BANKING / INVESTMENTS \ ADVISORY

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Global Financial Market: Topical Issues in August

Contents

Results of August 2012

Macroeconomic reports published in August, including data on GDP of many European countries for Q2 2012, confirmed weakening of the global economic process, especially in developed Europe.

GDP in the euro zone fell by 0.2% (q/q), while in Portugal it fell by 1.2%, in Cyprus – by 0.8%, in Italy – by 0.7%, and in Spain – by 0.4% (data for Ireland and Greece are not yet available, but in Greece it is expected to fall by 6.2% y/y).

The situation in the global manufacturing sector is extremely difficult now, since the problems long existing in European countries started to occur in the USA and are even encountered by the locomotive of world production – China.

At the corporate level, the situation is also far from the best. According to the reports for Q2 2012, US S&P 500 companies showed an increase in profits by 0.05% (compared to +7% in the previous quarter).

Much worse were the reports of European corporations, and the companies of BE 500 index (the 500 largest companies in Europe) demonstrated an average drop in quarterly profit almost by 10.8%!

But the focus of financial markets players in August was still the debt crisis in the euro zone. But this time the month was relatively quiet, with no serious negative news.

Absence of serious negative information allowed most stock markets in August to continue growing, and the MSCI World Index rose by 2.3% over the month after rising by 1.2% in July and 4.9% in June.

At the same time, the situation in the stock market of developing countries in August was less positive, and due to the fall of China and Hong Kong markets MSCI EM index closed the month with a decrease by 0.5%.

In the currency market, August was marked by the dollar weakening against most major developed and emerging currencies, but the magnitude of movement was negligible.

The precious metals markets, on the contrary, displayed significant price movements against the dollar, and all the metals showed a considerable increase: silver by 13.2%, platinum by 8.6%, palladium by 6.5%, and gold by 4.8%.

In the oil market, significant increase in prices continued in August, and the price of barrel of Brent rose by 7.5%, after rising by almost 11% in July, reaching $115. The spread between Brent and WTI also continued to expand, reaching $20 by the end of the month.

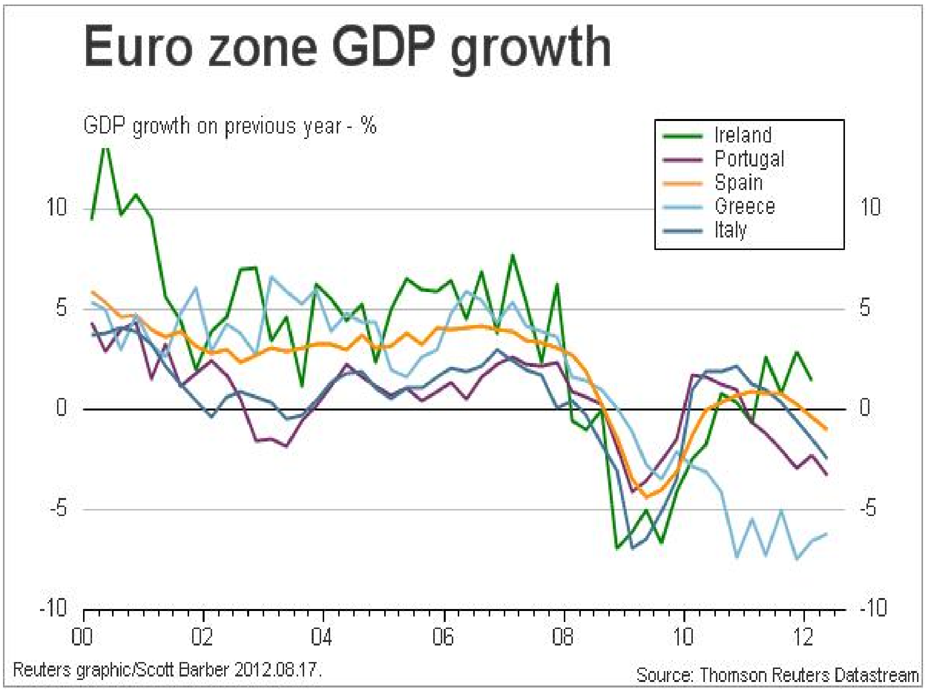
Situation in financial and economic system

Macroeconomic reports published in August, including data on GDP of most European countries for Q2 2012, evidenced continued weakening of the global economic process, especially in developed Europe.

In Q2 2012, euro zone economy fell by 0.2% after zero growth in Q1 2012 and falling by 0.3% in Q4 2011, and we can talk about the zone economy re-entry into recession after the deep recession of 2008-2009.

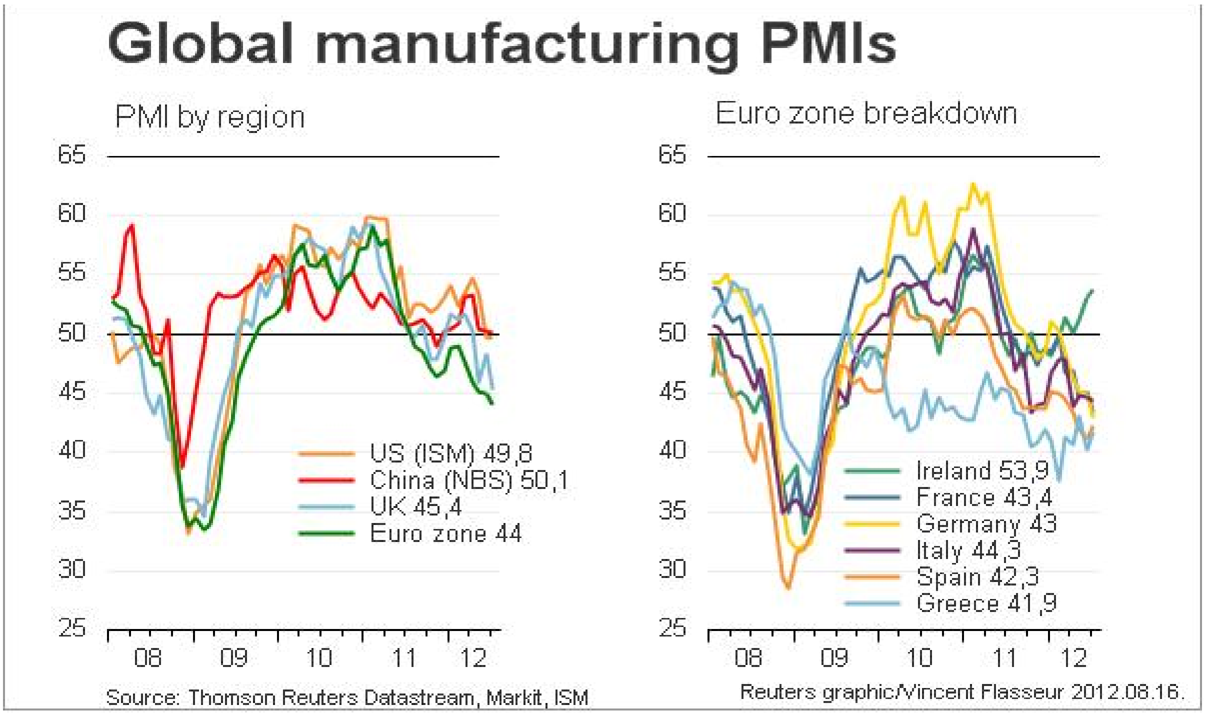
As for the troubled euro zone economies, most of those went into recession earlier, and deep enough (see Fig. 1).

Fig. 1. Dynamics of GDP changes in the euro zone countries y/y.



Stagnant trends are currently observed in the global manufacturing sector, where the vast majority of the world's leading economies face a decline in the indexes of business activity below the equilibrium level of 50 (see Fig. 2).

Fig. 2. Dynamics of the movement of index of business activity in manufacturing of some world countries



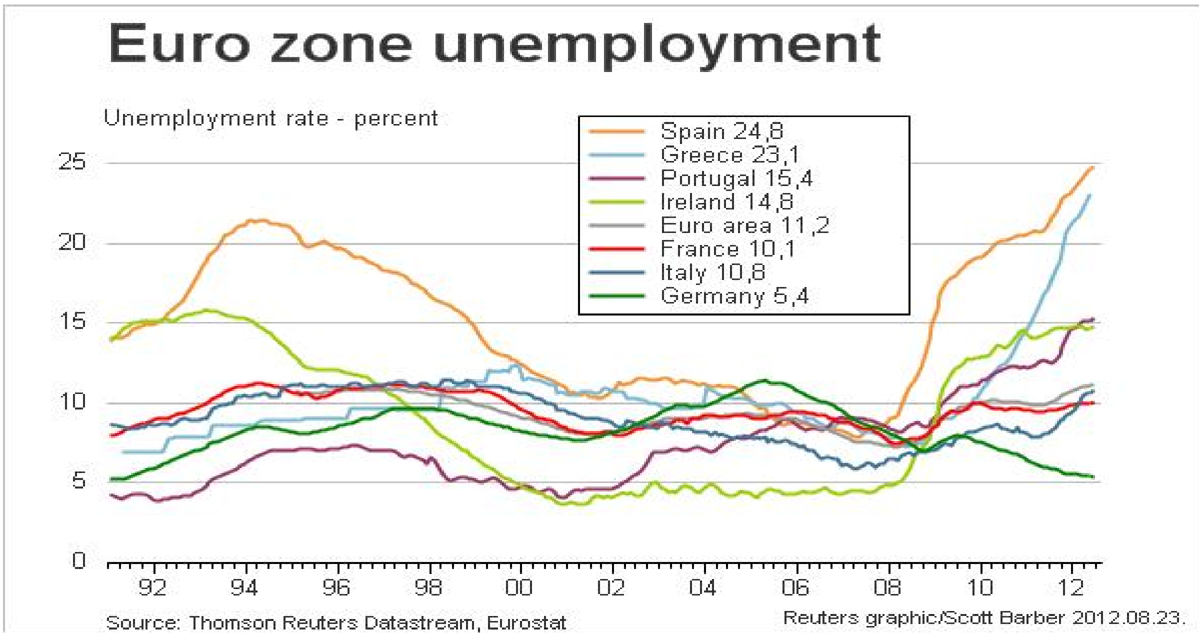
In turn, the US index of manufacturing activity in August was 49.6, for the third consecutive month pointing to a decline in the sector, resumed for the first time since August 2009.

Problems in the sector have also affected the locomotive of world production – China, where the PMI in August, according to both HSBC and the government, fell to the lowest level since November 2011.

The former to 47.8 for the second month in a row being below the level 50, and the latter to 49.2, dropping below the equilibrium level for the first time in the last 9 months.

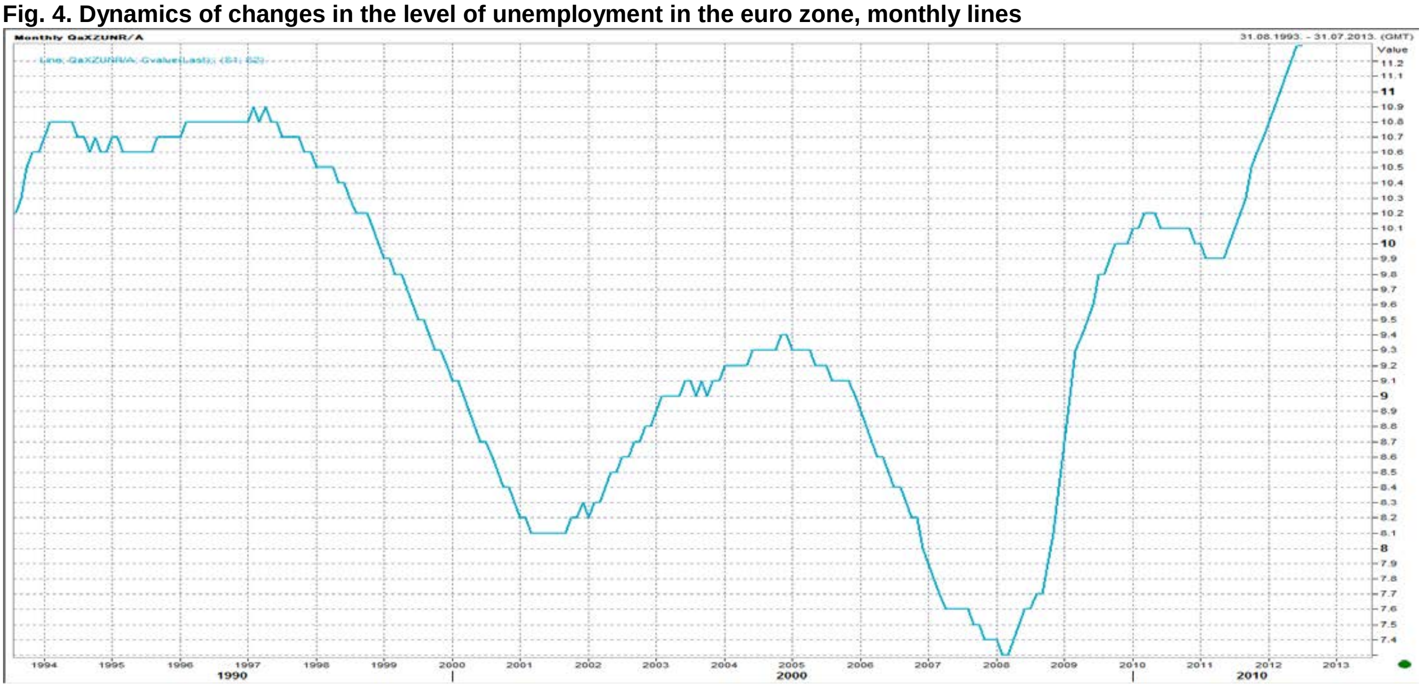
Another serious problem for the global economic process is the increase in unemployment, especially in the troubled euro zone countries (see Fig. 3).

Fig. 3. Dynamics of changes in the unemployment rate of some euro zone countries



Whereas data on unemployment in the euro zone in July, published in August, showed another historical record of 11.3% (see Fig. 4).

Fig. 4. Dynamics of changes in the level of unemployment in the euro zone, monthly lines



Source: Thomson Reuters

In August, unemployment also rose in the USA for the second time in three months – to the level of 8.3% (see Fig. 5).

Fig. 5. Dynamics of changes in the level of unemployment in the USA

Source: Thomson Reuters

Source: Bloomberg

In this situation, the FRS Chairman Ben Bernanke in a speech on August 31 gave a strong signal of a possible decision by the central bank on new incentives at a meeting on September 13.

Quite possibly, it will extend the period of low interest rates from 2014 to 2015, and perhaps the long-awaited launch of the program QE3.

But, in our opinion, a more productive step to help the economy would be a step similar to the July ECB measures.

That is, cancellation of interest payments on excess reserves of commercial banks, held with the central bank (currently 0.25% on almost $ 1.5 trillion!), which would be an additional incentive for banks to strengthen lending to the real economy.

Debt crisis in the euro zone: is there a way out?

The debt crisis in the euro zone is raging for more than two and a half years, representing a very negative impact on the global economic process and the situation in the global financial markets. Troubled countries of the euro zone have repeatedly entered deep recession, and growth of the leading countries' GDP has slowed sharply.

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Global stock market

Lack of serious negatives allowed most of the leading global stock markets to continue to grow in August and close the month with price increases (see Fig. 8).

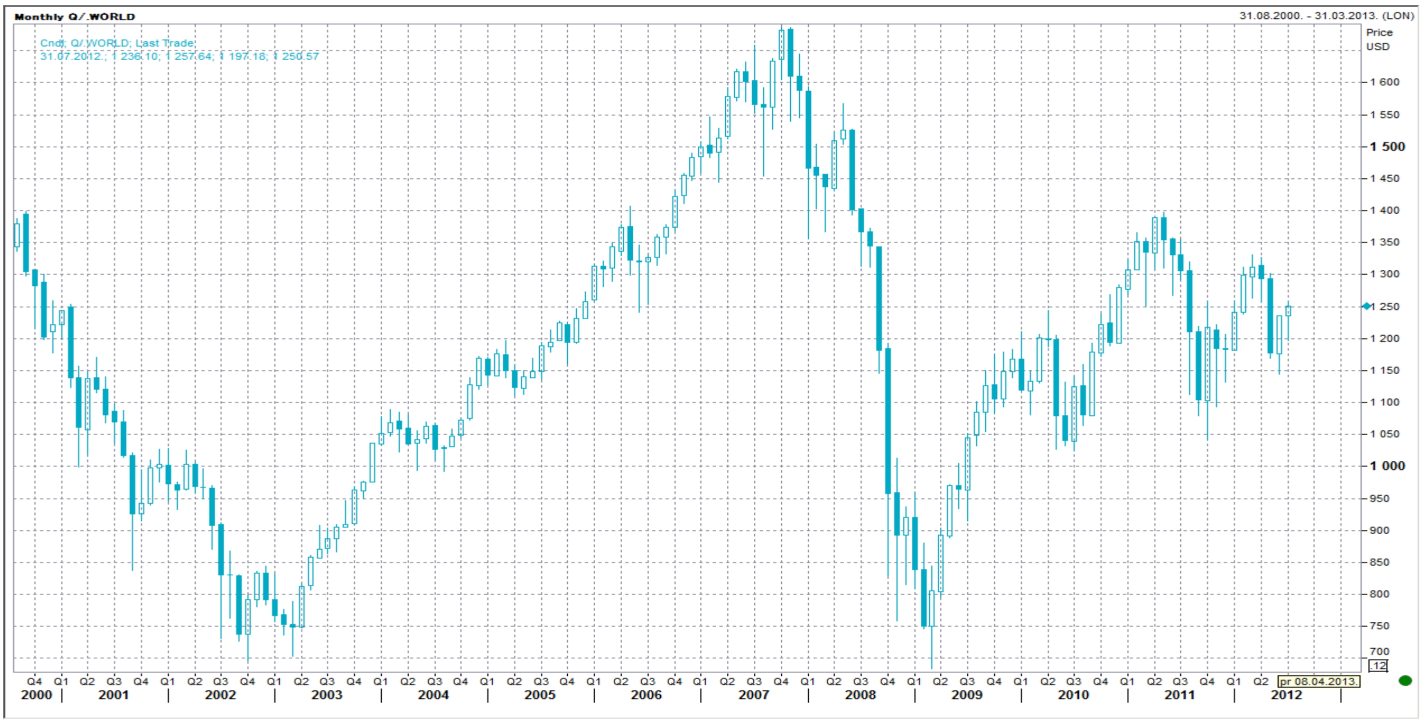
Fig. 8. The dynamics of movements of several leading world stock market indexes

Stock index	P/E	Div. Yield	2003-2007	2008	2009	2010	2011	Q1 2012	Q2 2012	July 2012	August 2012	Since the beginning of 2012
DJI (USA)	12.7	2.6	59.0%	-33.8%	18.8%	11.0%	5.5%	8.1%	-2.5%	1.0%	0.6%	7.1%
S&P 500 (USA)	13.4	2.1	66.9%	-38.5%	23.5%	12.7%	0.0%	12.0%	-3.3%	1.2%	2.0%	11.9%
Nasdaq Comp. (USA)	16.1	1.1	98.6%	-40.5%	43.9%	16.9%	-1.8%	18.7%	-5.0%	0.1%	4.3%	17.7%
GDAX (Germany)	13.8	3.5	178.9%	-40.4%	23.8%	16.1%	-14.7%	17.8%	-7.6%	5.5%	2.9%	18.2%
FTSE (UK)	10.6	4.2	61.5%	-31.0%	23.2%	9.0%	-5.6%	3.5%	-3.4%	1.1%	1.3%	2.5%
CAC (France)	10.1	5.9	83.2%	-42.7%	22.3%	-3.4%	-17.0%	8.4%	-6.7%	3.2%	3.1%	7.7%
N225 (Japan)	21.5	2.3	78.4%	-42.1%	19.0%	-3.0%	-17.3%	19.3%	-10.7%	-3.5%	1.7%	4.5%
RTS (Russia)	4.8	3.7	537.9%	-72.4%	128.6%	22.5%	-22.0%	18.8%	-17.7%	2.0%	0.9%	0.7%
MICEX (Russia)	4.4	3.8	492.3%	-67.2%	121.1%	23.2%	-16.9%	8.3%	-8.7%	1.5%	1.1%	1.4%
SSEC (China)	16	1	287.4%	-65.4%	80.0%	-14.3%	-21.7%	2.9%	-1.6%	-5.5%	-2.7%	-6.9%
HSI (Hong Kong)	9.2	3.1	198.4%	-48.3%	52.0%	5.3%	-20.0%	11.5%	-5.4%	1.8%	-1.6%	5.7%
KOSPI (Korea)	20.3	1.4	202.3%	-40.7%	49.7%	21.9%	-11.0%	10.4%	-7.9%	1.5%	1.3%	4.4%
TWII (Taiwan)	21.6	4.4	91.0%	-46.0%	78.3%	9.6%	-21.2%	12.9%	-8.6%	-0.4%	1.7%	4.6%
SENSEX (India)	14.1	1.5	500.7%	-52.4%	81.0%	17.4%	-24.6%	12.6%	0.1%	-1.1%	0.8%	12.5%
BOVESPA (Brazil)	11.8	4.6	467.0%	-41.2%	82.7%	1.0%	-18.1%	13.7%	-15.7%	3.2%	1.7%	0.5%
IPC (Mexico)	15.7	1.5	382.1%	-24.2%	43.5%	20.0%	-3.8%	6.6%	1.7%	1.3%	-3.2%	6.3%
TOP40 (South Africa)	11.2	3.4	202.4%	-25.9%	28.6%	14.6%	-0.6%	4.0%	0.1%	2.5%	2.6%	9.5%
MSCI WD (world)			100.6%	-42.1%	27.0%	9.6%	-7.7%	11.0%	-5.9%	1.2%	2.3%	8.2%
MSCI EM (emerging)			326.6%	-54.5%	74.4%	16.4%	-20.4%	13.6%	-10.0%	1.6%	-0.5%	3.4%

Source: Thomson Reuters,Bloomberg, ABLV Bank

While MSCI World Index rose by 2.3% over the month, following the growth by 1.2% in July and by 4.9% in June by 1.2% over July, rising since the beginning of the year by 8.2% (see Fig. 9).

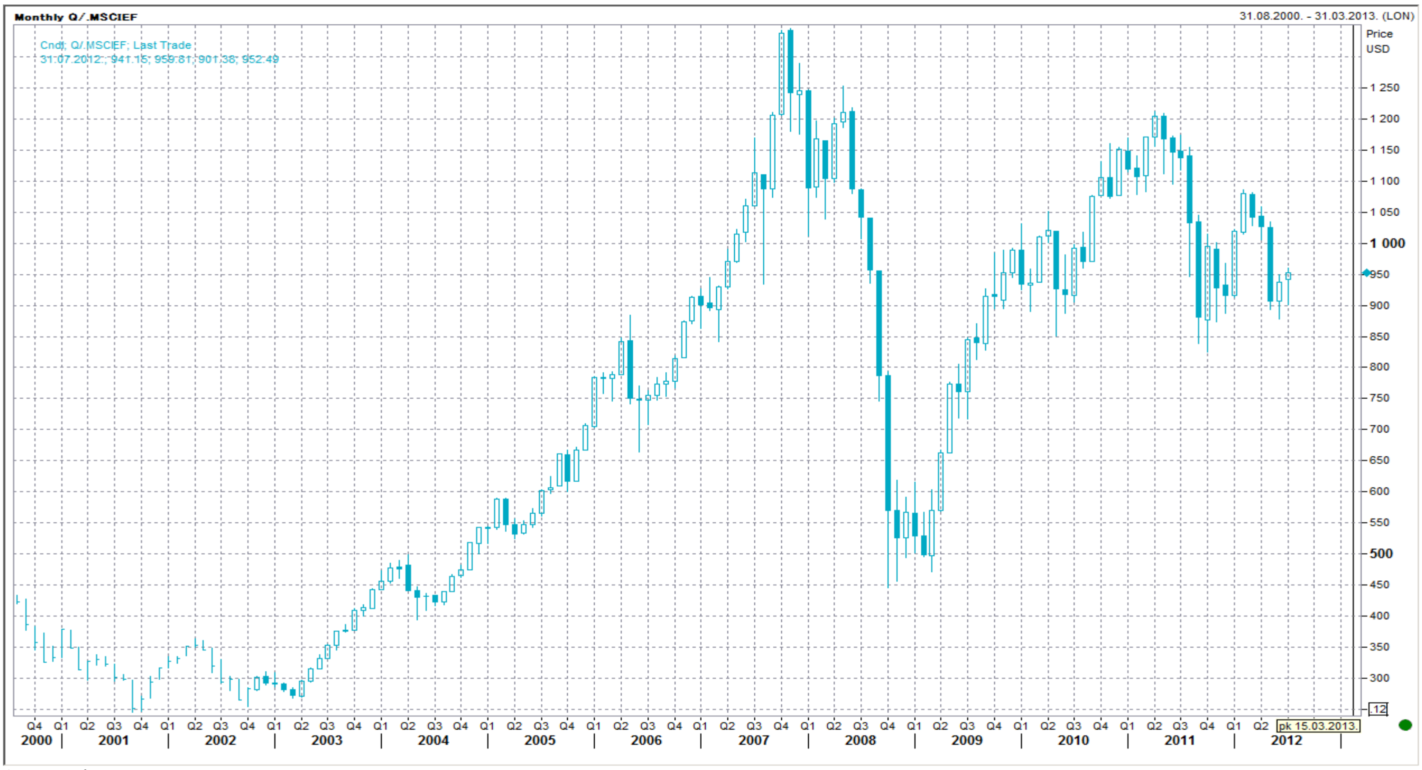
Fig. 9. Dynamics of the MSCI WORLD index, monthly bars



Source: Thomson Reuters

The situation in the stock market of developing countries in August was less positive, and due to the fall of China and Hong Kong markets MSCI EM index closed the month with a decrease by 0.5% (see Fig. 10), and its increase since the beginning of the year is just 3.4%.

Fig. 10. Dynamics of the MSCI EMERGING MARKETS index, monthly bars



Source: Thomson Reuters

The highest growth among leading world indexes monitored by us in July was shown by US high-tech stock index NASDAQ, which grew over the month by 4.3% (see Fig. 11). This allowed the index to become one of the leaders since the beginning of the year +17.7% (DAX +18.2%).

Fig. 11. Dynamics of NASDAQ index, monthly bars

Source: Thomson Reuters

The largest decline among indexes monitored by us, just like in July, was demonstrated by the Chinese SSEC, which fell in August by 2.7%, after falling by 5.5% in July and by 6.2% in June (see Fig. 12), which ensured this index the worst dynamics since the beginning of the year: -6.9%. Additional negative on the market, of course, is brought by the anticipated slowdown in the Chinese economy.

Fig. 12. Dynamics of SSEC index, monthly bars

Source: Thomson Reuters

Russia's RTS showed in August one of the worst dynamics and grew by only 0.9% (see Fig. 13), which, however, allowed it to return above the opening level of the year.

Fig. 13. Dynamics of RTS index, monthly bars

Source: Thomson Reuters

Our assessment of future scenarios

The situation in the global stock market remains highly volatile, and the strengthening of the debt crisis in the euro zone may return strong negative trends to the market.

However, one can continue to adhere to our proposed strategy for entering the market, choosing the "strong" companies (or indexes) with low P/E and high Div. Yield (see table).

Even if strong negative trends return to the market, the high level of dividends will allow investors to outwait the period of market decline, receiving a steady cash flow in the form of dividends, which currently exceeds yield under government bonds of the leading countries.

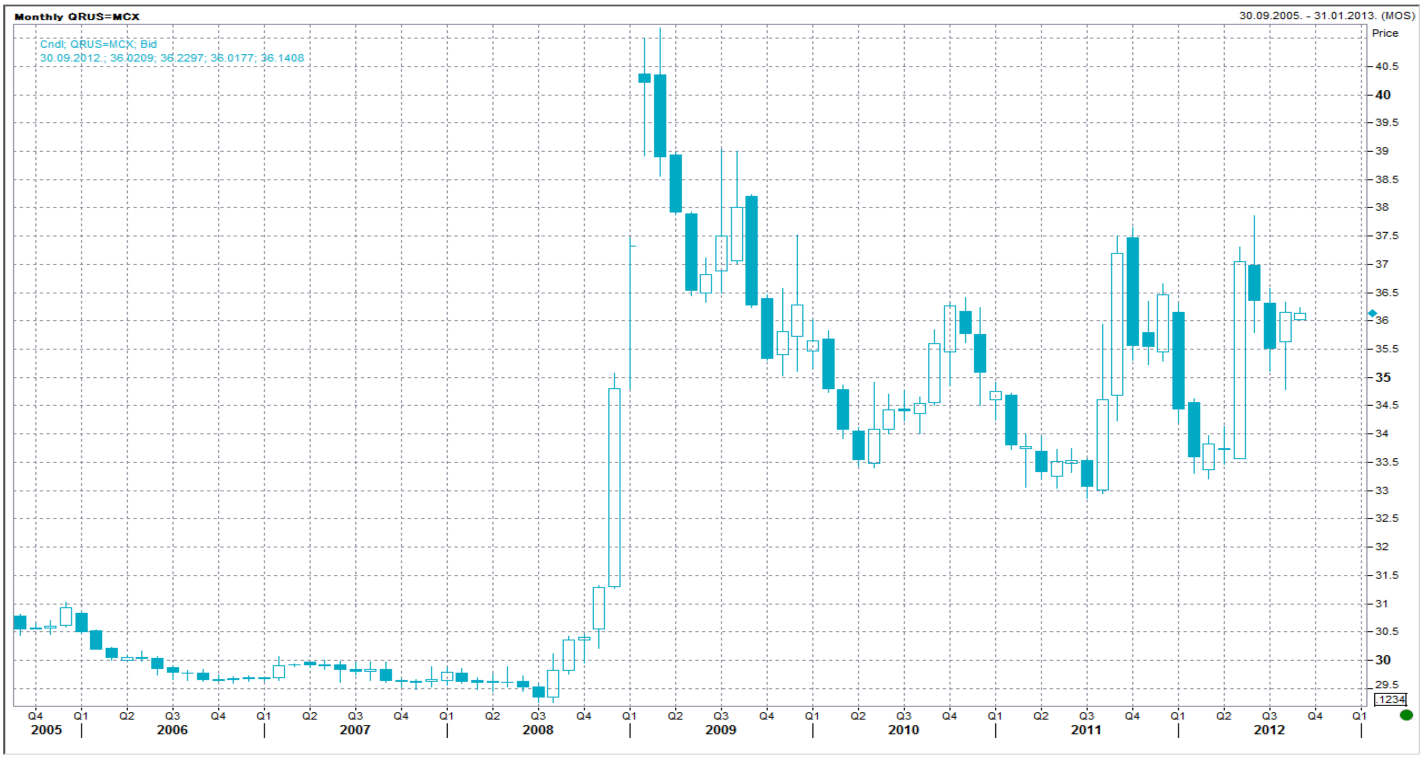
Whereas in case growth is resumed, the investor will gain considerable profit due to increase in stock prices.

Global currency market

In the currency market, August was marked by the dollar falling against most major developed and emerging currencies, but the magnitude of movement was negligible.

Russian rouble closed the month with almost no change to the dollar, but fell to the euro-dollar basket nearly by 2% (see Fig. 18).

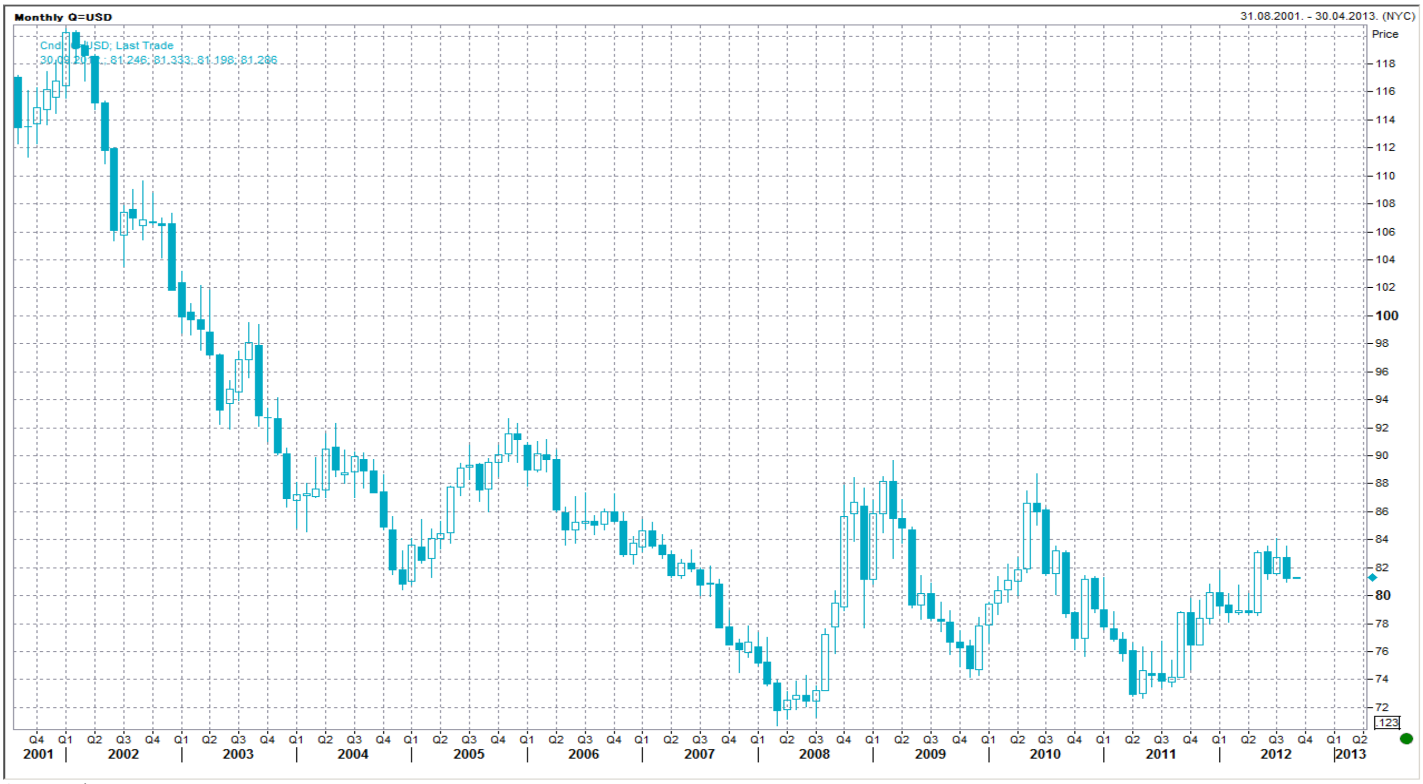
Fig. 18. Dynamics of the Russian rouble to euro-dollar basket, monthly bars



Source: Thomson Reuters

The dollar index – dollar's rate against six leading world currencies – closed August with a decrease by 1.8% (see Fig. 19).

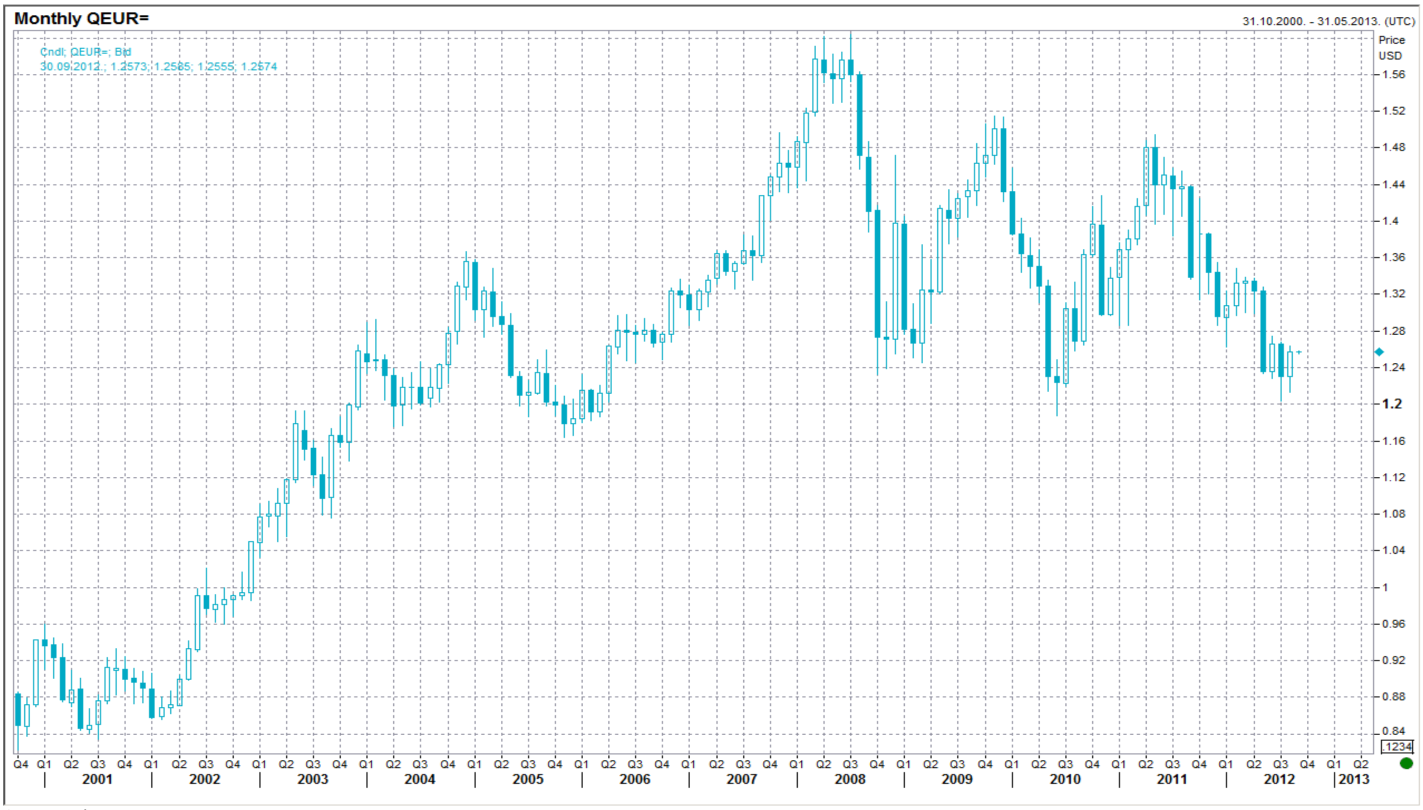
Fig. 19. Dollar index dynamics, monthly bars



Source: Thomson Reuters

As for the main rival of the dollar – euro, the US currency lost 2.2% over the month, following an increase by 2.7% in July (see Fig. 20).

Fig. 20. Dynamics of euro against dollar, monthly bars



Source: Thomson Reuters

Our assessment of future scenarios

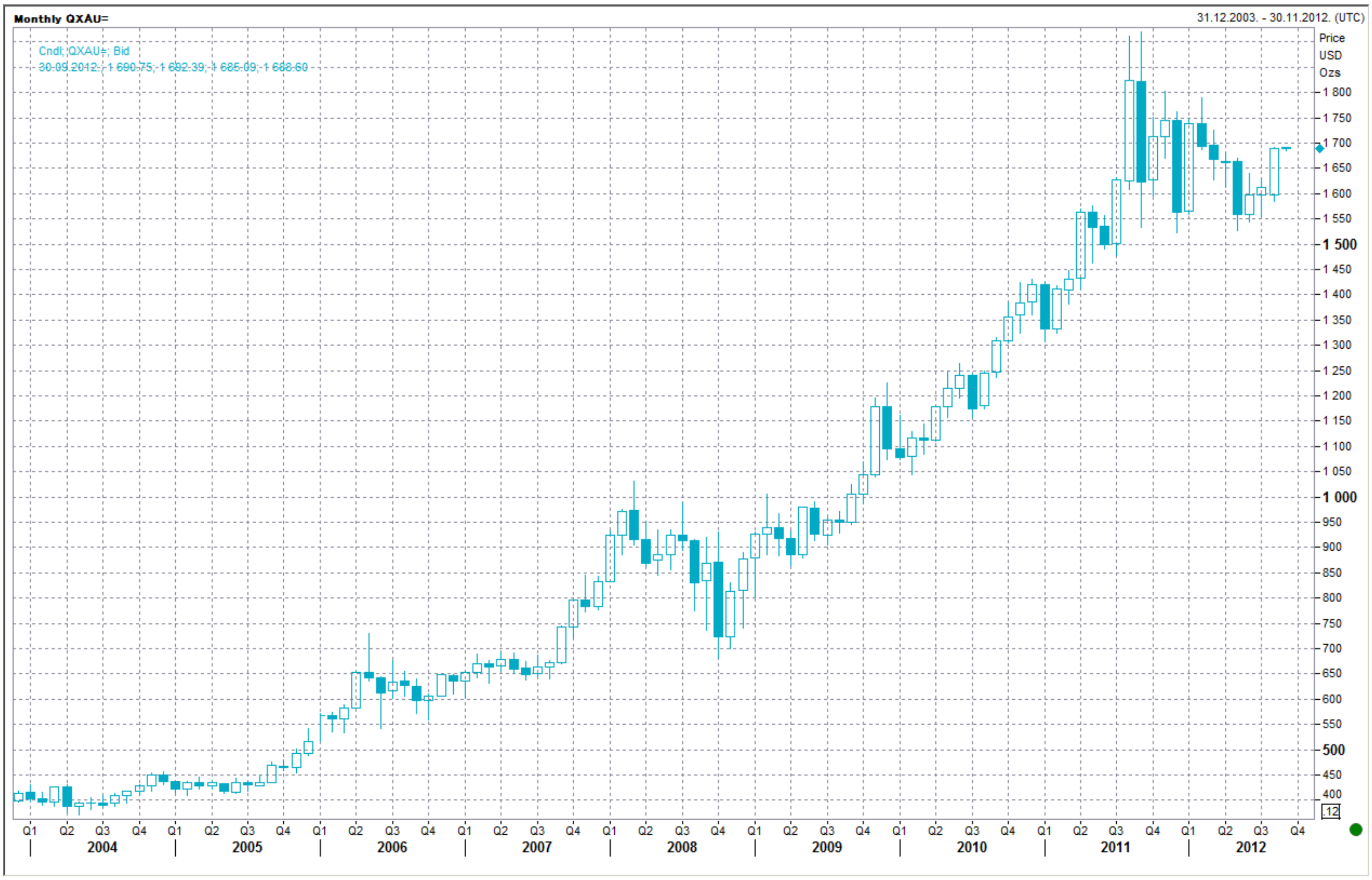
Our main scenario for the euro-dollar market remains unchanged. According to this scenario, the dollar minimum reached in July 2008 at the level of 1.6040 EUR/USD is the end point of the long-term trend of the dollar falling and the beginning of the trend for its long-term growth.

Consequently, we do not change our fundamental outlook for the market, according to which exchange of the euro to the dollar will fall to parity-close levels (1 EUR/USD) in 1-1.5 years.

Gold

In the gold market, August was the third consecutive month of rising prices. The growth in August was significant – by 4.8% (see Fig. 21), and the price of an ounce has almost reached the level of $1750.

Fig. 21. Dynamics of gold prices, monthly bars



Source: Thomson Reuters

Our assessment of future scenarios

Gold prices have already entered the corridor of $1750-$2000 per ounce, which at the beginning of the year 2011 was considered in our reviews a target one for the current growth trend and a level where the basis for the trend reversal will be formed. However, given the strength of the growth trend, it is still very likely that prices will continue to grow, reaching the level of $2000-$2500 per ounce. From a technical point of view, the current growth trend can be considered active until support zone of $1400-$1500 is not broken.

But it should be noted that the movement in gold prices in recent years is strikingly speculative, and prices are unlikely to remain at high levels for long periods of time. Later, we are likely to see a rapid fall in prices, often observed in other speculative bubbles. Of course, it is possible that prices do not go back to previous levels of $300-$400 per ounce, but return to levels near $1000 is very likely.

A possible signal for the bubble break can be a sharp rise in prices for a short time, similar to the silver price movements in February-April 2011, but with greater amplitude and during a shorter time.

Silver

Trends in the silver market in August were even more positive, and there was recorded the most significant increase in prices of precious metals – by 13.2%. Here, too, there was a slight increase in prices – by 1.6% (see Fig. 22).

Fig. 22. Dynamics of silver prices, monthly bars

Source: Thomson Reuters

Our assessment of future scenarios

The sharp rise and the subsequent strong drop in the price of silver in 2011 indicate that the price bubble of 2010-2011 actually burst in this market. However, the dynamics of further movement in prices is still uncertain and may depend on price movements in the gold market.

Platinum

In August, the price of platinum has also shown significant growth – by 8.6%, and the price of an ounce exceeded $1500 (see Fig. 23).

Fig. 23. Dynamics of platinum prices, monthly bars

Source: Thomson Reuters

Our assessment of future scenarios

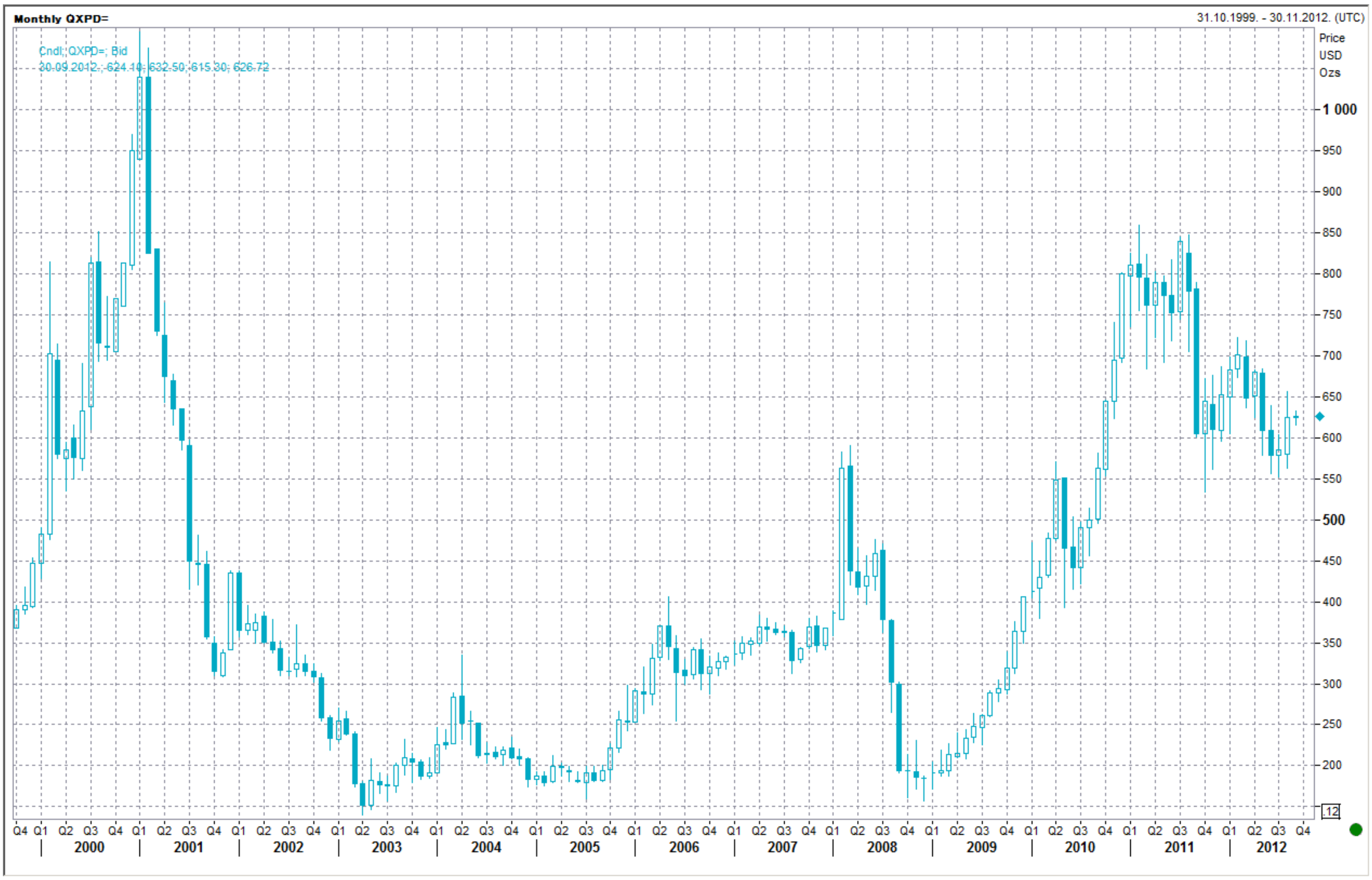
Giving forecasts for the movements in the platinum market, it should be noted that in 2004-2008 the speculators have already "played" the market. In 2004, after many years of history the price of platinum diverged from gold price and soared almost 3 times over 4 years (by 200%), and then fell by 65% in 2008 (i.e., again nearly three times).

After 2008, the correlation between the markets of platinum and gold was resumed, but now gold shows larger growth. We expect that in case gold prices resume growth and reach the range of $2000-$2500 per ounce, platinum prices will increase as well, but their growth will be less significant.

Palladium

Palladium in August, like all other precious metals, has shown remarkable growth – by 6.5%, and the price of an ounce was back above the important growth support level of $600 (see Fig. 24).

Fig. 24. Dynamics of palladium prices, monthly bars



Source: Thomson Reuters

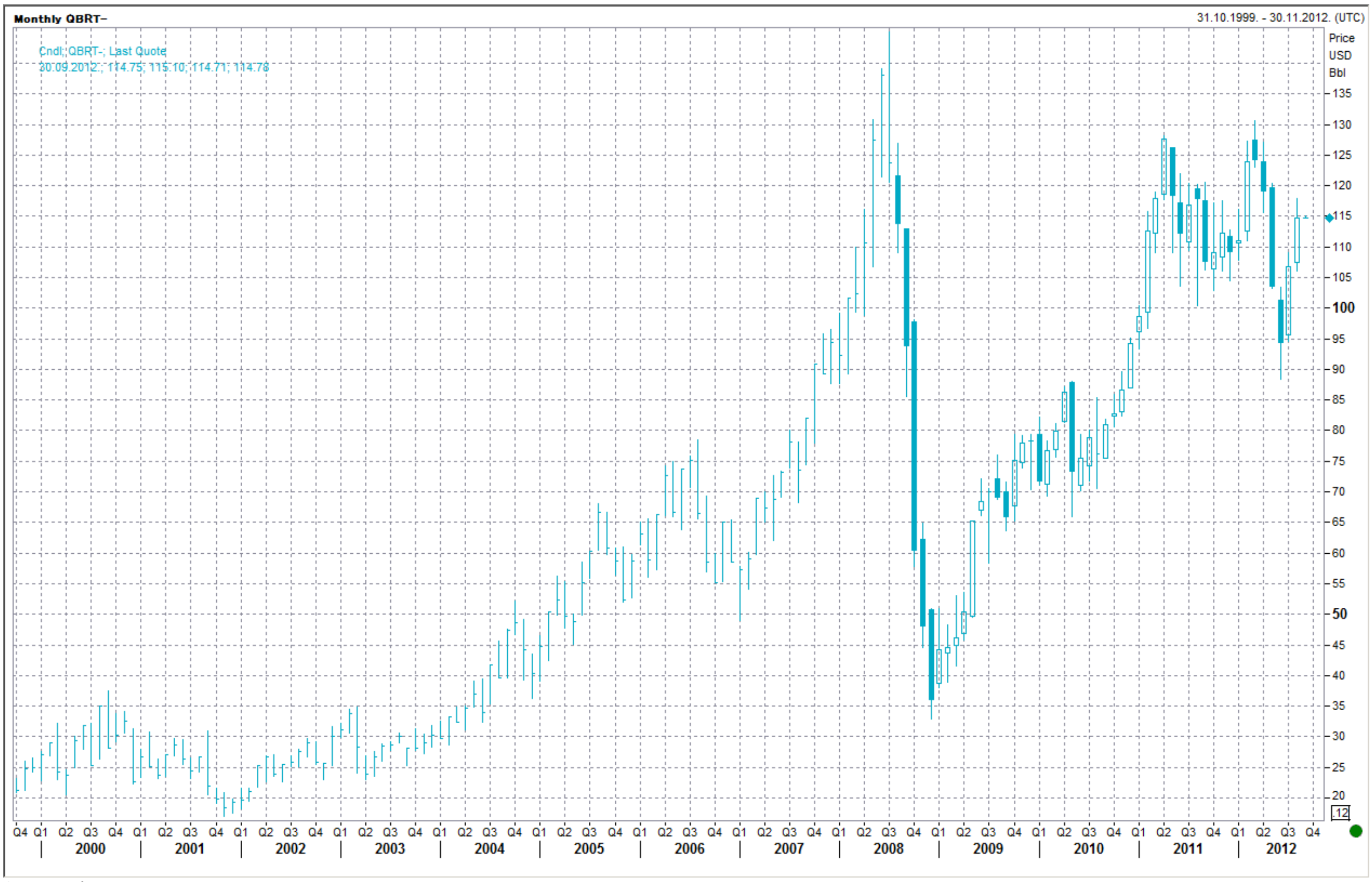
Our assessment of future scenarios

Palladium market has already experienced its "bubbling" – in 1998-2001 price of an ounce increased more than 5 times (by 400%), and then dropped 5 times in 2002-2003. Since 2009, there is a new, more moderate growth trend observed in this market. And after the correction in August - October 2011 from $850 to $550 per ounce, we expect further consolidation movement in the corridor of $550-$750 per ounce, followed by a more likely resumption of growth in prices.

Oil

In the oil market, significant increase in prices continued in August, and the price of barrel of Brent rose by 7.5%, after rising by almost 11% in July, reaching $115 (see Fig. 25). The spread between Brent and WTI also continued to expand, rising from $17 to $20 over the month.

Fig. 25. Brent price dynamics, monthly bars



Source: Thomson Reuters

Our assessment of future scenarios

Movements in May–June have confirmed our expectations of the organization of medium-term price correction in the market, with their drop below $100 a barrel. However, our expectations of further price consolidation in the corridor of $85 - $105 per barrel during several months were not confirmed. But we also do not expect prices to reach new local maximums, and we consider lateral movement of prices in the wider corridor with the upper level near $100 a barrel to be the most likely scenario.

Review information

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