Global Market Review

Anthony Jimenez, Funds Lawyer at Hassans, reviews the key factors which have been influencing investment and trading decisions over the first quarter of 2011, and subsequently the direction of global financial markets

Most major economies managed to stage something resembling a recovery by the end of 2010 and there was a high degree of optimism going into 2011, with the S&P 500 index climbing 1.50% during the first trading days of January. However, the first quarter of 2011 has not been all plain sailing, in fact, far from it, as economies have encountered new problems, as well as having to deal with the reprisal of ghosts from 2010.

US Labour Market

Investors have been scrutinising US labour data during the first quarter, on the grounds that analysts believe that this sector needs to improve in order for the US recovery to be sustainable. Reported data has been mixed since the beginning of the year, with unemployment claims, non-farm payrolls, challenger layoff reports, ADP non-farm employment change, printing both encouraging and disappointing figures. However, investors have been inspired by the continued downtrend of the US unemployment rate, which printed 8.9% for February and follows falling figures for January and December.

The declining unemployment rate has given investors some assurance about the US recovery, although the trend may be partially attributable to how the Bureau of Labour Statistics have reformed the method of calculating labour statistics. Nevertheless, investors moved into US stocks during the quarter; on the last trading day of March, the S&P 500 index closed at 1325.83 points, a rise of 4.24% since the beginning of the quarter, and up 17.02% since the beginning of 2010.

Sovereign Debt Markets

The "sovereign debt crisis" has continued to plague Europe during the first quarter of 2011; news regarding Europe's "peripheral countries" has been largely negative and has weighed on the minds of investors. The Euro Stoxx 50 index closed at 2910.91 points on the last trading day of March, down 2.52% for the quarter, and down 3.67% since the beginning of 2010. There have been several rating downgrades of "debt-club" members since the beginning of the year and analysts are adamant that Portugal will be the third member to seek a bailout. On 22nd March, the Portuguese Parliament rejected the Portuguese Governments' austerity plan and, the next day, Prime Minister Jose Socrates tendered his resignation. On the 31st March, Portuguese 10-year bond yields closed at 8.41%, compared with German 10-year bond yields at 3.35%. The variance reflects how investors continue to demand higher rates for lending to nations with questionable public finances. Analysts have warned that borrowing at such high rates is not sustainable and will inevitably lead to a default. To add to European concerns, on 17th January, Germany announced it was reluctant to add to the European Financial Stability Fund (EFSF), causing panic amongst investors who speculate that without the support of Europe's largest economy, the EFSF could not back nations, such as Italy and Belgium, if they also show signs of failing.

However, for now, investors are concentrating their anxieties on Spain. The Iberian giant is Europe's fourth largest economy and analysts have advised that it is too big for the EU to save with a bailout. However, tough austerity measures introduced by the Spanish Government in 2010 calmed bond markets to some extent, with both China and Russia publically announcing in 2011 that they would consider buying Spanish bonds. On 31st March, Spanish 10-year bond yields closed at 5.30%. However, Spain is by no means out of danger, as investors were reminded, on 29th March, by an announcement by Moody's rating agency that it would be downgrading the debt of Spanish banks.

UK policy problems - Inflation vs Interest Rate Hike

On 22nd March, the UK Consumer Price Index (CPI) for February printed at 4.4%, the sixth consecutive month in which it had increased. The Bank of England, like the European Central Bank, finds itself managing an economy with tepid growth but with above trend inflation, limiting policy decisions to a large extent. On the 26th January, the Monetary Policy Committee voted 7-0-2 in favour of leaving the official bank rate at 0.5% albeit with newest member, Martin Weale, joining Andrew Sentence in voting to raise rates. On 23rd February, Spencer Dale became the third member to vote for a rate increase. Investors speculate that Charles Bean will be the fourth member to vote for a rate hike in the second quarter due to his comments at the beginning of February. The FTSE 100 index closed at the end of March at 5908.76 points, down 1.78% from the beginning of the quarter, but up 7.43% from the beginning of 2010.

Asia – Slowing demand in China

Investors are concerned that cooling demand in China will have global implications. Fears of overheating markets, inflationary pressure and a housing bubble have caused the People's Bank of China (PBoC) to raise rates in an attempt to cool its economy. On the 8th February, the PBoC implemented a rate hike of 0.25% following hikes in January and December. China's CPI for February printed high at 4.9% leaving investors anticipating further rate hikes during the second quarter. To add to investors' concerns, on March 9th, China's trade balance printed at -$7.3B vs $4.9B forecast, the lowest reading in seven years, supporting fears the Chinese economy is slowing.

Tsunami Shakes Markets

On 11th March, an earthquake of magnitude 8.9 hit Japan triggering a devastating tsunami. The damage caused to Japan's domestic economy, as well as the global economy, is difficult to determine currently, given Japan's status as the third largest global economy, which is to a large degree, export oriented. Most notable were the problems caused at the Fukushima nuclear power plant. Speculation of a potential nuclear disaster caused markets around the world to plunge, however, most have since made up the losses. On 31st March, the Nikkei 225 index closed at 9755.10 points, down 6.41% for the quarter and down 9.22% from the beginning of 2010.

Commodity Markets – Middle East

The turbulence in Egypt and Libya caused equity markets to retract on the assumption that disturbances to the Suez Canal and the production of crude oil, would cause a surge in global oil prices and, in turn, cause additional inflationary pressures throughout world economies, potentially forcing central banks to increase rates. News of outbreak of civil war in Libya initiated a sell-off of riskier assets with investors determining that higher oil prices could affect company earnings, as well as depress consumer confidence. On the 31st March, Brent Crude future contracts closed at $117.10 per barrel.