



## Global Markets Weekly

### **What do recent events mean for the investment outlook?**

We had highlighted fiscal tightening as one of the three headwinds to the global recovery in our 2010 Investment Outlook. The crisis in the euro-zone is leading to acceleration in fiscal consolidation. Indeed, the probability of our key downside risk scenario, deflation, particularly in the euro-zone, has increased. More generally, a slowdown in global growth in the second half of the year is now to be expected. The UK, which has the euro-zone as its largest export market and also faces its own domestic fiscal consolidation, faces a potential 'double whammy' hit to growth.

### **Sweet spot in performance of risk assets is over.**

After the near 80% increase in the S&P 500 from March 2009 to late April 2010, we are entering a more difficult period for risk assets. Investors will have to prepare themselves for lower returns and greater volatility. Downside risks to the global economy have also increased, especially given the lack of policy coordination seen recently. On a brighter note, lower commodity prices reduce the inflationary threat, especially in emerging economies such as China and India, alleviating the need for further monetary tightening. Indeed, expectations for central bank policy tightening have receded just about everywhere. In addition, a weaker euro could be the safety valve needed to give a boost to the euro-zone export sector.

### **Doubts about euro-zone stability and its impact on global growth stalk risk assets.**

Risk assets came under severe pressure in the past week on investor concerns over the stability of the euro-zone and its impact on the global economy. On Thursday alone, the S&P 500 fell 4% to close 12% below its 23 April high. The Chinese stockmarket is now in official bear-market territory, having corrected 20% from its April high, and European markets are not far behind. Commodity prices, especially industrial metals and oil, have also declined sharply. The flip side to this has been a major rally in G7 bonds.

### **Currencies have also been volatile.**

Commodity currencies such as the Australian dollar took a substantial hit and the euro reached a four-year low against the dollar, before rebounding on rumours of ECB intervention. The speculation seems to have been triggered by renewed intervention by the Swiss National Bank to discourage investors from bidding its currency up on safe-haven demand.

### **Germany's ban on naked short selling raises political uncertainty.**

Germany's unilateral ban on shorting euro-zone government bonds and financial shares, and subsequent contradictory statements from euro-zone leaders over the stability of the euro, suggests a lack of euro-zone policy coordination. Political risk was not confined to Europe - the passage of the financial reform bill in the US Senate Thursday increases uncertainty for the financial sector, while news from Korea, Thailand and Iran heightened global political tension.

### **The trend of positive data surprises was reversed, especially in the US.**

We may be reaching an inflection point in US growth, with the economy still recovering, but the pace slowing. US weekly initial jobless claims increased and remain stubbornly high, which suggests job gains will be slow. The index of leading economic indicators was also weaker than expected, and US inflation came in lower than expected with consumer prices falling on a monthly basis for the first time in a year. Meanwhile, there has been a growing realisation that a period of severe belt-tightening across the euro-zone, which represents 20% of global GDP, is likely to lead to stagnation for the region and cause a drag on global growth.

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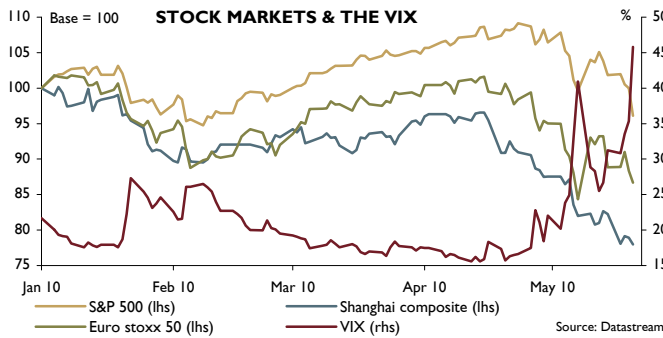
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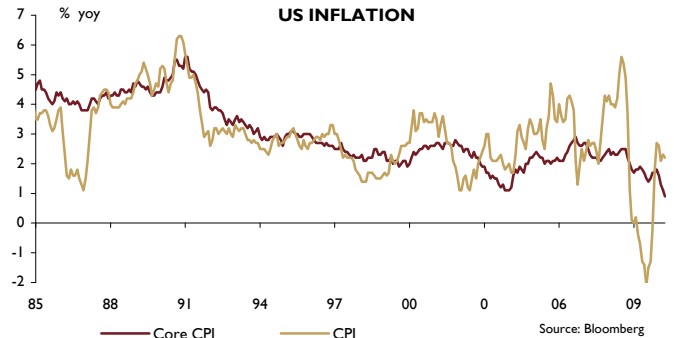
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# Charts of the Week

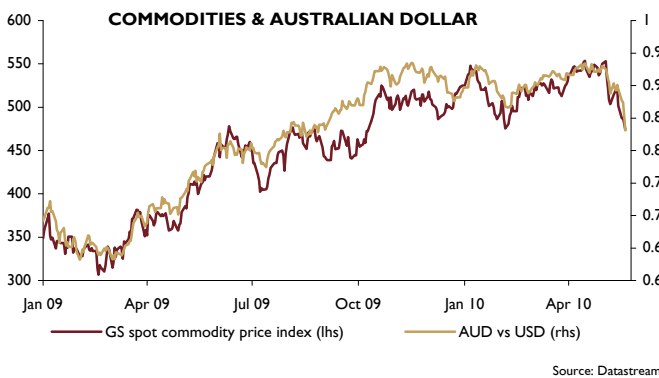
Volatility returns, with sharp declines in equity markets globally



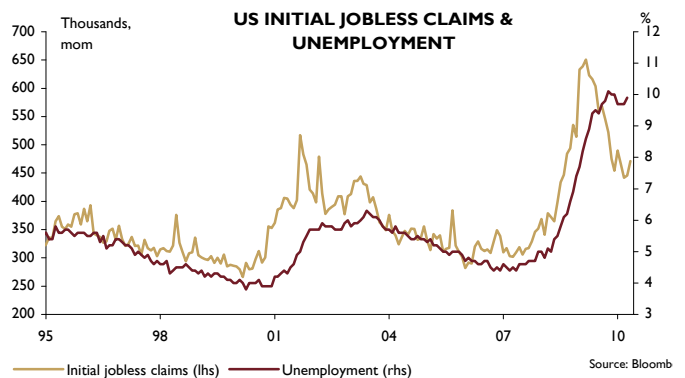
Headline and core US inflation fall



Commodity currencies such as the Australian dollar match declines in commodity prices



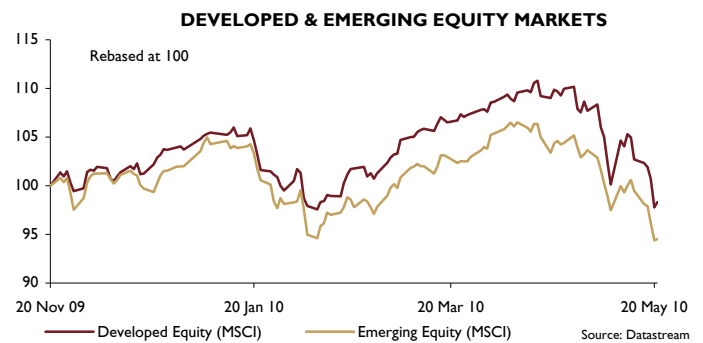
Stubbornly high initial jobless claims suggest US unemployment rate to remain high



# Market Performance

Equity Markets As of: 21-May-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
<b>Developed Equity (MSCI)</b>	<b>792</b>	<b>-4.3</b>	<b>-10.4</b>	<b>-3.4</b>	<b>-4.8</b>	<b>22.8</b>
FTSE All Share	2,611	-4.1	-11.2	-4.8	-5.4	25.0
FTSE 100	5,063	-3.8	-11.5	-5.5	-6.5	22.1
S&P 500	1,088	-4.2	-9.8	-1.9	-2.5	23.5
Nasdaq Composite	2,229	-5.0	-11.0	-0.7	-1.8	43.9
DJ EuroStoxx	246	-3.0	-12.3	-6.4	-10.6	23.4
Nikkei 225	9,785	-6.5	-11.8	-3.4	-7.2	19.0
Hang Seng	19,546	-3.0	-9.1	-1.8	-10.6	52.0
<b>Emerging Equity (MSCI)</b>	<b>39,690</b>	<b>-5.0</b>	<b>-9.6</b>	<b>-3.4</b>	<b>-8.0</b>	<b>58.6</b>
BRIC (MSCI)	476	-5.1	-11.5	-5.8	-10.9	68.0

Source: Datastream



10-Year Bond Yields As of: 21-May-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	3.2	-23	-52	-56	-62	158
UK Gilts	3.5	-20	-52	-78	-62	102
Euro Bonds	2.6	-20	-47	-67	-77	44
Japanese Bonds	1.4	-6	-10	-9	-5	11

Source: Datastream

Commodity Markets As of: 21-May-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	248	-3.5	-8.6	-8.5	-11.3	18.9
WTI Oil Price (Spot)	67	-6.4	-19.1	-15.9	-15.4	102.4
Gold Bullion (Spot)	1182	-3.3	3.6	5.6	7.9	27.1
Industrial Metals (TR)	316	-2.9	-16.1	-8.4	-9.5	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)	2.3	0.25	0.75	1.75	23-Jun
United Kingdom	(Base Rate)	3.4	0.50	0.50	1.00	10-Jun
euro-zone	(Repo Rate)	1.5	1.00	1.00	1.00	10-Jun
Japan	(Call Rate)	-1.1	0.10	0.10	0.10	15-Jun

Source: Courts, RBS, Datastream

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