

Radar

Monthly Global Macro Strategy

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Pierre Lapointe
Global Macro Strategist

514-932-7171

plapointe@brockhousecooper.com

HIGHLIGHTS OF THE MONTH

The recent weakness in equities is the result of a tug of war between two robust opposite forces: 1) Strong economic fundamentals completely overshadowed by 2) sovereign worries. What will it take to get out of this financial torpor?

On the economic front, recent economic data is clear: the world is in recovery mode. But investors have been mostly focused on Europe lately. The EU's rescue plan announced recently is poised to keep speculators at bay, but it will not solve the region's economic woes. European countries will have to implement austerity measures to get their economies back on track.

History tells us that a peak in the U.S. unemployment rate has the potential to sustain the equity rally... globally. We have calculated that every time the unemployment rate peaks after a business cycle, the post-recession global equity rally gets a second wind.

Sustained and viable job creation is poised to move the focus of investors back to fundamentals. And, to us, they are fully supportive of a continued uptrend in stock markets for the following reasons:

- Global economic growth is expected to remain in positive territory over the next few years.
- Top line at the company level is also expected to be very strong.
- Strong earnings growth expected.
- Earnings estimates are revised upwards
- Valuation is very appealing

The brunt of new inflows in equities should come from a reduction in fixed income assets. In the second half of 2009, investors poured close to \$40 billion into U.S. fixed income funds. And they basically ignored equity funds. The total return on U.S. government bonds since then has been zero. And we do not see how it could get better in coming months with interest rates at such low levels. Rates have nowhere to go but up. As sovereign risk fears abate and confidence in the economic recovery increases, we would expect to see market participants selling their low-return fixed income assets to buy equities.

For more information or to subscribe to this publication, please contact [Pierre Lapointe](#), Global Macro Strategist, by phone at 514-932-7171 or by email at plapointe@brockhousecooper.com.