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"Is the Patient Starting to Respond?"

Could it be that the extraordinary determination of policy makers to halt the freefall in the world economic activity might just be starting to produce results? The combination of ultra-low interest rates, massive fiscal stimuli, state guarantees for banks and the ultimate central bank weapon, quantitative easing could at last be appearing to slow the rate of the fall. In response, Purchasing Managers Indices, an early sign of corporate buying intentions, have begun to recover; housing activity has stopped falling and despite the disappointing retail sales in March, consumption appears to be steadying. Less bad data by no means suggests that the ingredients for a rebound are necessarily in place, but the first quarter's panic-driven collapse in activity is hopefully behind us.

Financial markets so often respond well ahead of the real economy, reflected in the strong rally in equities seen during the second quarter from the March lows. Corporate bonds (especially bank issues) have seen spreads narrow dramatically whilst volatility has continued to fall across most asset classes. Reviving the economic patient will certainly take longer than reviving financial markets, but if investors invest at the mid point of the economic down cycle, then equities have rarely failed to make money. If economic recovery is starting to stabilize, then investors are going to need to become fully invested in the months ahead. Concerns could rapidly shift from the crisis itself, to worries of the longer-term effects of the huge deficits and inflation risks that have been incurred to counteract it. Indeed, some eminent economists are becoming concerned that the counter-measures we are seeing around the world, financed by enormous amounts of debt, could be paving the road to the next crisis.

Some moderation in the rate of decline (or freefall) in the global economy certainly seem to be evident recently. Regionally, the biggest contributor has been China, where bank lending has risen almost six-fold to almost 277 billion US Dollars, alongside money supply growth of 25.5%, the highest ever recorded. (source: Reuters). Even high end consumer spending seems to be responding with local motor sales in China from both Mercedes-Benz (up 50%) and General Motors (up 38%). Such a rapid economic response to the Government spending and credit plans underlines that China is unusual and that it has an incredible capacity to immobilize all of its institutions, central and local governments and the entire banking system to boost government influenced investments.

Beyond China, other domestically orientated emerging markets have been surprisingly resilient. Take India for example, its domestic economy is not debt dependant and when considering the decline in oil and food prices, inflation is now down to zero and has now bolstered incomes. Government programs to support rural incomes have gained attraction and up and coming elections suggest that such programs will continue to play a key role in supporting incomes. On balance, the Indian economy is expected to grow at 5% in the year ahead, coupled with a banking system that is in remarkable health. Similarly, in Latin America, the low exposure to credit has helped to control the impact of the global credit crisis.

Confidence is returning as Governments introduce policies to bullet proof their economies from further external shocks. Access to resources from the IMF are giving support to Government finances and the corporate sector. So far, this has translated into strengthening currencies and rising equity markets after the losses accumulated in 2008.

All in all, world growth momentum should turn positive in the third quarter of this year as confidence and consumption recover in the advanced economies, and global re-stocking of inventories leads to a pick-up in industrial production. In other words, the less bad world economy will gradually give way to a slightly better world economy.

In summary, the three core trends underpinning global strategy for the remainder of 2009 will be (i) an economic recovery, led for the first time by the "emerging" rather than the "developed" world (ii) the continued use of aggressive monetary tools, including quantitative easing to influence investor behaviour and psychology; and (iii) a tentative recovery in investor risk appetite across all major asset classes.

Soon, markets may be worrying less about the economic crisis and more about the massive legacy left by Government intervention to try to prevent it. In recent months, it has become evident that those out-of-favour asset classes such as commercial property, corporate bonds and stock markets which have suffered terribly over the last two years, do not need to remain unloved forever. With valuations depressed and sentiment slowly turning, a stabilizing economy or even a dose of inflation could see investors switching their attention from less risk-averse assets.

Whilst interest rates are almost certain to remain low for the foreseeable future, those investors requiring income and some inflation protection for their capital, can, through well diversified portfolios meet their income and growth requirements for many years to come.

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