

Global Markets Weekly

Markets rally sharply, but still short of the highs for this year.

Equity markets driven by company results and positive comments on the outlook.

Double-dip fears for 2010 had turned into a consensus – but not supported by economic data.

2011 is more of a concern – economic contraction appears inevitable for parts of Europe and a risk in the rest of the developed world.

European bank stress tests, due next Friday, have already boosted euro markets by demonstrating political commitment.

After a dreadful end to the first half of 2010, the second half was off to a strong start with global equities recovering some 6% by Thursday in a broad-based move led by a recovery in developed markets. However, despite the recovery, global equity markets are still short of any of the previous monthly highs for this year. Indeed, caution amongst investors over the outlook remained evident, with sovereign bonds broadly unchanged and gold back above \$1,200/oz.

Second-quarter corporate earnings have generally been beating consensus expectations so far, with some high-profile successes. Intel reported its highest earnings per share ever, while BMW raised its 2010 sales forecast, based on strong auto demand from China, predicting 10% growth for the full year. JP Morgan, despite lacklustre quarterly results, managed to beat analysts' estimates and reported encouraging news of declining losses on mortgages and credit card lending. While Google's earnings were below expectations, the 3% of S&P 500 companies that have reported results so far have beaten expectations by an average of about 13%. We expect earnings to remain robust this year, but believe profit growth next year could disappoint.

Recent press coverage has focused on the possibility of a double-dip recession. Yet the recent flow of economic data, while far from uniformly positive, has consistently failed to confirm worst fears. If anything, recent corporate results suggest that growth momentum persists. The pace of China's growth may have slowed from a break-neck speed of 11.9% in the first quarter, but it still grew 10.3% in the second. This underpins the case for positive, albeit volatile, equity returns this year.

Reports from the US Federal Reserve (Fed) and the Bank of Japan highlighted concerns over next year's growth outlook. While the latter raised its forecasts for the current fiscal year (to April) to 2.6%, it held next year's at 1.8% and cut the following year to 1.9%. The minutes from last month's Fed meeting revealed declining optimism in the economic outlook and stated that further policy stimulus might be appropriate if it deteriorated further. These comments reinforce our view that interest rates will remain low for longer, with growth and inflation risks skewed to the downside. This was borne out by the resilience of Treasuries and other government bonds, which largely held their recent gains as equities rallied. In this environment we continue to favour corporate bonds, which benefit from investors seeking yield and from strengthening corporate balance sheets. The increased likelihood of 'policy stimulus', which we take to mean quantitative easing, is a potential negative for the dollar and a positive for gold.

While a host of unanswered questions remain ahead of the European Union bank stress tests due on 23 July, as with the creation of the European Financial Stability Facility, the mere fact that governments and institutions are seen to be acting is important for investor sentiment. This has boosted Spanish bond sales and allowed Greece to re-enter the debt market. However, there remains a gap between sentiment and reality, with Moody's downgrading Portugal's sovereign debt rating and euro interbank offered rates continuing to rise as banks hold back on lending to each other ahead of next Friday's announcement, which will clarify counterparty risk. While acknowledging the benefit of the stress tests, we remain cautious, as resolution of structural issues in the euro-zone will be a long, drawn-out and risky process.

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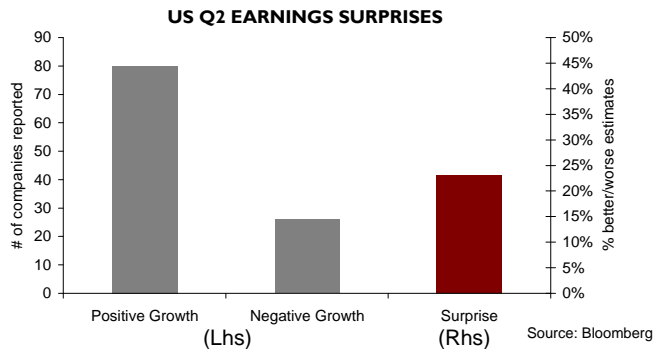
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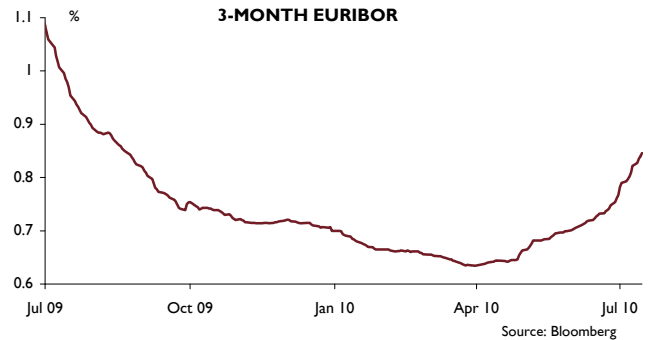
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Charts of the Week

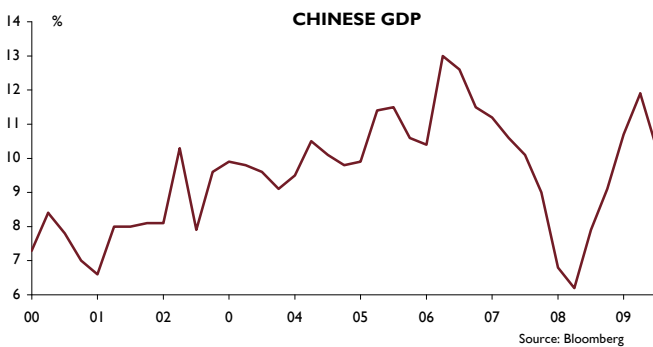
Companies report that growth is stronger and outlook is more positive than investors' depressed expectations



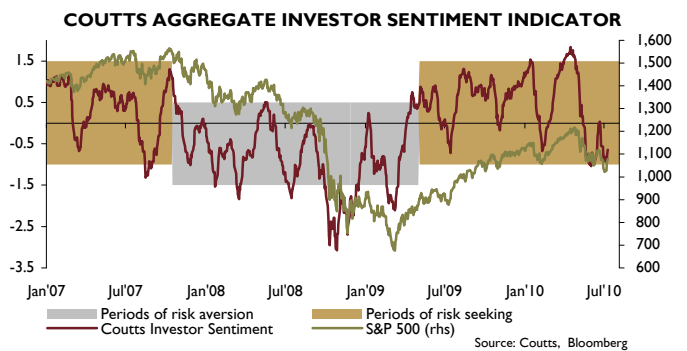
European inter-bank lending rates continue to rise as market awaits bank stress tests results



Chinese growth slows, but still has positive momentum



Investors are currently very risk averse – leading to sharp rallies on even just less-bad news

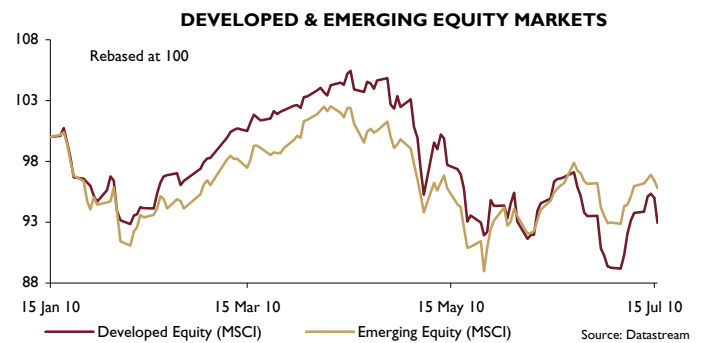


All charts as at 16/07/2010

Market Performance

Equity Markets As of: 16-Jul-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
Developed Equity (MSCI)	787	-0.9	-3.7	-10.6	-5.4	22.8
FTSE All Share	2,665	0.5	-1.4	-9.7	-3.5	25.0
FTSE 100	5,159	0.5	-1.5	-10.2	-4.7	22.1
S&P 500	1,065	-1.2	-4.5	-10.7	-4.5	23.5
Nasdaq Composite	2,179	-0.8	-5.5	-12.2	-4.0	43.9
DJ EuroStoxx	253	-0.9	-2.5	-9.5	-7.8	23.4
Nikkei 225	9,408	-1.9	-6.5	-15.3	-10.8	19.0
Hang Seng	20,250	-0.6	0.9	-7.4	-7.4	52.0
Emerging Equity (MSCI)	41,796	-0.2	0.0	-5.2	-3.1	58.6
BRIC (MSCI)	496	-1.1	-1.3	-8.4	-7.1	68.0

Source: Datastream



10-Year Bond Yields As of: 16-Jul-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	2.9	-13	-34	-84	-91	158
UK Gilts	3.4	0	-5	-55	-68	102
Euro Bonds	2.6	-2	-5	-47	-77	44
Japanese Bonds	1.4	-6	-15	-25	-20	11

Source: Datastream

Commodity Markets As of: 16-Jul-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	256	0.5	-0.9	-5.6	-8.3	18.9
WTI Oil Price (Spot)	76	-0.5	-2.3	-8.8	-4.4	102.4
Gold Bullion (Spot)	1193	-1.4	-3.3	5.0	8.8	27.1
Industrial Metals (TR)	297	-3.3	-2.8	-21.6	-14.9	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)	1.1	0.25	0.25	0.25	07-Sep
United Kingdom	(Base Rate)	3.2	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	07-Sep

Source: Coutts, RBS, Datastream

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