

12 July 2010



## Global Markets Weekly

**Relief rally – markets bounce sharply as bad news abates.**

Equities and industrial commodities both rose by over 5% in the past week, as a pause in bad news encouraged bargain hunting after a dreadful June. The best performers were European markets that had been hit hardest, with the euro also rallying strongly. Losers were gold, the yen and the high-quality sovereign bonds that investors had bid up as safe havens.

**European Union bank stress tests are expected to reassure.**

Investors are increasingly looking to Europe's stress tests of 91 top banks, the results of which will be published on 23 July, for clarity and reassurance on the strength of the banking system. Banks' balance sheets will be reviewed against a scenario where current EU economic growth forecasts are undershot by three percentage points – representing a return to recession. There will also be an assessment for losses on sovereign debt, though the question of how to effectively test against a default by a euro-zone member state and whether to single out particular countries (e.g. Greece) is a highly contentious one. Information remains scarce, the tests are still in progress and haggling over details continues, especially how much will be made public. The 'how and who' on providing additional capital to banks that 'fail' the stress tests remains to be described and, although the euro has rallied, the interbank lending market remains under pressure until counterparty bank risk can be properly assessed.

**IMF upgrades forecasts for global growth - for 2010 only - and downgrades pan-European estimates.**

The IMF's upgraded global growth forecast appeared anomalous amid the current loss of faith in the sustainability of recovery, but it is the nature of global economic forecasts to lag the most recent events. In raising its 2010 forecast the IMF acknowledged current uncertainties and did not upgrade its 2011 estimate, leaving growth below the previous trend rate of 4.5%. While the overall forecast is increased, this is driven by emerging and developing economies and the US. Estimates across Europe and the UK, including emerging central and eastern European economies, were cut to reflect the impact of fiscal tightening. While European equities enjoyed the biggest rally on reiterated growth projections, they are still underperforming in the year to date. Overall, emerging markets have been more resilient and we expect this to continue.

**Less-bad news from developed economies – better news from emerging economies.**

Better than expected industrial production numbers from Germany and the UK suggested that the recovery still has legs, but the European and UK central banks both held rates steady. We forecast a protracted period of low interest rates, underpinning our positive view on corporate bonds and property, while keeping government bonds in demand. By contrast, the Reserve Bank of India pre-empted its scheduled 27 July meeting with a quarter-point hike. While the Reserve Bank of Australia did not raise rates, it highlighted continued global growth led by Asia. This was underlined by a 46,000 gain in jobs in June and helped the Australian dollar rally.

**US results season – anticipate profit upgrades for 2010, but 2011 estimates still look high to us.**

Earnings season kicks off in earnest next week with the first of the large caps reporting, such as GE and Alcoa, amid consensus expectations for earnings in general to grow relative to last quarter. Major US banks JP Morgan, Bank of America and Citigroup all report in the latter half of the week, with consensus expecting a fall in the sector's earnings since last quarter. In general we believe earnings will be in line with/beat expectations, providing a much needed support to equities. However, looking further ahead to end-2011 we expect earnings forecasts to decline. Although consensus estimates have been downgraded for four consecutive weeks, we expect the cuts to continue as the market adjusts to the reality of slower economic growth.

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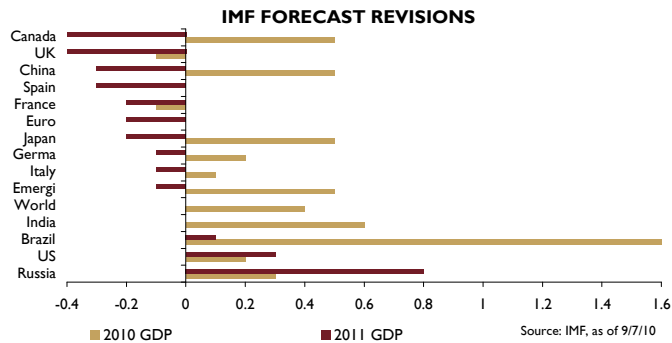
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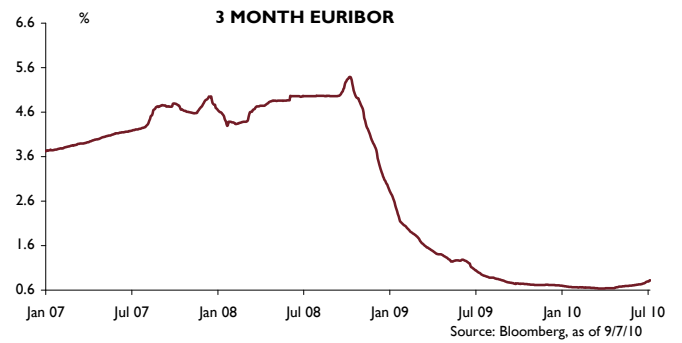
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# Charts of the Week

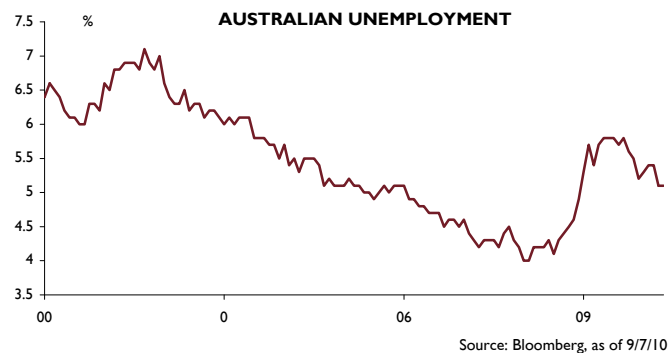
IMF upgrades 2010 global growth forecasts only, not 2011, and 2010 Pan-European forecasts are cut due to fiscal austerity



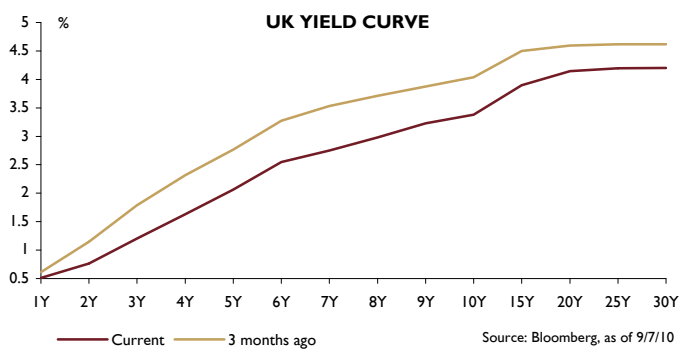
European interbank lending rates continue to rise ahead of the publication of bank stress tests in late July



A dip in Australian unemployment reinforces hopes for economic recovery



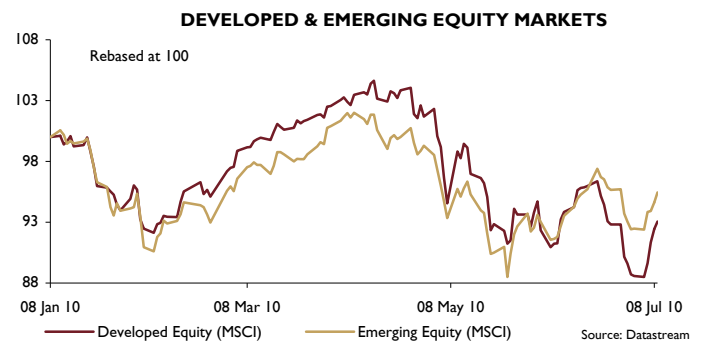
Fiscal austerity and outlook for weak growth and low inflation are driving UK gilt yields lower



# Market Performance

Equity Markets As of: 9-Jul-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
<b>Developed Equity (MSCI)</b>	<b>794</b>	<b>5.0</b>	<b>2.0</b>	<b>-10.1</b>	<b>-4.6</b>	<b>22.8</b>
FTSE All Share	2,653	5.9	1.2	-10.4	-3.9	25.0
FTSE 100	5,133	6.1	0.9	-11.1	-5.2	22.1
S&P 500	1,078	5.4	2.1	-9.8	-3.3	23.5
Nasdaq Composite	2,196	5.0	1.7	-10.5	-3.2	43.9
DJ EuroStoxx	256	5.7	3.9	-9.7	-7.0	23.4
Nikkei 225	9,585	4.2	1.6	-14.5	-9.1	19.0
Hang Seng	20,379	2.4	3.9	-8.2	-6.8	52.0
<b>Emerging Equity (MSCI)</b>	<b>41,862</b>	<b>3.2</b>	<b>4.0</b>	<b>-6.4</b>	<b>-2.9</b>	<b>58.6</b>
BRIC (MSCI)	501	3.1	3.5	-9.6	-6.1	68.0

Source: Datastream



10-Year Bond Yields As of: 9-Jul-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	3.1	7	-12	-83	-78	158
UK Gilts	3.4	12	-3	-61	-68	102
Euro Bonds	2.6	7	8	-51	-75	44
Japanese Bonds	1.4	5	-5	-24	-13	11

Source: Datastream

Commodity Markets As of: 9-Jul-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	255	2.4	2.7	-5.7	-8.7	18.9
WTI Oil Price (Spot)	76	5.6	3.1	-10.2	-3.9	102.4
Gold Bullion (Spot)	1209	0.2	-1.3	4.3	10.3	27.1
Industrial Metals (TR)	307	4.4	4.9	-18.5	-12.0	80.0

Source: Datastream

# Interest Rates & Inflation

Inflation & Interest Rates		Current Inflation (%)	RBS Interest Rates Forecast (%)			Rate Announcement Next Date
			Current	Sep '10	Dec '10	
United States (Fed Funds)		2.0	0.25	0.25	0.25	10-Aug
United Kingdom (Base Rate)		3.3	0.50	0.50	0.50	05-Aug
euro-zone (Repo Rate)		1.4	1.00	1.00	1.00	05-Aug
Japan (Call Rate)		-0.9	0.10	0.10	0.10	10-Aug

Source: Courts, RBS, Datastream

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