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Some Notes On The World Around US
World Equity Markets Towards 2011

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Over the last period (two months or so) there have been many positive reports confirming new economic growth or a slowdown in the contraction of various economic aggregates from many parts of the world, both developed and emerging. The following are just a few recent examples:

- The International Monetary Fund cut its projection for global write-downs on loans and investments by 15 percent to $3.4 trillion, citing improvements in credit markets and initial signs of economic growth.
- U.K. consumer confidence jumped in September by the most since 1995 as optimism about economic prospects rebounded.
- The Bank of Japan may decide as soon as next month to let its emergency corporate-debt buying programs expire as businesses regain access to private funding.
- The European Central Bank's second offer of 12-month loans may attract less than a third of the bids received in the first tender, indicating banks' need for extra cash has eased for now.
- Japanese manufacturers increased production for a sixth month in August, capping the longest stretch of gains in 12 years, as emergency spending by government's worldwide rekindled global trade.
- China's celebration of 60 years of Communist Party rule and an eight-day holiday may trigger a tourism boom, boosting consumer spending and helping the economy recover from its slowest growth in almost a decade. China's production has increased for the sixth month in a row.
- Australian retail sales, approvals to build private homes and bank mortgage lending jumped in August, stoking speculation the central bank will raise borrowing costs from a half-century low in coming weeks. Sales climbed 0.9 percent from July and approvals to build private houses increased 3.1 percent, the eighth consecutive month of gains. Bank lending rose 0.1 percent and loans to consumers buying houses jumped 0.6 percent.
- Federal Reserve Bank of Dallas said there's a limit to the "life support" the central bank can provide to boost U.S. housing, and suggested the industry is showing signs of bottoming.

- ❖ Employment in the U.S. is rebounding at a "significantly faster" pace than seasonally adjusted data on jobless claims would suggest.

It is reasonable to expect that these items of good (or better than expected) news will continue throughout 2010. It is indeed possible (and probable) that the emerging economies will show strong growth during 2010 (and beyond) while the developed nations lag (far) behind by showing a small positive growth rate during 2010 and 2011.

The developed world has given a large step (forward) to expand the G8 to G20 by including emerging market nations (South Africa is included). This reflects the relative strength and growing importance of the eastern and other emerging economies.

Well, the recovery in the first world economies has been so strong that the various reserve banks have been extremely concerned about the current level of stimulation present in those economies. During late September the Federal Reserve, the European Central Bank, the Swiss National Bank and the Bank of England announced that some of the emergency arrangements to provide liquidity to the money markets will be scaled back from October. This is a sure sign that money markets and the economic environment is returning to normality. In fact, this announcement was followed by a consolidation in the surge in world equity markets.

The average price/earnings multiple of United States stocks immediately before the crises of 2008 was 27. Currently US stocks are trading at a multiple of 18. At the peak of the internet boom the p/e was 43!!

The current world equity market environment can be summarized as follows:

- ❖ The world is in a good news environment which will probably last through 2010 to somewhere in 2011. Company and economic news in all major world centers will continue to break news better than expected or better than the recent history.
- ❖ In the US stocks are not particularly expensive. This is important because the US is probably the driver of world investment sentiment. In South Africa the p/e ratio of the Alsi 40 and the All Share Index is probably very close to the 10 year average.
- ❖ Money market funds in the US still hold many trillions of dollars that needs to be allocated to the equity market. This is likely true for most countries/economies.
- ❖ Lots of international investment cash is being allocated to the emerging markets. This is likely to continue throughout 2010. In SA we have received ZAR55billion this year so far. This is of course one of the reasons for the strong rand.
- ❖ International news reports and anecdotal evidence seems to indicate that many portfolio managers have missed the bull run of 2009.

The above facts may indicate that there will be many buyers if the equity markets are weaker during the next three to six months. This will translate to not much downside potential during this period. After the very strong run in world markets since early March 2009 (the Dow Jones Industrial Index increased from 6457 to 9712 as at close 30

September, an increase of almost 50%) one may expect a period of rest and very possibly some downside potential. How much? This note proposes that there is much potential demand for equities and that downside price potential is limited. Over the longer term (six to 18 months) we have a healthy economic environment that will stimulate equity markets.

Markets will remain volatile. Cheer up, things look much better. Internationally, risk appetite has improved significantly and will probably continue to do so during the next number of months. A selection of quality listed equities will not disappoint. And remember, cash does not have a real return.

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Sources
Various news items from the Financial Times and Bloomberg during late September 2009.