

In May 2010, when European finance ministers emerged from a weekend of emergency meetings to present a €110bn bail-out for Greece, there was belief that the crisis had been stemmed. European finance ministers have now announced agreement on a further bailout, following protracted negotiation. This will allow Greece to avoid a disorderly default when a €14.5bn bond payment comes due on March 20. Although no one is certain what the consequences of such an event would be, economists have warned that it could not only force Greece out of the EU but also trigger bank runs in Portugal, Italy, Spain and even France. It is perhaps too early to judge, but it seems that the Greek problem may be parked for a while, although it has not gone away.

Many feel burnt by the Greek political class for its failure to implement the conditions of the first bail-out. Some diplomats talk openly about this rescue as little more than an attempt to buy more time until the Continent's banks are better prepared and Greece can be allowed to go bankrupt. Opinion polls show that while more than 70% of Greeks would like to remain in the Eurozone, only half believe the country will be able to do so. Greece has a poor record of implementing policies it has agreed and the mistrust is understandable. But to overcome this, the Eurozone is seeking assurances that are unbelievably extreme. The immediate response from investors was "buy the rumour, sell the fact" as an initial bounce in risk sentiment quickly faded and further news of the horrendous state of Greek finances was revealed. We must always be wary of knee jerk responses and allow markets to consider and digest the information.

Prior to this recent development, one of Schroder's fund managers, with whom we work, suggested a positive outcome between Greek and core European leaders could result in a more sustained global equity rally. "If we have positive news on the matter, and Greece can secure another bailout package, this will be very positive for the markets," she said. "It would be too premature to say the Eurozone crisis would then be over, as there is no easy long-term solution to Greek's debt; however, if these tail risks are pushed to one side, the endgame will have been postponed for a long while, and there is potential for equities to do very well." That would be a very welcome outcome from an otherwise Pyrrhic victory and one we consider to be highly possible.

Since January appetite for risk has been very obvious in equity markets; developed market indices are typically up by between 5% and 10% and there have been strong returns in many emerging market indices. Commodity markets have exhibited the trend to some extent, but industrial metals and gold which rose quite strongly in January have flattened out recently and the oil price has been broadly flat since the end of 2011.



31/07/2011 - 20/02/2012 Data from FE 2012

Better macro numbers worldwide have also supported the recent strength in risk assets. Nonetheless, it is only really in the US that we have seen a discernable acceleration in growth from a low point in the middle of last year. S&P 500 index recorded its best January rally since 1997. The S&P 500 Index has risen 7.3% so far this year driven mainly by cyclical sectors such as technology, consumer discretionary and industrials.

Although it is the US data that is turning, many UK equities are beneficiaries of this. Most of the global industrial sectors are starting to perform better, and while they might still be seeing more downgrades than upgrades, it is at a far slower and increasingly better rate. Those companies exposed to weaker domestic demand are struggling.

However, many UK listed companies are major global players in their chosen industry and so the contribution to total sales from the UK and the impact of changes in the domestic economy, are comparatively small. We remain of the view that UK equities are an attractive asset class for those taking a long term view, both for their capital growth potential and ability to deliver growing dividends in a period when income returns from a number of other assets classes are suffering.

We continue to develop our portfolio exposure to global funds with strong North American exposure, as well as emerging markets and technology funds for some higher risk pre-retirement portfolios. The 'large cap' European Funds that we support should be viewed as providing a strongly global exposure and a strong bias towards emerging markets and are not dependent on the Eurozone alone. Our tendency is to focus more on income generating funds, and this is unlikely to change in the foreseeable future.

Global emerging equity markets also had their best start to the year since 2001. However, the Baltic Dry Index, a measure of costs for shipping commodities, fell to its lowest level in 25 years, largely reflecting a surge in shipping capacity and lack of demand coming on stream. It is an indicator for emerging market activity.

Elsewhere we have seen some moderation in declining economies, but these are yet to be replaced by clear positive movements. This is particularly evident in Europe where there have been better numbers from Italy and Spain, but they have not been strong enough to suggest the economies have turned a corner. Credit rating agency Moody's took action to downgrade its rating of the credit worthiness of six Eurozone sovereigns. This included single notch downgrades in Italy and Portugal, while Spain was downgraded by two notches. In addition, Moody's downgraded the outlook on the ratings of France, Austria and the UK from stable to negative, warning that there is a 30% probability that these three sovereigns could lose their respective AAA ratings in the next 18 months. During the period Eurozone unemployment edged higher.

The change in outlook from Moody's for the UK should be taken as a warning that any slippage in the government's fiscal programme must be made up for with additional fiscal tightening. At the same time, the government is being warned that it must do more to boost growth through structural reforms and we await the budget with interest but low expectation of much change from the current course.

On the plus side we have seen substantial reductions in Italy and Spanish bond yields. Also, over the past few days the Portuguese ten-year bond yield has fallen from 17% to 12%, although 12% is still unsustainable over the long term. However, higher quality government bonds have bucked this trend. In the UK and Germany ten-year yields have remained very close to the low points reached last autumn. This is an interesting feature, as over the past few years when risk assets have been rising strongly, typically bond yields have climbed reflecting a fall in demand for 'safe haven' assets. In the current period, risk assets have enjoyed reasonable returns but bonds have not sold off.

An important driver of the recent rally has been the behaviour of central banks: a generous liquidity provision from the European Central Bank, additional quantitative easing in the UK, the Federal Reserve extending the period in which very low interest rates are likely to remain and the first signs of easing in a number of larger emerging markets. This central bank activity has helped to lower bond yields directly but also has reduced some of the downside risk to economies and markets as well as modestly enhanced growth expectations. Sovereign bond yields among nations with strong credit ratings are likely to remain low while central banks persist in such a permissive mode. Our view remains to support corporate bonds and high yield bonds as this sovereign debt including gilts and treasuries remains expensive.

Looking ahead, we share the view that loose monetary stances will continue worldwide. There may not be much additional activity in developed economies but we could see much broader easing coming through in some of the larger emerging economies. We expect headline inflation will fall quite sharply in both the developed and emerging worlds as the impact of previous high commodity prices falls away.

Concerns still remain about the European economy. It is hard to see a great deal of momentum from Europe over the next few months and some form of mild recession remains the most likely outcome. However, the news from the US economy looks sustainable and we would hope to see better growth numbers from the larger emerging economies over the course of the year. Overall, the global macro environment is likely to remain fragile, but there are some positive signs for it to get slightly better from where we are now.

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