Monthly outlook – July

András Cserháti: Summer's here, and no problems?

Not every market has the same outlook mid-year

Half of 2009 has passed, and for now it seems that the capital markets have temporarily caught their breath after the horrors of January and February. The current rally, which is now in its fourth month, has pushed the Chicago Board Options Exchange volatility index, the VIX, back down to below 25.66 points, which is where it stood before the Lehman Brothers meltdown, the greatest bankruptcy of all time. The index, which in the past few days closed at as low as 25.33 points, has fallen 69% from its October peak, and 37% since the beginning of the year. Nevertheless, the current level is still high, at well over the 20 points that can be regarded as average. Investors are not entirely certain that there will be no more bad developments; they merely suspect that we are over the worst, but the majority remain uncertain about the likely speed of the recovery. And this uncertainty is understandable in the light of the events that have followed similar VIX levels in the past. In 1998 the "fear barometer" plunged to 25.95 points, then over the next two-and-a-half months, as a result of the Russian crisis and the collapse of U.S. hedge fund Long-Term Capital Management, the S&P 500 index fell 11%. At the end of March 2000 the volatility index stood at 25.47 points, following which the bursting of the dot.com bubble (exacerbated by the 2001 terror attacks) sent the bear market into freefall, plummeting 49% by autumn 2002. From then on, a rise of around 20% up to the end of the year was followed by another 15% fall, lasting until spring 2003, and only then was the way clear for a bull market that lasted four years. Another, similarly important gauge of sentiment, the equity put/call ratio, also shows that it is better to err on the side of caution, as after tentatively foraying into "bull" territory, it has today slipped back to the middle of the neutral zone.

Based on the performance of the US equities market over the past six months, we could perhaps even ask ourselves what all the fuss has been about, since investors are now in roughly the same position as they were on New Year's Eve 2008. In the meantime, the S&P 500 index has had its best quarter-year (+15.2%) since 1998, and the Nasdaq Composite index rewarded investors with growth of over 20%. Over the same period the price of oil rose by 41%, a rate unprecedented since the third quarter of 1990 when Iraq, under the rule of Saddam Hussein, invaded Kuwait.

The stock exchanges of old Europe, based on the performance of the FTSE EUROFIRST 300 index (disregarding the nosedives of January and February) bettered even the results of the Dow Jones Industrial Average and performed well in the first half-year, despite the fact that the continent is in a very deep recession. The steepest rises in the eurozone were produced by precisely the most risky countries: Austria (17.6%) and Greece (24.3%). Outside the eurozone, but still in the developed region of Europe, Norway achieved a 32.6% increase on the back of the spiralling oil price, and Denmark a 20.2% rise.

The optimistic sentiment was certainly lent buoyancy by the usual round of quarterly "window dressing", which, it can be presumed, was far more vigorous this year than in previous Junes, since the portfolios contained a high share of cash and several portfolio managers had reservations about the rally from the day it started. As its name suggests, window dressing, which is discussed in detail in a number of financial theories and other studies of financial behaviour, is where towards the end of the quarter the managers of portfolios sell the badly-performing shares and replace them with good performers, so that in their financial statements (effectively their window display) they can present a more favourable picture of themselves, by showing that they invested in the "star" stocks.

As regards the future, the upward trend may continue for a short while, but after this it is conceivable that proponents of both the bull and the bear scenarios (although the author is among those who expect to see a correction) will be disappointed, and the market will narrow to a thin band, which could form the basis for a rise in late 2009 or 2010. In March it was still possible to trade the shares at below the long-term P/E levels, but today this is no longer the case. The stock cannot be regarded as particularly cheap, and the reduction in yields means that corporate bond investments represent serious competition. As the rise became steeper, profit forecasts flattened out or fell. The American flash-report season could still hold surprises, where in the improving market environment favourable figures may even see the light of day, although it is generally held that in most cases the results will be worse. And to be frank, the growth in unemployment, which shows no signs of abating, and the tendency to save as a result of the crisis do not bode well for an upturn in consumption any time soon. At this moment there is no true fundamental catalyst that could drive the market significantly above its current level.

The situation is different in East Asia, however, especially in China. Here the recession really does seem to be V-shaped. The latest, seasonally adjusted Chinese Purchasing Managers' Index for June rose to 53.2 points from the May figure of 53.1. These values of over 50 points indicate an upturn in economic growth. China's industrial output is rising for the fourth consecutive month, the CNY 4 trillion (USD 585 billion) economic stimulus program is working, and bank lending is at a record level. The volume of new bank loans disbursed in the first five months of the year was almost three times that of the same period of the previous year. However, the growth in the Chinese economy is not only taking the form of an expansion in the domestic market, as the increase in export orders is also highly encouraging, this being a crucial factor for a country that is still highly dependent on its foreign markets. The Shanghai Composite Index topped 3,000 points for the first time this year, and commodity prices have also started to rise. The price of copper has shot up (due to growing demand in the automotive and construction industries), displaying the steepest price increase of the past 22 years. In the third and fourth quarters the Chinese economy is certain to keep on growing, and this year's target of 8% economic growth is now achievable. However, despite being the world's third-largest economy, in itself China is insufficient to pull everyone else out of the morass; the most it can do is speed up the global stabilisation process. The Shanghai Composite Index jumped 66/% higher over the half-year, while the markets of the "other Chinas", Hong-Kong and Taiwan, also performed well, although they rose by "a mere" 24.4% and 38.8% respectively. Fortunately, similarly to China, several other Asian countries have also produced good figures. The old BRIC favourite India rose by almost 50%, while Indonesia displayed growth of 55.1%, and Thailand 31.8%. Other Asian markets such as Australia, Malaysia, Pakistan, South-Korea and Singapore, also produced double-digit increases. The greatest disappointment of the region was (once again) Japan, which was chosen by numerous international investors (to their subsequent chagrin) as their number-one market for 2009. The Nikkei 225 only managed a lacklustre 2.9% rise.

In the past six months the economic problems of the new, emerging Europe (Central and Eastern Europe) have caused serious headaches both for their own governments and those of the developed European nations, notable examples being Ukraine, the Baltic States and Hungary. Despite the problems, the Hungarian equities market swelled by 20% in the first half, accompanied by a 2.13% fall in the CETOP20 Index over the same period. The second quarter, which ended with the weaker performance of June, brought a long-unprecedented rise in the stock markets, mainly due to the previous overselling, the recapitalisation of banks in the mature economies, a certain degree of improvement in the US economy, the strengthening of Chinese growth, the return of appetites for risk and the rising oil price. Travelling farther south, Turkey rose by 32.4% in dollar terms despite the increasingly turbulent political situation and the lack of any easing in tensions between the secular and religious parties. But it was Russia's star, an all too common sight in Hungary in times gone by, that shone the brightest at the midpoint of the year. This formerly troubled market achieved a prodigious rise of 51.8% in dollar terms.

Latin America performed excellently in the first half of 2009. Brazil, one of the BRIC nations, and the non-BRIC Chile, both displayed rises of over 50% in dollar terms. The marked increase in the value of natural resources also contributed greatly to the rallies in these countries. Argentina, Venezuela and Columbia were not far behind, with rises of 30.4%, 33% and 34% respectively. Mexico, which is closely intertwined with the US economy and was the epicentre of the breakout of the H1N1 strain of swine flu, only saw a “mini rally” of 10.2%. The movements in stock prices in the Latin American markets are closely interrelated with movements in the commodities market; and therefore, assuming the raw-materials market supercycle that began in 2001 will continue, the Latin American markets could keep on performing as brilliantly as they have to date.

Although Africa and the Middle-East still remain absent from many investors’ portfolios, a number of surprisingly well-performing stock markets can be found here as well, half way through the year. Israel, Egypt, the Kingdom of Saudi Arabia and the South African Republic jumped 36%, 19.7%, 16.9% and 19.8% respectively. However, we should bear in mind that despite the impressive numbers, the Middle-Eastern region remains a potential source of serious tension.

The EUR/HUF exchange rate has been through a lot in the past six months. After opening at HUF 265.60 to the euro in January, the forint weakened to 317.22, before recovering to 272.31 by the end of the half-year. Yields rose and then fell in line with the changes in the exchange rate. At the end of the first half, similarly to the beginning of the year, all reference yields dropped below 10%; but the returns on 10 and 15-year reference bonds rose in comparison to January, and the yields on 3, 5, 10 and 15-year government bonds have to all intents and purposes fused together at a level of 9.75%. As a result, the MAX Composite Index, even managing to compensate for the fall in prices caused by the enormous yield hikes of January and February, had risen by 3.2% at the end of the half-year. In June the international markets stabilised, and much of the din also abated on the home front. The restrained market atmosphere in the first half of the month also entailed a lack of any serious demand; then at the end of June the government securities portfolios of foreign investors, following the expiry of a sizeable proportion of the securities, hit a new low. Against this backdrop of declining volatility, the end of the month saw an upsurge in the forint carry trade, with the high interest differential attracting short-term investors, which has in turn led to a fall in yields. At the end of June the State Debt Management Centre raised the quantities of bonds it plans to issue, and this has so far been met with a positive reception. If this can be kept up and the state can sustainably return to financing itself from the market, the National Bank of Hungary will also have the scope to be bolder in reducing its base rate, which could result in a substantial strengthening, this time primarily in the case of the far more oversold, long maturities.

Prepared by AEGON Magyarország Befektetési Alapkezelő Zrt. (1091 Budapest, Üllői út 1.)
András Cserháti – Senior Product Manager
Supervisory authority: Hungarian Financial Supervisory Authority