



## Global Markets Weekly

**2010 got off to a great start for risk assets.**

After a strong finish to 2009, markets for risk assets hit 15-month highs in the first week of the new year. **Equities and commodities were bolstered by news of continued economic recovery**, while even the prevailing cold snap was taken as a positive for the oil price, which touched its highest level since October 2008.

**Asia continues to head up world growth, but the risk of overheating spells tighter monetary policy.**

The official Chinese Purchasing Managers' Index (PMI) rose in December to 56.6, a 20-month high. This was confirmed by separate, independent surveys, which also showed increases for manufacturing PMIs in India, South Korea and Taiwan. Exports from Taiwan in December jumped by 47% from a year earlier and rose by 34% for South Korea. Both were led by a leap in exports to China of more than 90% compared to the crisis-affected end of 2008. Such news proved a boon for risk assets over the week but **investors' fervour was swiftly checked by news that the Chinese central bank had raised the yield in the auction of three-month bills**. Admittedly, this was only a modest 0.04% higher, but the action was regarded as a portentous move to tighten liquidity after the huge lending growth seen in 2009.

**The US economic picture is improving, marred by the occasional blot on the landscape...**

The US manufacturing PMI hit a new high for this cycle, at 55.9 for December, rebounding from a setback in the previous month as more companies reported higher new orders and prices, while inventories remained below average. Yet it should be noted that the survey is of large manufacturers, including many leading exporters which are benefiting from the prior weakness of the US dollar. By contrast, the National Federation of Independent Businesses, which covers a wide spread of smaller US companies, showed a slight deterioration in optimism about the outlook in December. That said, **unemployment is showing clear signs of stabilising**, with new claims averaging 450,000 per week over the past month, down from 650,000 at the peak. December non-farm payrolls fell by 85,000, disappointing expectations of an immediate end to job losses. However, this comes after the unexpected addition of 4,000 jobs in November, so that the underlying trend appears to be continuing to improve.

**...but it is Europe that really appears to be trailing.**

So it was really Europe that best illustrated our view that the recovery is far from plain sailing. **Eurozone retail sales fell** by 1.2% in November, down 4% on the year, against consensus expectations for an increase. **The drop was largely the result of declining sales in Germany, but Finland, France, Portugal and Slovakia also witnessed falls**. Meanwhile, Germany also saw its key manufacturing sector struggle as orders grew by a mere 0.2% in November, while export orders declined, perhaps in reaction to the euro's former strength. That export-currency link was evident in Japan, where optimism among exporters about the prospect of a lower yen, following comments from the new finance minister, supported the local equity market's strong performance.

**Bond yields have risen on the thorny issues of issuance and sovereign risks.**

The sovereign bond yields of major developed countries have moved higher over the past month. A universal driver is the increase in risk appetite as investors switch out of safe havens in search of higher returns. **A further impetus is the scale of new issuance, with the UK – which has the highest proportional budget deficit – seeing gilt yields at a 14-month peak**. Despite this, the first auction this year, of £4bn gilts, was more than twice oversubscribed. However, with the Bank of England announcing that its gilt purchase programme has now accumulated £193bn of the £200bn allocated, one source of buying will be removed.

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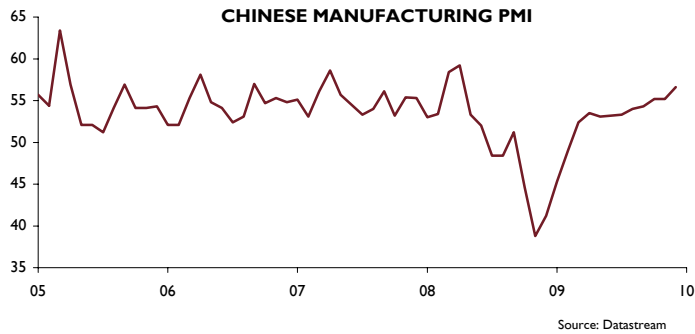
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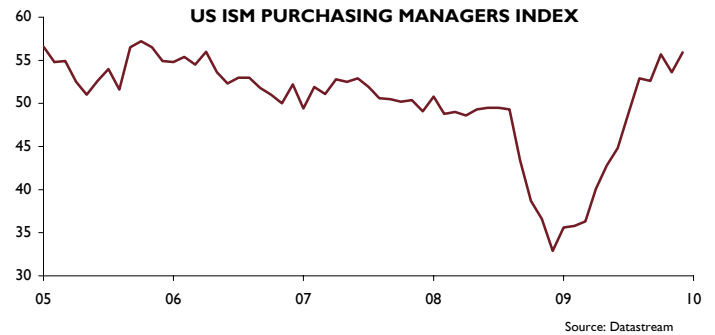
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# Charts of the Week

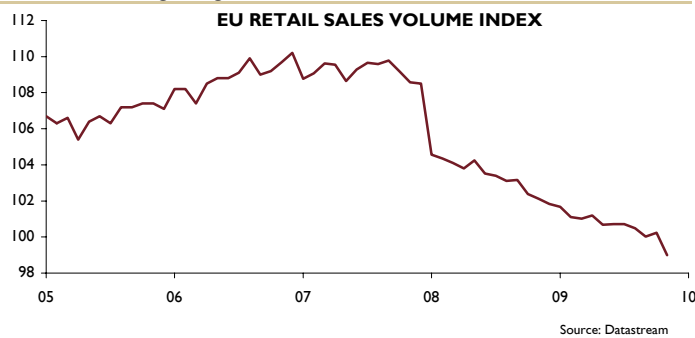
Chinese growth continues to steam ahead, generating concerns that inflationary problems may materialise this year.



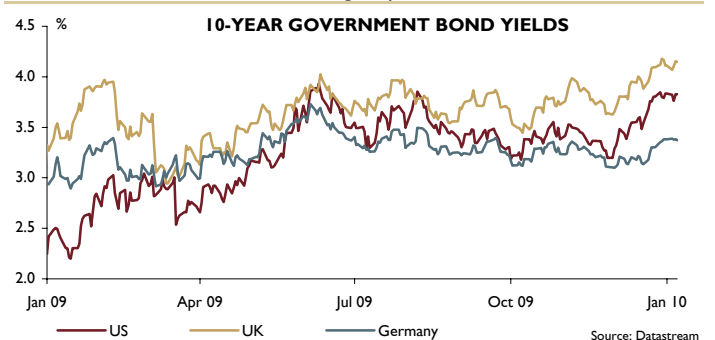
The US economy continues to deliver positive surprises with the strength of its recovery.



European domestic consumption continues to slump, suggesting the eurozone will lag the global economic rebound.



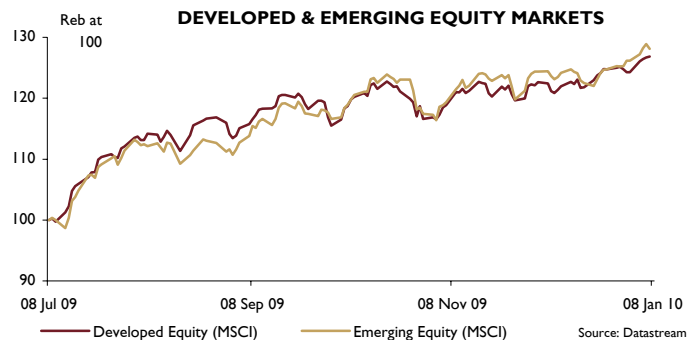
Rising sovereign bond yields reflect the economic recovery but also concerns about the scale of funding required.



# Market Performance

Equity Markets As of: 8-Jan-10	Current	Performance (% local)				
		-1W	-1M	-3M	YTD	09
<b>Developed Equity (MSCI)</b>	<b>853</b>	<b>2.5</b>	<b>5.1</b>	<b>6.3</b>	<b>2.5</b>	<b>22.8</b>
FTSE All Share	2,829	2.5	6.1	6.7	2.5	25.0
FTSE 100	5,534	2.2	6.0	7.4	2.2	22.1
S&P 500	1,145	2.7	4.9	7.5	2.7	23.5
Nasdaq Composite	2,317	2.1	6.6	9.1	2.1	43.9
DJ EuroStoxx	281	2.4	6.0	3.8	2.4	23.4
Nikkei 225	10,798	2.4	6.5	9.8	2.4	19.0
Hang Seng	22,297	1.9	1.1	3.7	1.9	52.0
<b>Emerging Equity (MSCI)</b>	<b>43,854</b>	<b>1.7</b>	<b>3.7</b>	<b>7.0</b>	<b>1.7</b>	<b>58.6</b>
BRIC (MSCI)	545	2.0	2.5	7.3	2.0	68.0

Source: Datastream



10-Year Bond Yields As of: 8-Jan-10	Current	Change (basis points)				
		-1W	-1M	-3M	YTD	09
US Treasuries	3.8	0	45	58	0	158
UK Gilts	4.2	5	35	71	5	102
Euro Bonds	3.4	0	24	26	0	44
Japanese Bonds	1.4	7	8	9	7	11

Source: Datastream

Commodity Markets As of: 8-Jan-10	Current	Performance (%)				
		-1W	-1M	-3M	YTD	09
<b>Commodities (TR)</b>	<b>286</b>	<b>2.3</b>	<b>6.5</b>	<b>9.2</b>	<b>2.3</b>	<b>18.9</b>
WTI Oil Price (Spot)	83	4.5	14.0	15.9	4.5	102.4
Gold Bullion (Spot)	1132	3.3	-2.2	7.2	3.3	27.1
Industrial Metals (TR)	352	0.6	7.2	13.6	0.6	80.0

Source: Datastream

# Interest Rates & Inflation

Inflation & Interest Rates		Current Inflation (%)	RBS Interest Rates Forecast (%)			Rate Announcement Next Date
			Current	Mar'10	Jun'10	
United States	(Fed Funds)	1.8	0.25	0.25	1.00	27-Jan
United Kingdom	(Base Rate)	1.9	0.50	0.50	0.50	04-Feb
Eurozone	(Repo Rate)	0.5	1.00	1.00	1.00	14-Jan
Japan	(Call Rate)	-1.9	0.10	0.10	0.10	26-Jan

Source: Coutts, RBS, Datastream

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