

## Global Markets Weekly

**Another tricky week for risk assets on disappointing data and euro-zone banking concerns.**

Risk assets had another difficult week on the back of disappointing economic data in the US and China, and concerns over euro-zone banks' access to liquidity from the European Central Bank (ECB). In an environment of reduced appetite for risk, safe haven currencies such as the yen and Swiss franc strengthened, while US treasury yields continued to fall. Although US Treasuries benefited from a flight to safety, the dollar weakened against a number of other major currencies, including the euro. Indeed, if we are right that the US will eventually have to engage in more quantitative easing, the dollar is likely to weaken further.

**Calm returns as the ECB's one-year emergency loans are wound down.**

The ECB's one-year ultra-low-rate loans to European banks provided during the credit crisis expired on Thursday. Rather than renew the loans for another year, the ECB offered them for only a three-month period on a rolling basis, to gradually wean banks off ECB funds and switch them back to private credit instead. However, this is unlikely to occur until publication of euro-zone bank stress tests, expected at the end of July, and evidence of a credible plan for recapitalisation of weaker banks. Concerns that short-term liquidity provision would be insufficient for the European banking sector led to market jitters early in the week, with the S&P500 falling 3% on Tuesday alone. In the event, the demand for 3-month loans on Wednesday was lower than many expected, helping alleviate market concerns.

**Some disappointing data from developed and emerging economies, but US payrolls were as expected.**

Weakness in risk assets was also partly the result of a slew of macroeconomic data that came in worse than expected. US consumer confidence measured by the Conference Board fell 10 points, Japanese unemployment increased while wage growth turned negative, and the Chinese PMI survey was weaker than expected (though still consistent with economic expansion). Of particular note in Asia is that the PMIs for China and Korea have moderated for two consecutive months, and for three months for Taiwan, so it is difficult to dismiss the June readings as one-offs. Fortunately, Friday's monthly US employment report came in more or less as expected, with private non-farm payrolls increasing by 83,000 in June. Nonetheless, whilst positive, this is not enough to stimulate strong growth in wage income or consumer spending.

**A continued slowdown into 2011 to usher in 'QE2'**

Indeed, in addition to a second-half slowdown this year, we are concerned about the 2011 outlook when simultaneous global fiscal consolidation will hit hard. On a more positive note, central banks including the US Federal Reserve are likely to respond to evidence of a global slowdown and intensifying deflationary threats by engaging in more quantitative easing (some are already referring to this as QE2) and keeping interest rates low for longer than generally expected. Core US and euro-zone inflation is already below 1%.

**Investors will be keeping an eye on corporate profits as US earnings season arrives.**

Finally, the imminent US earnings season will be particularly important to watch given increased sensitivity to a slowdown in growth. US corporate profits rose by 47% quarter-on-quarter (qoq) in the first quarter of 2010, rebounding to more normal levels. This quarter expectations are for qoq growth of 11%. However, given our concerns over the growth outlook for next year, earnings expectations of 18% yoy still appear too high to us. While valuations are attractive on a long-term price-to-earnings basis, this suggests that equity investors should be prepared for more volatility until the consensus gradually shifts to recognise weaker growth.

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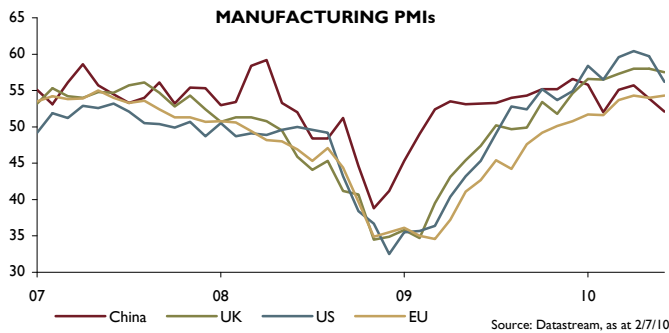
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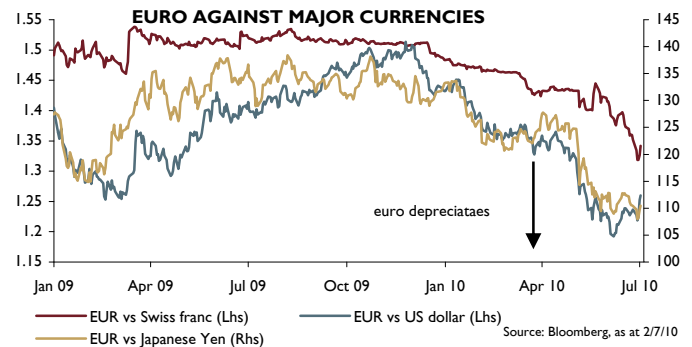
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# Charts of the Week

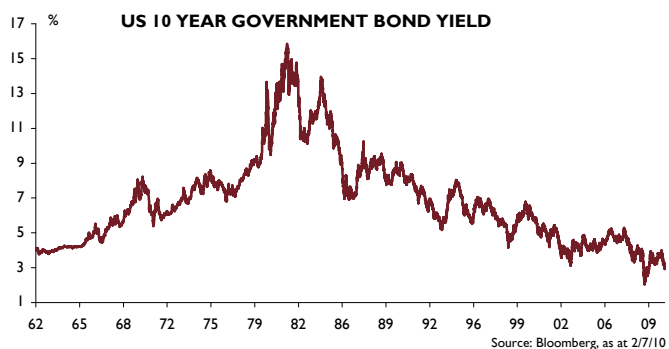
Key developed- and emerging-market PMIs showing signs of slowing, but remain in expansionary territory



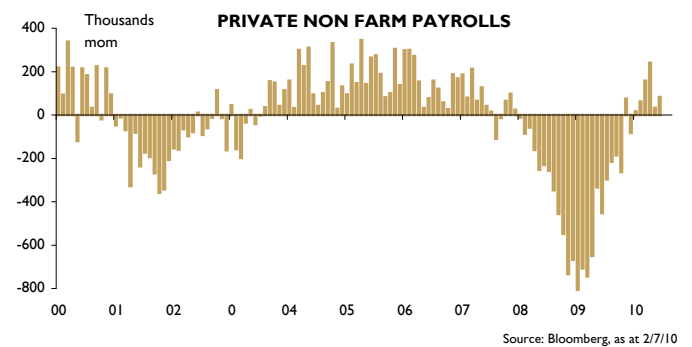
Swiss franc and yen benefit from risk aversion, but recent dollar weakness against euro suggests concern about US economy



Treasuries boosted by safe-haven demand, sending 10-year US yields below 3% for the first time in over a year



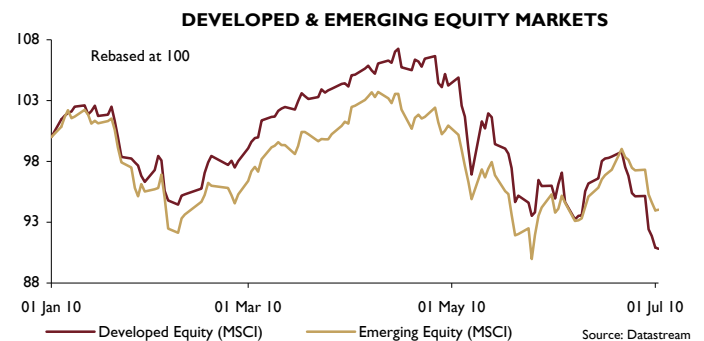
The private sector continues to generate new US jobs, but not fast enough to boost consumer confidence



# Market Performance

Equity Markets As of: 2-Jul-10	Current	Performance (% local)				
		-1W	-1M	-3M	YTD	09
<b>Developed Equity (MSCI)</b>	<b>756</b>	<b>-4.5</b>	<b>-5.5</b>	<b>-13.6</b>	<b>-9.2</b>	<b>22.8</b>
FTSE All Share	2,505	-4.0	-5.7	-14.9	-9.3	25.0
FTSE 100	4,838	-4.1	-6.1	-15.8	-10.6	22.1
S&P 500	1,023	-5.0	-6.9	-13.2	-8.3	23.5
Nasdaq Composite	2,092	-5.9	-8.3	-12.9	-7.8	43.9
DJ EuroStoxx	242	-4.2	-3.0	-14.1	-12.0	23.4
Nikkei 225	9,204	-5.5	-4.2	-18.5	-12.7	19.0
Hang Seng	19,905	-3.8	2.2	-7.6	-9.0	52.0
<b>Emerging Equity (MSCI)</b>	<b>40,554</b>	<b>-3.3</b>	<b>-0.1</b>	<b>-8.3</b>	<b>-6.0</b>	<b>58.6</b>
BRIC (MSCI)	486	-3.8	-0.6	-11.0	-8.9	68.0

Source: Datastream



10-Year Bond Yields As of: 2-Jul-10	Current	Change (basis points)				
		-1W	-1M	-3M	YTD	09
US Treasuries	3.0	-13	-36	-89	-86	158
UK Gilts	3.3	-2	-19	-62	-80	102
Euro Bonds	2.6	-4	-8	-52	-81	44
Japanese Bonds	1.4	-5	-13	-26	-18	11

Source: Datastream

Commodity Markets As of: 2-Jul-10	Current	Performance (%)				
		-1W	-1M	-3M	YTD	09
Commodities (TR)	249	-3.7	0.0	-7.3	-10.9	18.9
WTI Oil Price (Spot)	72	-8.6	-1.9	-15.1	-9.0	102.4
Gold Bullion (Spot)	1206	-3.9	-1.0	7.2	10.0	27.1
Industrial Metals (TR)	294	-4.9	-3.7	-21.4	-15.8	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)	3.4	0.50	0.50	1.00	08-Jul
euro-zone	(Repo Rate)	1.4	1.00	1.00	1.00	08-Jul
Japan	(Call Rate)	-0.9	0.10	0.10	0.10	15-Jul

Source: Coutts, RBS, Datastream

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