



## Global Markets Weekly

**Strong earnings give risk assets a boost as they challenge key technical resistance.**

Risk assets enjoyed a positive week on the back of further strong second-quarter (Q2) earning reports in the US and Europe, and a positive reaction to the European stress tests results. Many markets are now sitting at important technical levels, either just above (e.g. copper, gold and oil) or just below (e.g. S&P500, FTSE 100 and silver) their 200-day moving averages. However, the economic data last week was suggestive of a mid-cycle slowdown, limiting gains in risk assets. Emerging market equities outperformed, supporting our positive view on these markets given their structural strengths, such as less indebted consumers and governments.

**Investors focus on the positives from Europe's bank stress tests.**

The European bank stress tests were not as stringent as they could have been and plans for recapitalisation were relatively small, with only 7 out of the 91 banks assessed deemed in need of extra capital. But judging by the market reaction, investors have focused on the positives. These include the large amount of information released helping investors rank banks by relative strength and conduct their own stress tests if they wish, and the fact that the stress tests, even if not perfect, reduce the outlier risk of a collapse in the European financial system.

**Stress tests provide a catalyst for reform and assuage default fears for Spain.**

By country, Spain was a clear winner, despite five of its banks being identified as needing more capital. The tests acted as a much needed-catalyst for reform of its troubled 'cajas' and have reassured investors over the scale of potential losses. As a result, prices on credit default swaps (the cost of insuring against default) for Spanish government debt have fallen, and the spread between Spanish and German government bond yields has narrowed.

**Enough results to provide a clear signal of consensus-beating earnings...**

With 43% of the market having reported Q2 earnings, a large enough proportion to give us a strong signal, net income is up 16% quarter-on-quarter (QoQ) and sales have risen 3% QoQ, convincingly beating consensus forecasts. While there have been some disappointing results from the healthcare and utilities sectors, a majority of the market including the banks, industrials, energy and information technology sectors, posted positive results.

**...but equities continue to be buffeted by weak US economic indicators.**

However, equities remained volatile, oscillating between positive corporate earnings and lacklustre US economic indicators. Consumer confidence fell to its lowest level in five months, weekly jobless claims are stuck at a high level and the US Federal Reserve's (Fed) Beige Book survey of regional activity suggests that growth has moderated. Consumers are also continuing to pay down debt, which is positive in the long-term, but suggests they will not fulfil their traditional role as the motor of growth. Indeed, second quarter US GDP growth was a disappointing 2.4% QoQ, reflecting weak consumer spending.

**The Fed's Bullard calls for further quantitative easing, but remains a lone voice for now.**

With core inflation already below 1%, Fed board member James Bullard fuelled deflation worries by saying the threat was greater than it had ever been and the Fed should consider buying more Treasuries. We agree that deflation is a serious threat, and think quantitative easing (QE) will eventually resume. This could boost emerging-market currencies against the dollar and increase the attraction of gold as an ultimate store of value, though it would be a while before a consensus could be reached on QE. Meanwhile interest rates will stay low for a long time, supporting government bonds and further flattening in the US yield curve, while the increasing threat of deflation makes inflation-linked bonds expensive versus conventionals. Search for yield will also boost corporate bonds and high-yielding equities.

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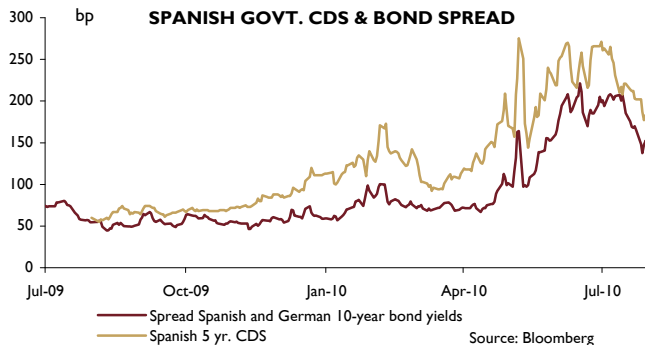
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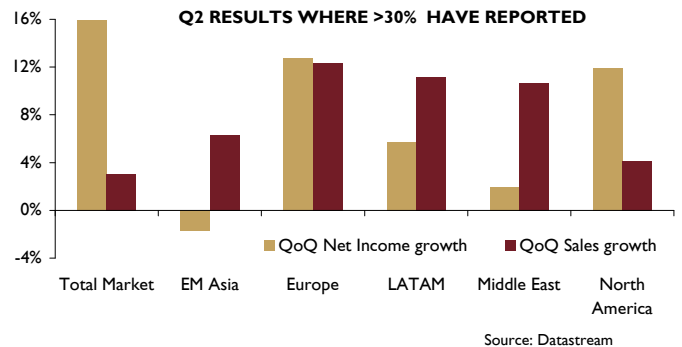
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# Charts of the Week

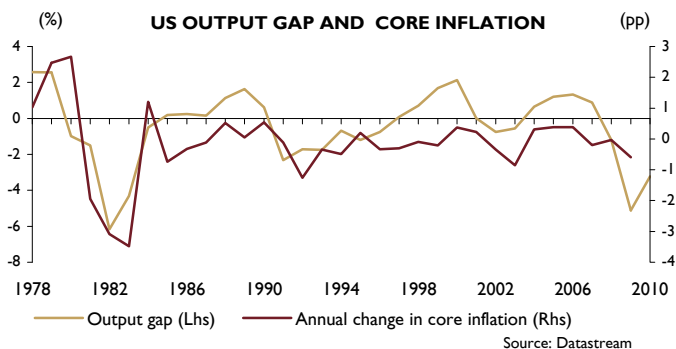
The cost of insuring against Spanish default fell and yields narrowed versus Germany, following EU bank stress tests



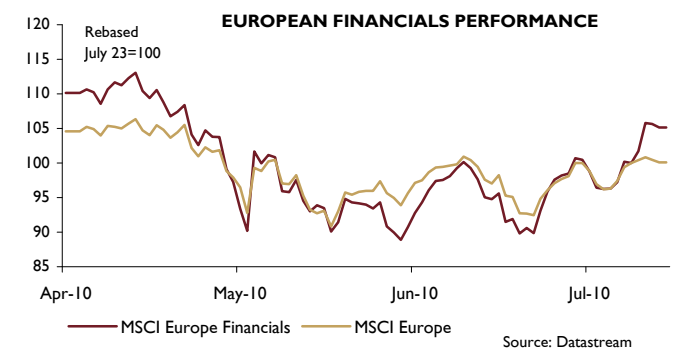
With a large chunk of companies having reported, consensus-beating Q2 earnings appear likely



US core inflation is heading lower amid a persistent output gap, fuelling deflation worries in the world's largest economy



Investors reacted favourably to stress tests, boosting European banks

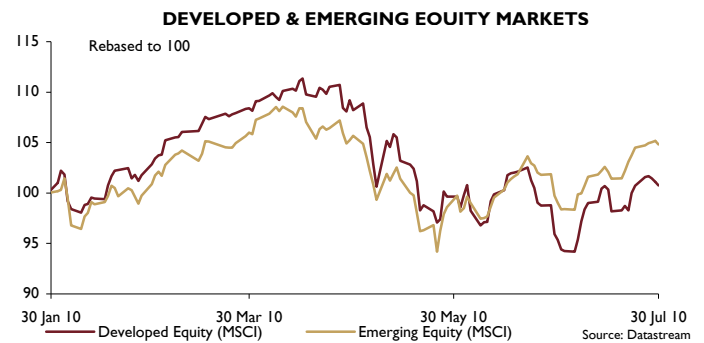


All charts as at 30/07/10

# Market Performance

Equity Markets As of: 30-Jul-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
<b>Developed Equity (MSCI)</b>	<b>808</b>	<b>0.0</b>	<b>5.7</b>	<b>-6.9</b>	<b>-2.9</b>	<b>22.8</b>
FTSE All Share	2,715	-1.0	6.8	-5.2	-1.7	25.0
FTSE 100	5,258	-1.0	6.9	-5.3	-2.9	22.1
S&P 500	1,102	-0.1	6.9	-7.2	-1.2	23.5
Nasdaq Composite	2,255	-0.7	6.9	-8.4	-0.6	43.9
DJ EuroStoxx	262	0.5	6.2	-2.9	-4.8	23.4
Nikkei 225	9,537	1.1	1.7	-13.8	-9.6	19.0
Hang Seng	21,030	1.0	4.5	-0.4	-3.9	52.0
<b>Emerging Equity (MSCI)</b>	<b>43,195</b>	<b>0.3</b>	<b>5.8</b>	<b>-0.8</b>	<b>0.2</b>	<b>58.6</b>
BRIC (MSCI)	520	0.6	6.2	-1.6	-2.6	68.0

Source: Datastream



10-Year Bond Yields As of: 30-Jul-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	2.9	-9	-3	-75	-93	158
UK Gilts	3.4	-11	10	-44	-70	102
Euro Bonds	2.7	-3	10	-30	-71	44
Japanese Bonds	1.4	1	-1	-21	-21	11

Source: Datastream

Commodity Markets As of: 30-Jul-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	270	3.4	6.8	-0.3	-3.5	18.9
WTI Oil Price (Spot)	79	-0.1	4.4	-8.3	-0.4	102.4
Gold Bullion (Spot)	1175	-1.3	-5.5	-0.4	7.3	27.1
Industrial Metals (TR)	332	5.2	10.7	-7.4	-4.9	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	10-Aug
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	10-Aug

Source: Courts, RBS, Datastream

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