Market review of 2009

2009 was another turbulent year on global stock markets, but ultimately yielded strong returns with the MSCI World Index up 26.7% in euro terms. Government bond investors fared less well, with the JPMorgan Global Bond Index down 1.3% for euro investors, although credit (both investment grade and high yield) performed strongly (Source: Factset, returns quoted are for 2009).

The year got off to a bad start as the continued repercussions of the financial crisis resulted in the worst January on record for several equity markets. Stock markets continued to decline in February and early March as credit conditions remained tight and economic data deteriorated rapidly. The flight to quality witnessed in late 2008 continued apace, and combined with the falling interest rate backdrop and extreme economic pessimism to push government bond yields to record lows.

A turning point finally came in mid March, when investor sentiment was boosted by improvements in the financial sector, as well as by signs that global authorities would do whatever was necessary to shore up the financial system and restart economic growth.

Record-low interest rates around the globe provided support, as did announcements from the US Federal Reserve and the Bank of England that they would begin quantitative easing (effectively printing money to buy government bonds in an attempt to raise asset prices). Investors also responded positively to a commitment to concerted stimulus action from the G20 countries and to US Treasury Secretary Timothy Geithner's plan to remove toxic assets from banks' balance sheets.

As a result, equities and other risk assets rallied sharply from March, with investors also drawing comfort from possible "green shoots" among economic data releases, notably signs that manufacturing and housing may be beginning to recover, albeit from very low levels. A further boost came as the second-quarter earnings season got underway in July. US banks reported strong profits, while cost cutting helped many companies to beat earnings expectations and there were even signs that demand was beginning to recover in some sectors. Emerging markets performed particularly strongly, with China leading the way as government stimulus measures quickly fed through into signs of economic recovery.

In fixed income markets, the end of the economic and market freefall encouraged investors to buy riskier assets and sell government bonds, while increased supply also weighed on the government bond market. In contrast investment grade and high yield corporate bonds as well as emerging market debt rallied as risk appetite improved and economic conditions stabilised.

Global stock markets, corporate credit and other risk assets showed signs of exuberance over the third quarter, supported by evidence that the global recession was bottoming, with Germany and Japan reporting quarter-on-quarter GDP growth in the second quarter. Yet while stock markets appeared to be pricing in economic recovery, low and falling government bond yields were interpreted by some investors to be giving the opposite signal: that a prolonged period of low growth, and possibly deflation, may lie ahead.

In the final quarter of the year, a note of caution crept into equity markets, as investors feared the rally may have outpaced the prospects for recovery. Concerns that Dubai may default on its debt sent a further shiver of risk aversion through markets. However, this was quickly shrugged off as positive economic data from around the globe, including a drop in the US unemployment rate, suggested the recovery remained on track.

Market review of 2009

Outlook for 2010

In terms of the outlook for global growth, the evidence is for ongoing recovery over the next few quarters. However, the scope for disappointment in expectations has arguably increased as 2009's key question, "Will there be a recovery?" has been replaced by, "How strong will it be?"

While we have seen a synchronised global recovery from the credit crunch thus far, the divergence in economic and stock market performance between countries is likely to be marked in 2010, with both the pace of growth and inflationary pressures remaining very country specific. For the G7 nations, high unemployment, low-to-negative income growth, household debt reduction and large budget deficits continue to pose bigger threats than renewed inflation. The main risks to growth are that the developed nations may undershoot their GDP forecasts and that emerging markets may suffer economic overheating.

The outlook for company profits remains crucial to the performance of equities in 2010. After the rapid and extensive cost cutting witnessed this year, sales growth is vital to take profits growth to the next stage. There is likely to be much greater differentiation in profit growth between countries and industries next year, and profit disappointments are likely to be punished hard.

Please contact your usual J.P. Morgan Asset Management representative for further information or visit:
www.jpmorganassetmanagement.co.uk/institutional

For professional investors only – not for onward distribution.

Past performance is not a guide to the future. The value of investments and the income from them may fall as well as rise and investors may not get back the full amount invested. The opinions expressed are those held by J.P.Morgan Asset Management at the time of publication and are subject to change. This material should not be considered by the recipient as a recommendation relating to the acquisition or disposal of investments. This material does not contain sufficient information to support an investment decision and investors should ensure that they obtain all available relevant information before making any investment. Issued in the UK by JPMorgan Asset Management Marketing Limited which is authorised and regulated in the UK by the Financial Services Authority. Registered in England No. 288553. Registered address: 125 London Wall, London EC2Y 5AJ.

LV – JPM3460 03/10