Weekly Stock Market Report

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US

Fed signals zero rates until 2014

- Wall Street stocks were boosted last week by indications that interest rates will remain near zero for longer than expected, but dropped after GDP data fell short of forecasts. The Dow Jones lost 0.5%, while the S&P 500 and the NASDAQ held on to some of their gains, returning 0.1% and 1.1% respectively.

- After its meeting on Wednesday, the US Federal Reserve signalled that it would keep interest rates 'exceptionally low' until 2014 - a year longer than it had previously estimated. At the press conference following the meeting, the Fed chairman, Ben Bernanke, said policymakers have not ruled out further quantitative easing given the subdued inflation outlook and persistently high unemployment.

- Unlike many of the world's other major central banks, the Fed has not traditionally set inflation targets. However, it announced last week that it would adopt a long-term target of 2% for the personal consumer expenditure price index, which it said was consistent with its mandated goals of price stability and full employment. The move reflects Bernanke's goal of increasing the transparency of policy formulation.

- Equities responded positively to the statement from the Fed, with cyclical stocks in particular boosted by expectations that the central bank will do whatever is necessary to safeguard growth. Positive fourth-quarter earnings reports also provided support, with strong revenue and profits at Apple lifting technology stocks.

- However, the release of slightly weaker-than-expected GDP data undermined sentiment on Friday. The US economy grew at an annualised rate of 2.8% in the fourth quarter, its fastest rate in 18 months and up from 1.8% in the third quarter. However, economists had expected growth of 3%, and were also disappointed by some aspects of the underlying data.

- At first glance, a 2.8% annualised expansion would suggest the US is moving back towards more typical, recovery growth rates, but the detail is not so encouraging. A rebuild in inventories (which fell sharply last quarter) accounted for 1.9% out of the 2.8% gain. Consumer demand continued at a subdued, but still robust, 1.5% pace. The main reason for the slowdown in underlying growth (that is, excluding inventories), was a fall in business investment, from 1.5% in the third quarter to just 0.2% from October to December.

EUROPE

No agreement on Greek debt restructuring

- The MSCI Europe Index ended 0.1% higher last week. The European Central Bank's support for the region's banks continued to support sentiment, but fears of a Greek default helped keep markets in check.

- Among the major markets, Italy's FTSE MIB rose 2.0%, Germany's DAX was 1.7% higher and Spain's IBEX was up 1.1%. The UK's FTSE 100 managed a modest 0.1% rise, while the French CAC 40 was down 0.1% and the Swiss SPI dropped 1.2%.

- The impact of the European Central Bank's long-term refinancing operation (LTRO) continued to be seen last week, as Italy raised EUR 11 billion in a successful debt auction at significantly lower yields, while investors shrugged off sovereign downgrades to several eurozone countries from Fitch, a smaller US rating agency.

  The LTRO has provided crucial funding for many European banks that were struggling to raise finance on the markets. By rescuing the banks, the LTRO has helped stop contagion from Greece, Ireland and Portugal to Spain and Italy.

- However, the LTRO may not be enough to prevent a damaging drop in lending by European banks. European Central Bank (ECB) data showed that bank lending to non-financial corporations contracted by nearly EUR 40 billion in December, thanks to funding difficulties and to shrinking balance sheets as banks strive to meet stricter regulatory requirements.

- The drop in bank lending bodes ill for economic growth this year, particularly with peripheral eurozone countries already facing a deep recession. The Bank of Spain said last week that it expected Spanish GDP to have contracted 1.2% on an annualised basis in the fourth quarter of 2011. Conditions look far worse in Greece and Portugal.

- Recession makes it much more difficult (some would say impossible) for peripheral eurozone countries to reduce their deficits to sustainable levels. As a result, in recent weeks there have been demands for Germany to reduce its emphasis on austerity and help boost growth.

- However, Germany's chancellor, Angela Merkel, remains adamant that the fiscal pact will contain tight spending limits on governments, and is resisting calls to stump up more money from German taxpayers to increase the eurozone's bailout funds. Therefore, while the ECB's LTRO has helped to reduce sovereign risks in the short term, Europe remains some distance from a comprehensive long-term solution to the crisis.

- The most pressing issue remains Greece, with the Greek government still unable to reach agreement with private bondholders about the restructuring of EUR 200 billion of its debts, which is designed to bring Greece's debt-to-GDP ratio down to 120% from the current 160%.
- Agreement is a vital precondition for the European Union and International Monetary Fund to launch a second EUR 130 billion Greek bailout package. With Greece facing a large bond repayment deadline on 20 March, a damaging default is on the cards if agreement is not reached.

PACIFIC

Japanese manufacturing rebounds

- The MSCI Pacific Index returned 1.1% last week, outperforming the MSCI World, which rose 0.3%.
- Japan's TOPIX delivered a 0.7% gain. Japan's trade balance turned negative in 2011 for the first time since 1980, recording a JPY 2.49 trillion deficit, compared to an average annual trade surplus of JPY 7.7 trillion over the past ten years.
- Japan's exports were hurt last year by the 11 March earthquake, a very strong yen, weak global growth and the Thai floods. Meanwhile, fuel imports rose sharply as Japan required more oil and liquefied natural gas to offset the loss of nuclear power after the quake.
- In Korea, the KOSPI returned 0.8%. The Korean economy grew 0.4% quarter on quarter in the fourth quarter, marking its slowest pace in two years, due to weaker spending, investment and exports. For 2011 as a whole, the economy grew 3.6%, down from 2010's 6.2% advance.
- In a week shortened by the Chinese New Year holiday, Hong Kong's Hang Seng posted a 1.9% gain. Financial firms and property developers benefited from expectations of continued low interest rates in the US, while the broader market was supported by hopes of monetary easing in China, following disappointing growth data.
- Australia's All Ordinaries was up 1.1%. Domestic inflation remained unchanged in the fourth quarter from the third, versus economists' expectations of a 0.2% gain, boosting hopes that the Reserve Bank of Australia will cut interest rates for a third time this cycle when it meets next week.
- In Singapore, the Straits Times was up 2.3%. Singapore's manufacturing rose 12.6% in December from a year earlier, led by the pharmaceutical industry. The expansion surprised analysts, who had expected a 7.3% rise, following a fall of 8% in November.

EMERGING MARKETS

Hopes rise for monetary easing in China and Brazil

- Emerging markets outperformed their developed counterparts last week as US economic growth fell short of expectations and fears of a Greek default grew. The MSCI Emerging Markets Index was up 1.0%, versus a 0.3% gain for the MSCI World.
- Chinese stocks ended the Chinese New Year holiday higher, with the MSCI China returning 2.2%. Retail sales growth over the holiday period slowed, with sales up 16.2% year on year (y/y), compared to last year's 19.0% gain. With economic data disappointing and liquidity remaining tight, expectations grew for monetary easing.
- In India, the SENSEX returned 3.0%. The Reserve Bank of India cut the minimum cash reserve requirement for banks by 50 basis points to 5.5%, effectively introducing about INR 320 billion (USD 6.5 billion) into India's banking system and raising hopes the tightening cycle is over.
- Russia's RTS added 4.6%. Oil prices rose after the European Union agreed to stop importing oil from Iran, and Iran's parliament indicated it would pre-empt the sanctions by voting to ban oil exports to Europe.
- Elsewhere in emerging Europe, Hungary's BUX was up 2.3%. Prime minister Viktor Orbán and the EU resumed talks on an aid package for Hungary, but the International Monetary Fund said the country would only need financial help if the eurozone crisis worsened. Poland's WIG rose 2.4% on much better-than-expected 2011 GDP data, and the Czech PX-50 ended the week 3.5% higher.
- In Latin America, Brazil's Bovespa was up 1.0%. The Brazilian central bank signalled its continued worries over sluggish economic growth and downplayed inflation concerns, raising hopes for interest rate cuts. Mexico's Bolsa and Argentina's Merval fell 0.5% and 1.3% respectively.

Source for information: J.P. Morgan Asset Management, Bloomberg, FactSet, Financial Times.

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