

A long bottomed U-shaped recovery

The short bottomed 'V' is wishful thinking given the magnitude of the crisis, **KEVIN SCULLY** contends

WE'VE all heard about the alphabet economics of the Global economy - from short bottomed "V" in 2009 to a double dip "W" in 2010 - but I think it's been a long bottomed "U" since early 2009.

Since April 2010, starting with the sovereign debt crisis in Greece and the PIGS (Portugal, Ireland, Greece and Spain) and subsequently growing signs of weak and benign economic growth in the US and slower growth in China, there has emerged a growing view that the global economy could be facing a double dip or "W" recovery.

Let's look back at the late 2008/2009 global financial crisis which almost led to the collapse of the global financial sector. The first thing to note is that these events - the collapse of Lehman and near collapse of AIG, Fannie Mae and Freddie Mac, the near financial collapse of the PIGS are unprecedented and resulted in significant falls in stock markets around the world. In early 2009, the alphabet being banded around ranged from a long bottomed "L", a long bottomed "U", to the most optimistic short bottomed "V".

What followed seemed like a short bottomed "V" with many stock markets especially those in Asia (China) rising more than 70 per cent in 2009 while most Asian stock markets rebounded between 50 and 60 per cent. This rebound can be attributed to a number of factors:

- ◆ an unprecedented coordinated policy response by most of the major economies in the world which undertook massive fiscal spending to bolster the sudden collapse in private consumption;
- ◆ the printing of money and a pressing down of global interest rates to near zero levels. This liquidity caused the sharp rebound in most asset classes from property, commodities and stocks;
- ◆ governments' guaranteeing the deposits of banks, underwriting new loans and in the case of Singapore, special payments to companies to help them avert retrenchment.

These government responses had to stop or be curtailed and this was the major risk factor in 2010, that is, when would governments start to raise interest rates and curb fiscal stimulus.

The weakness in global economies in mid-2010 is not unexpected as it is the result of the end of a number of fiscal policies without an offsetting or rise in private consumption. The huge fiscal stimulus packages have also drained national balance sheets especially in Europe, forcing many to curb fiscal spending even before a broad-based private consumption recovery can take place. This could be a double whammy.

Fortunately for Europe, a weak euro has improved exports and tourism/services and helped their economies to recover even as private consumption remains fragile.

SINGAPORE - NET LOSERS								
LAST	CHNG	VOLUME	B.VOL	HSI	RSBY	A.PVOL	HIGH	LOW
71.980		32,251		8,171,845	71,986	1,28	73,890	71,170
86.820		2,730		6,190,606	81,889	9,5	95,000	86,280
82.200		502		3,182,608	82,493	8	182,500	82,800
10.200		453,999		2,10,241	10,260	7	32,740	10,100
10.920		13,358,990		13,16,970	10,900	117	11,200	10,790
19.130		26,739		2,19,134	19,708	5	19,600	19,180
13.970		3,081,380		39,13,908	13,970	9	14,100	13,845
8.290		152,910		39,8,291	8,290	25	8,470	7,990
10.180		22,308		4,5,10,085	10,200	5	10,500	10,180
5.540		11,737,909		58,5,538	5,540	87	5,890	5,510
11.900		2,494,990		4,11,900	11,900	32	12,130	11,800
2.660		4,390		78,2,656	2,660	70	2,840	2,610
9.950		96,120		28,9,950	9,978	56	9,950	9,890
11.960		13,283		8,2,11,960	12,000	4,2	12,140	11,820
1.050		832,899		28,1,050	1,050	108	1,120	0,995
3.640		78,889		25,3,640	3,510	78,5	3,540	3,370
0.470		180,800		38,0,470	0,488	58	0,470	0,470
2.290		3,136		3,8,2,290	2,300	1	2,330	2,290
3.780		28,880		2,3,770	2,850	3	3,900	3,780



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Something to think about: Sentiment today is becoming more cautious but this is because of inflated expectations and unwarranted optimism of a "V" shaped recovery

Unemployment figures especially in the US have remain sticky to firm despite the improvement in GDP. This has recently prompted the US Federal Reserve to signal the launch of new fiscal packages to stimulate growth. The Fed has also signalled its intention to keep interest rates low for an extended period of time.

I think the short bottomed "V" was wishful thinking given the magnitude of the crisis. To me it's always been a long bottomed "U" because of the damage that this crisis has done to wealth and savings in the US and Europe and while China is an emerging consumption economy, it will take a few years before China's domestic consumption can offset the decline in consumption in the US and EU.

Unemployment is never a leading indica-

tor in an economic recovery. The US recession of 1973-75 actually saw unemployment continue to rise by 2 per cent six months into the economic recovery as more under-employed individuals returned to the labour force when economic activity started to improve. Companies were also slow to increase full time headcount during that period, preferring to use over-time or contract workers.

Sentiment today is becoming more cautious but this is because of inflated expectations and unwarranted optimism of a "V" shaped recovery. We are actually coming back down to Earth and accepting a long bottomed "U". I am encouraged by the growth in capital formation which to me is a better sign that economic recovery is on the way, albeit modestly.

I am bullish on stocks mainly because the quality of corporate earnings growth in 2010 is from both top and bottom line compared to a decline in top line but better bottom line in 2009, that is, cost cutting.

PER valuations of most stock markets around the world from the Dow, Shanghai/Shenzhen, Hong Kong, Tokyo and even Singapore are at the low end of their historic PER ranges (low teens) giving earnings yields of 8-9 per cent.

This is extremely attractive compared to short term interest rates at near 0 per cent and with central banks forced to keep interest rates low for another six to nine months, I believe we could be looking at another strong liquidity driven re-rating rally towards the end of 2010.

The catalyst for this re-rating must be some stability in the pace of the economic recovery which I believe the monthly economic data will show, that is positive GDP growth for the US and Europe but at a more modest pace of recovery.

What can investors do during the uncertain period as we wait for confirmation that it's a "U" not a "W"?

You cannot hold cash... so the conservative money is going defensive, that is, into bonds and high-yield currencies. The more aggressive would be in equities on low PERs, with strong balance sheets and having attractive dividend yields in excess of 5 per cent. I am in the latter camp.

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