



Global Markets Weekly

Strong earnings and economic data boosts equities, but dollar comes under further pressure

Continued strong Q2 corporate earnings, and better-than-expected US surveys of the manufacturing and service sectors buoyed equity markets at the start of the week. The prospect of further quantitative easing (QE) by the US Federal Reserve may also have boosted sentiment. The mere discussion of additional QE purchases indicates that US rate increases are firmly off the agenda. As a result, bond yields drifted lower, a trend which we expect to continue. The prospect that US interest rates will remain low for longer than expected led to further softness in the dollar - the greenback fell to 1.33 against the euro and 1.59 versus sterling. The weaker dollar also helped buoy commodity prices. Oil rose above 80 dollars per barrel, and wheat prices recorded their strongest gains since 1974 due to a poor Russian harvest, which led to a temporary ban on all grain exports from the country.

Despite recent gains, stocks continue to offer good value

Developed world and emerging market equity indices are up 11.5% and 10.7% respectively over the past month, driven by strong corporate earnings. Japan has been the weakest of all major economies, up only 1.7% over the same period. Poor corporate revenues - down by an average 5.5% q/q in the second quarter, relative to a global gain of 3.4% over the same period - probably contributed to Tokyo's underperformance. Despite the recent strength of world equities, they remain down 1.4% YTD, leaving PE valuations just below their long-term average at 16.8. While we believe that the 12 month forward PE of 12 rests on overly optimistic growth assumptions, moderating these forecasts to below average growth levels still leaves equities looking cheap.

Data points to slowdown, but not a double-dip recession

Last week saw the release of a raft of surveys covering activity in the manufacturing and services sectors. These confirmed a slowdown in global growth, but not a slide back into recession. The official Chinese manufacturing PMI showed a further decline in July. The UK manufacturing and services PMI also fell during the month, consistent with growth of 0.5% q/q in the third quarter, marking a slowdown from the 1.2% gain seen in Q2, but also representing respectable growth.

Jobs data prompts renewed concern about the US economy.

US survey data from the manufacturing sector confirmed the picture of a slowing, but still expanding economy. Indeed, although manufacturing confidence declined in July, the fall was less than expected, and confidence in the larger service sector actually rose. However, some of the detail of the manufacturing ISM survey was a concern - new orders fell and inventory accumulation accelerated. July private non-farm payrolls rose 71K, slightly below the 90K expected, with downward revisions to June's gains adding to the disappointment. The data (unveiled on Friday) revived fears over the strength of the recovery, weighed down on equities and led to further falls in US bond yields.

Fed reportedly mulling new measures to stave off deflation - further QE also likely as inflation ebbs

The normally well-informed 'Wall Street Journal' carried a story that the Fed is considering further measures to counter deflation, and may use the proceeds from its holdings of mortgage-backed securities to buy US Treasury debt. An estimated \$200 billion worth of these bonds will expire by 2011. An announcement could be made at the next Fed rate setting meeting (10th August). However, such a move would simply keep the Fed's balance sheet at current levels, rather than expanding it. If, as we expect, the US economy enters a period of below-trend growth, core inflation will drift lower over the coming months and probably hit zero within a year, suggesting that the Fed will eventually need to engage in much greater QE.

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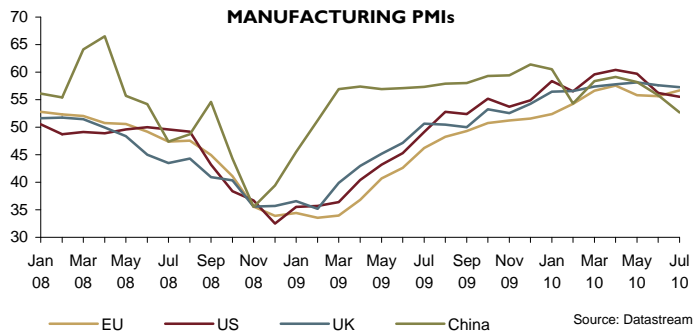
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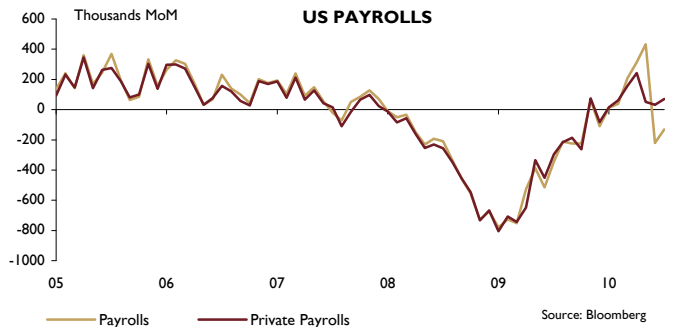
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Charts of the Week

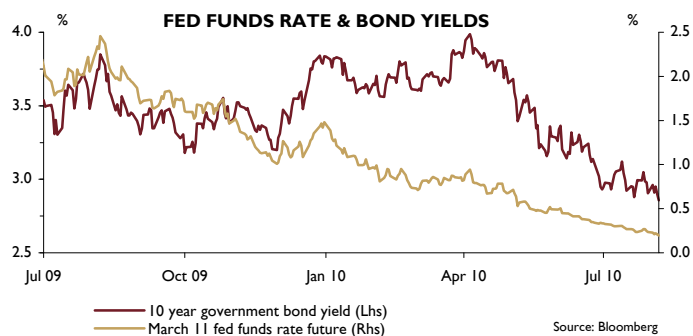
Global manufacturing PMIs suggest slowdown in growth in US and China



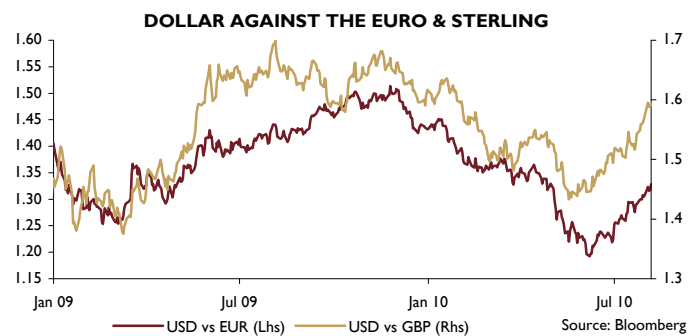
US labour market only showing modest job creation - consistent with subpar economic recovery



US Treasury yield declines as market scales back expectations for Federal Reserve rate rises



Dollar weakens on soft economic data and expectations of low rates for longer

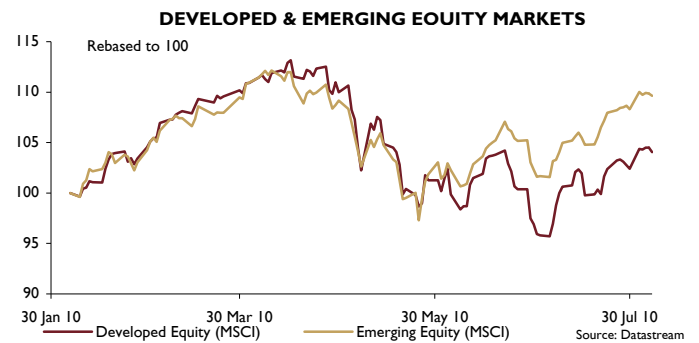


All charts as at 06/08/2010

Market Performance

Equity Markets As of: 6-Aug-10	Performance (% local)					
	Current	-1W	-1M	-3M	YTD	09
Developed Equity (MSCI)	821	1.6	7.3	-0.4	-1.4	22.8
FTSE All Share	2,754	1.4	7.2	1.4	-0.3	25.0
FTSE 100	5,332	1.4	7.4	1.4	-1.5	22.1
S&P 500	1,122	1.8	9.1	-0.6	0.6	23.5
Nasdaq Composite	2,288	1.5	9.3	-1.3	0.9	43.9
DJ EuroStoxx	265	1.3	7.3	5.7	-3.5	23.4
Nikkei 225	9,642	1.1	3.3	-9.9	-8.6	19.0
Hang Seng	21,679	3.1	7.9	7.7	-0.9	52.0
Emerging Equity (MSCI)	43,731	1.2	6.3	5.3	1.4	58.6
BRIC (MSCI)	528	1.4	7.0	5.7	-1.2	68.0

Source: Datastream



10-Year Bond Yields As of: 6-Aug-10	Change (basis points)					
	Current	-1W	-1M	-3M	YTD	09
US Treasuries	2.8	-9	-11	-57	-102	158
UK Gilts	3.3	-10	-14	-43	-80	102
Euro Bonds	2.5	-15	-6	-23	-86	44
Japanese Bonds	1.4	-2	-8	-22	-23	11

Source: Datastream

Commodity Markets As of: 6-Aug-10	Performance (%)					
	Current	-1W	-1M	-3M	YTD	09
Commodities (TR)	272	0.8	9.2	5.5	-2.7	18.9
WTI Oil Price (Spot)	81	2.4	12.3	5.9	2.0	102.4
Gold Bullion (Spot)	1209	2.8	1.3	2.0	10.3	27.1
Industrial Metals (TR)	339	1.9	12.5	3.3	-3.1	80.0

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	09-Sep
Euro-zone	(Repo Rate)	1.7	1.00	1.00	1.00	02-Sep
Japan	(Call Rate)	-0.7	0.10	0.10	0.10	10-Aug

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