over the past several months. Notably, J.P. Morgan's survey of manufacturing purchasing managers in 30 countries rose from 50.2 in December to 51.2 in January, indicating further gains in output in coming months. This supports expectations of a first-quarter rise in global manufacturing output at a 5 percent pace, with a possibly temporary supportive factor being the restoration of global supply chains following devastating floods in Thailand last October. Although U.S. real GDP growth in the fourth quarter came in at only 2.8%, a bit lower than expectations, a downward trend in jobless claims and positive indications from manufacturing stories suggest that the U.S. is still on track for modestly positive GDP growth in 2012. China has also reported surprisingly strong GDP growth of 8.9% from a year ago in the fourth quarter and December data releases point to solid growth momentum at the turn into the new year. Accordingly, fears that the U.S. and/or Chinese expansions would falter in response to a euro-area recession have faded significantly in recent weeks.

In addition to generally supportive economic data, equity markets have also benefited from a rising tide of monetary policy support. In January the Fed extended its low-rate guidance from mid-2013 to late 2014 while Chairman Bernanke also signaled a low bar to engaging in further asset purchases. The Bank of England has also undertaken a very aggressive expansion of its balance sheet and is expected to approve on February 9th a £75 billion extension of its quantitative easing program which will bring the total to £350 billion. And while the ECB has tried to avoid direct quantitative easing and has instead focused on ensuring banking system liquidity, its unprecedented 3-year Long-term Refinancing Operation (LTRO) announced in December has resulted in a rapid improvement in euro-area financial conditions that should help limit the downside to the region's current recession.

In emerging markets most central banks have lately turned toward monetary easing as inflation pressures have receded and growth has disappointed. In Asia, central banks in Indonesia, Taiwan, and Thailand have lowered rates recently, while China has begun to lower reserve requirements with India recently doing the same. Elsewhere, Brazil has eased aggressively, Chile has entered an easing mode, while Turkey has maintained its rate corridor but has been bringing down its effective funding rate recently. The exception to the trend has been Hungary, whose central bank was compelled to raise rates in November and December in response to capital outflows and downward pressure on its currency. However, an easing of such market pressures in January helped Hungary's equity market to be one of the best performing markets in the world so far this year. In short, what were positive headwinds for many emerging nations in 2011 – rising inflation and tighter monetary policy – have reversed as the tide has turned toward easier policy.