

## Mondo ETF

Strategie obbligazionarie globali nel nuovo contesto economico. Quali scenari?

Dominic Pegler, 19<sup>th</sup> October 2011

## What is wrong with the global economy? The Four Horsemen

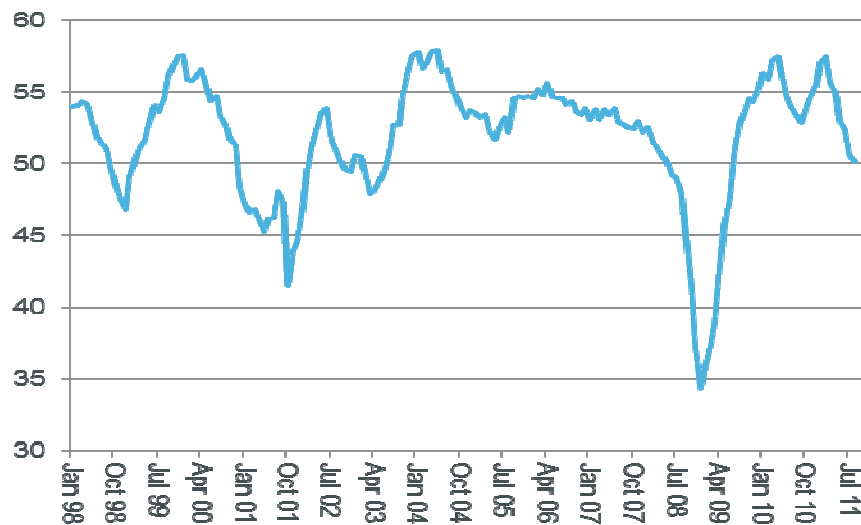
1. The global economy has slowed in recent months, recession risk has risen
2. A range of secular growth headwinds were already a challenge - deleveraging
3. Conventional policy responses are increasingly limited
4. Europe – significant recent progress but still much to be done



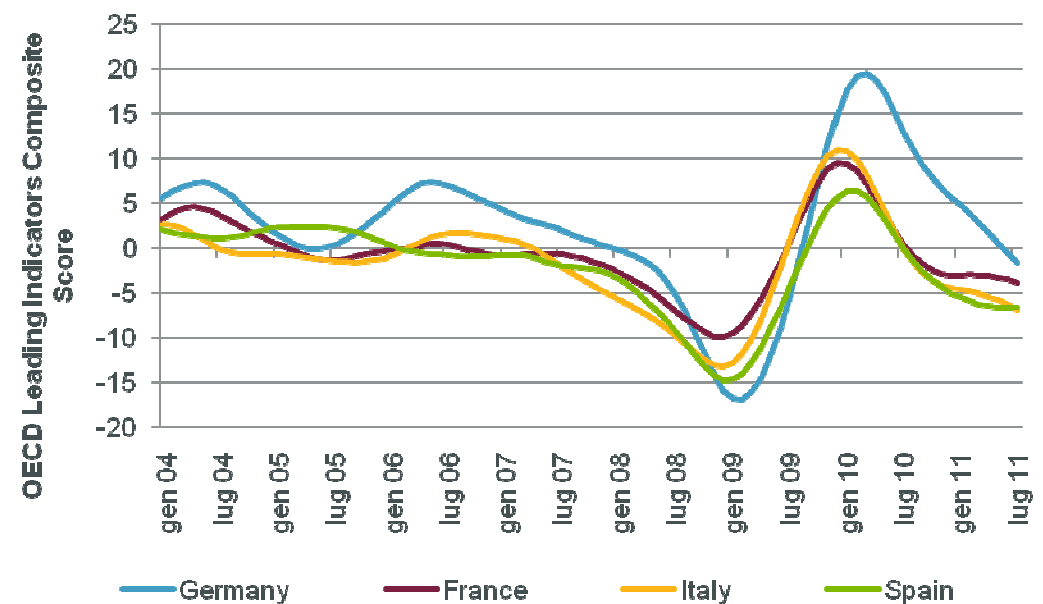
Four Horsemen of Apocalypse, by Viktor Vasnetsov. Painted in 1887.

# Macro-Economic Stresses Will Not Be Resolved Quickly

Global Purchasing Managers Index

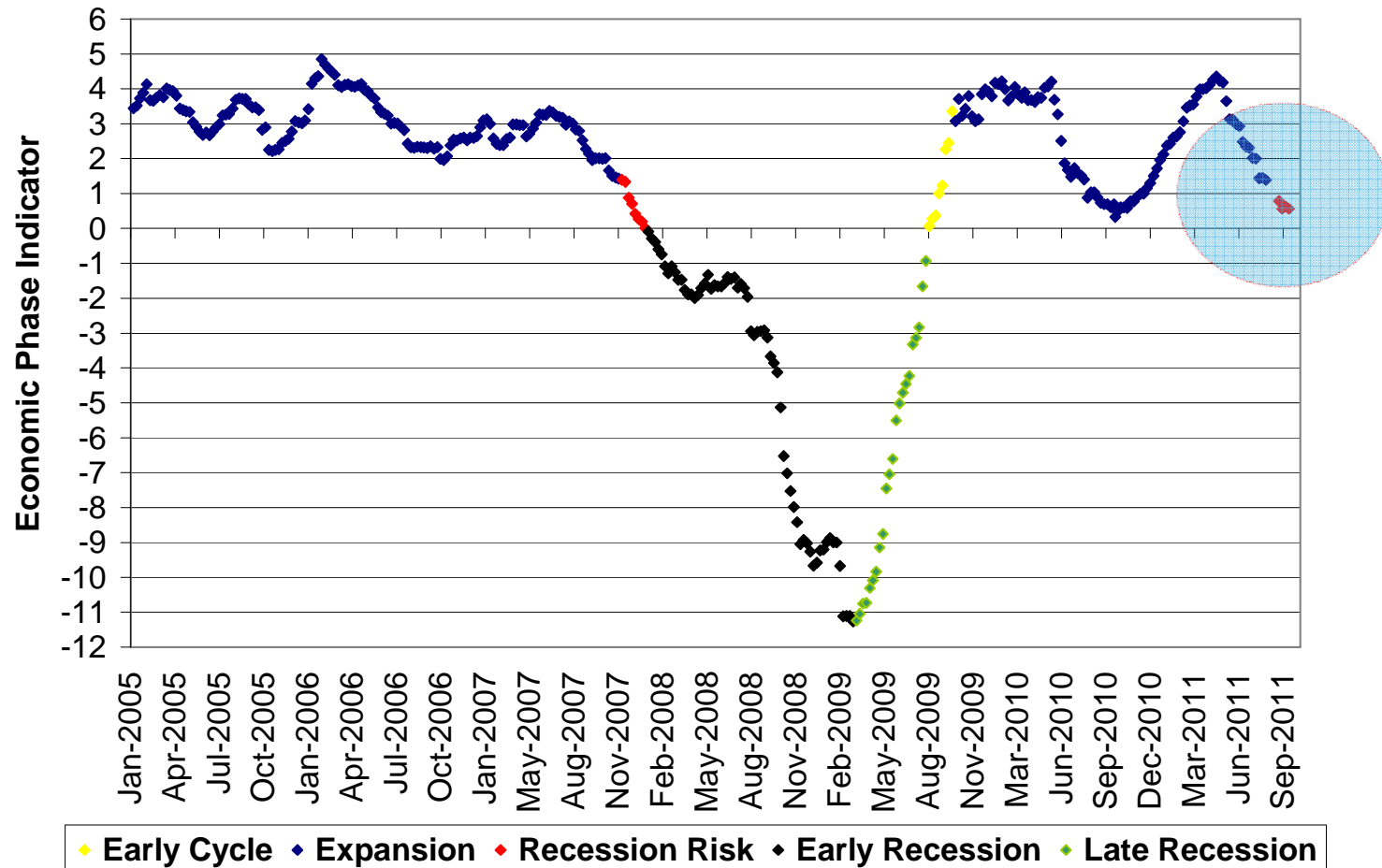


OECD Leading Indicators Composite



- The global economy has slowed sharply; recession risks highest in Europe, lowest in emerging economies, middling in US
- Slowdown reflects some temporary shocks but Corporate caution rather than aggressive consumer deleveraging the key issue
- Even if recession is avoided it is hard to see an environment of sustainable strength in economic activity for some time

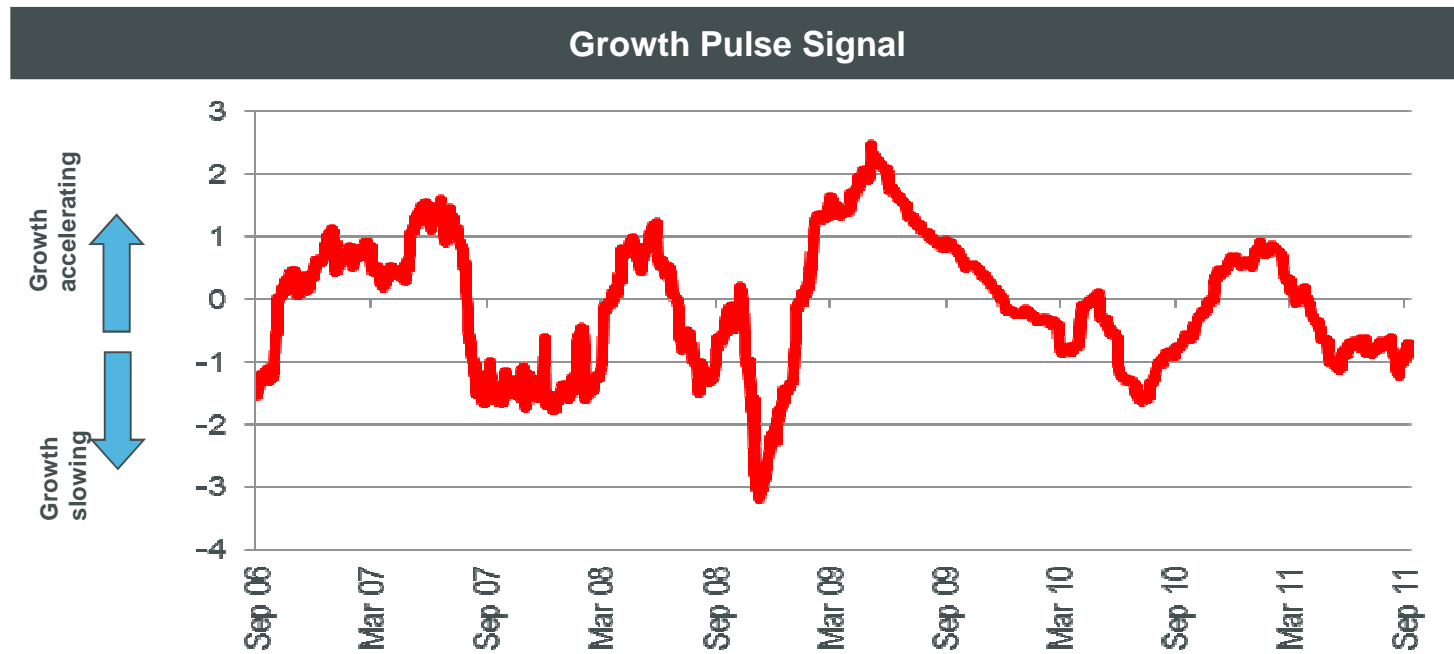
# BlackRock Phase of Cycle Indicator has recently moved into recession risk



# Outlook for Global Rates

## Difficult to see the forces that will drive yields higher

- BlackRock's Global Growth leading indicator has been pointing to slowing economic activity since March
- Growth in Q4 will be boosted by recent falls in commodity prices and a recovery in Japan but the outlook remains lacklustre
- Sentiment & Momentum indicators still support case for lower bond yields

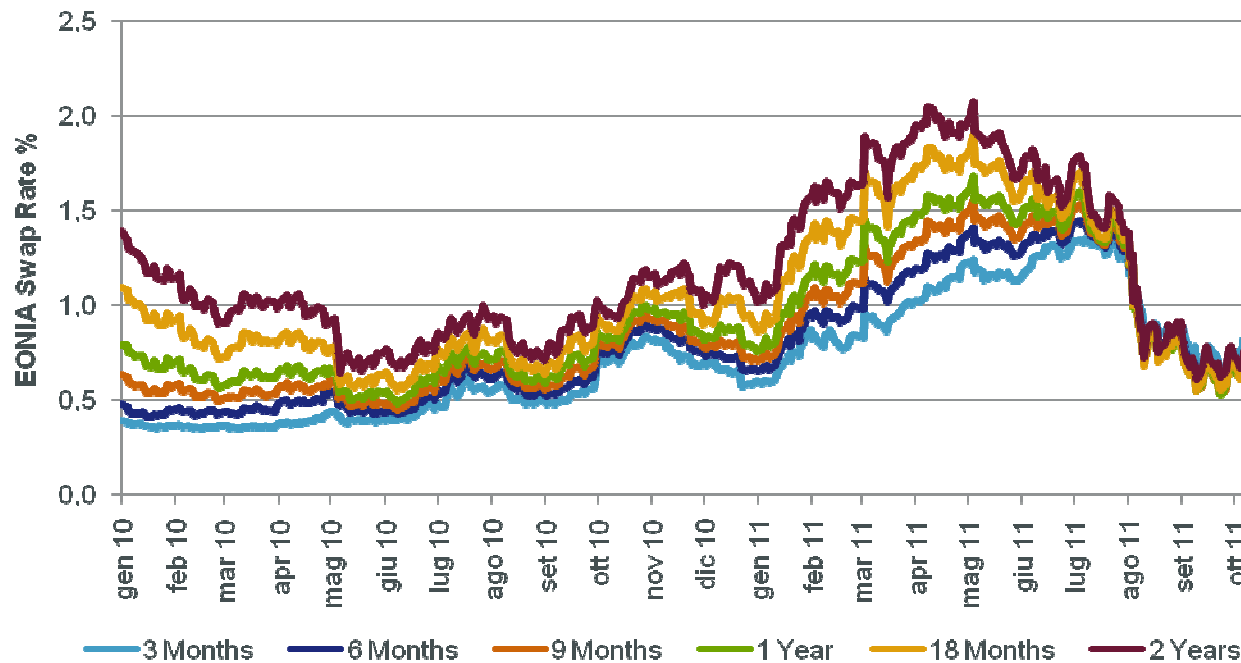


Source: BlackRock

## Official rates expected to stay low for the next two years

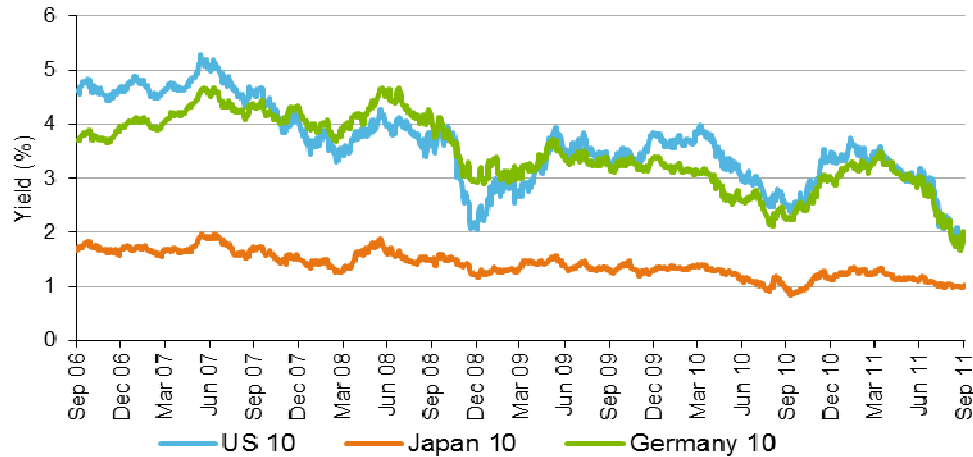
- Economic conditions have weakened since the start of the year
- The global recovery is slowing and this is adding pressure to Eurozone sovereigns trying to enact austerity measures
- The market now expects the ECB to reverse previous tightening and rate cuts are priced in over the next year

EONIA Swap Rates by Number of Months Forward

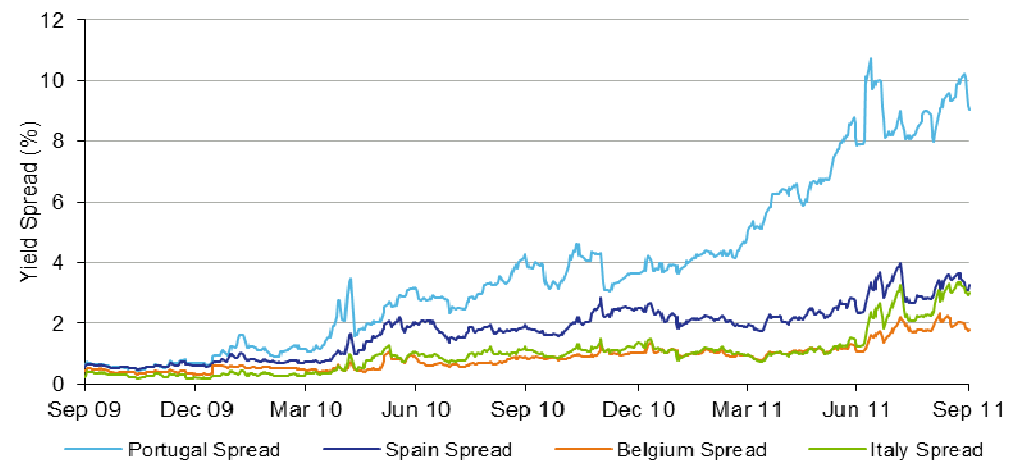


# Lower underlying global yields, but higher sovereign spreads in the Euro Zone

## Global Government 10-yr Bond Yields



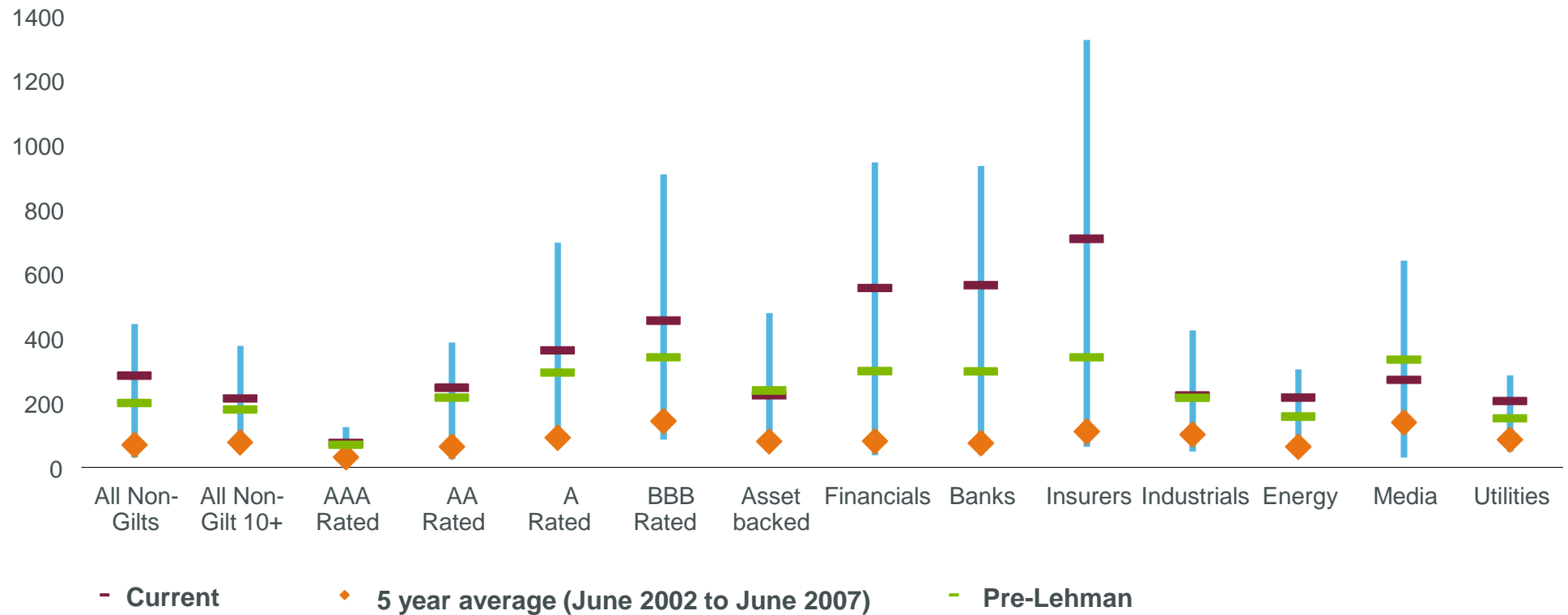
## Euro Sovereign 10-yr Bond Spreads to Germany



- US and German government bond yields have moved sharply lower as investors reacted to the slowing macro-economy
- Peripheral European spreads have continued to trend wider
- Despite the crisis situation, the European Central Bank has increased official rates, by 0.25% to 1.5% in July

# What about Corporate Bond Markets?

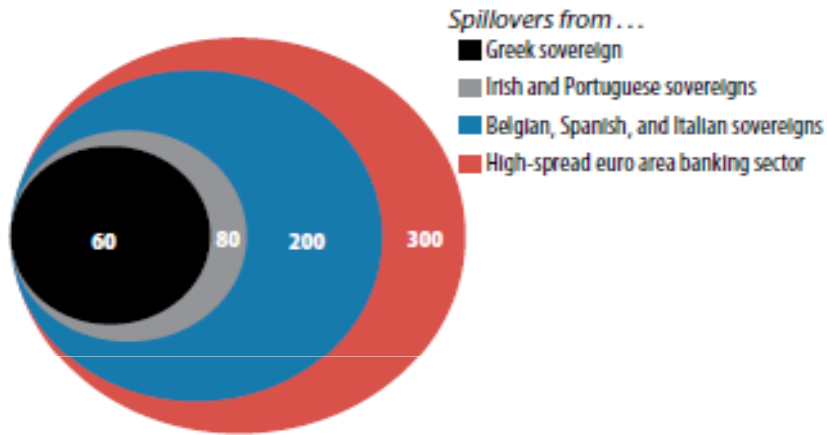
## Spread Range (Minimum/Maximum) 1996 –2011



Source: BlackRock/BofA Merrill Lynch As of 30 September 2011

# The Euro Zone Banking Sector: Capital needs and ECB activity

## IMF estimate of the European banking sector capital shortfall

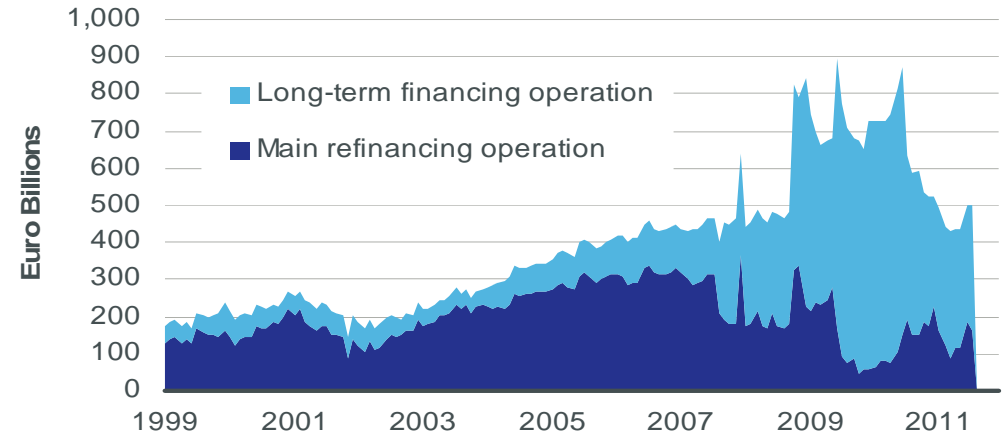


Source: IMF staff estimates.

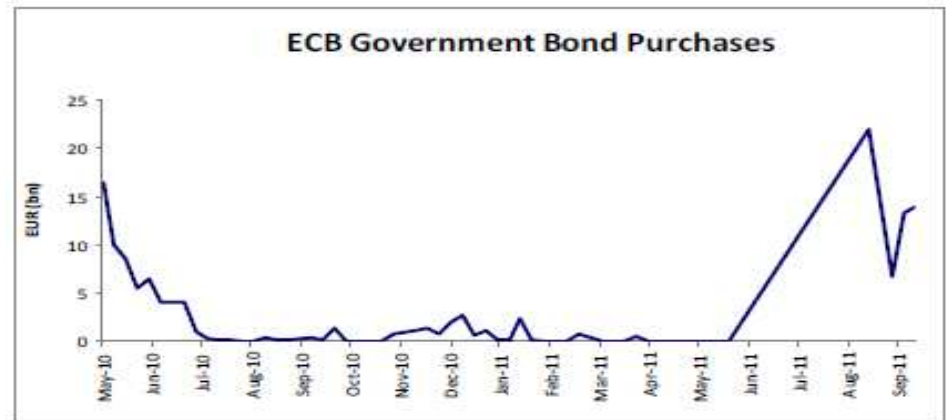
Note: The size of the circles is proportional to the size of the spillover. Includes banking systems in 20 European Union countries. The high-spread euro area countries are Belgium, Greece, Ireland, Italy, Portugal, and Spain. Figures are rounded to the nearest 10 billion euros.

Source IMF, Bloomberg

## ECB Refinancing Operations 1999-2011 YTD

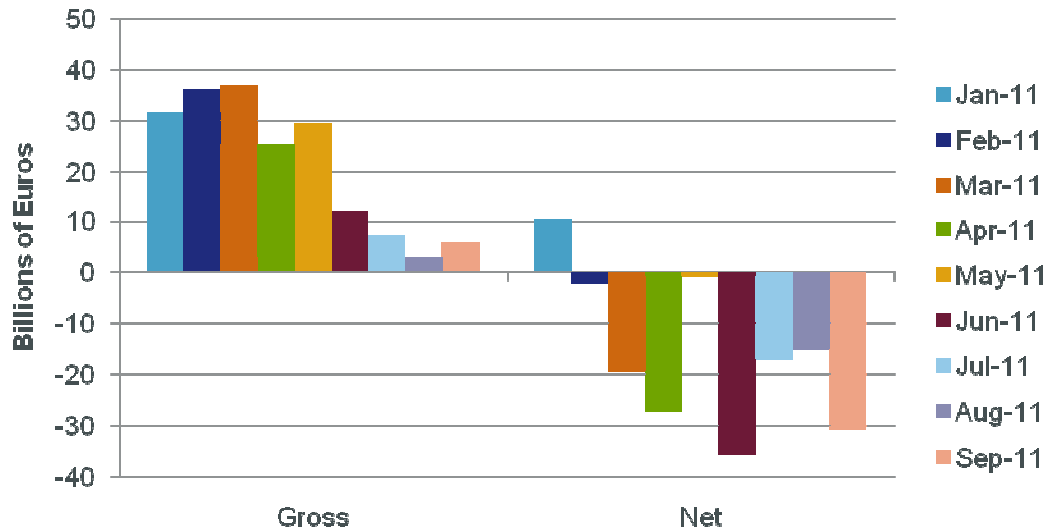


## ECB Securities Purchase Programme

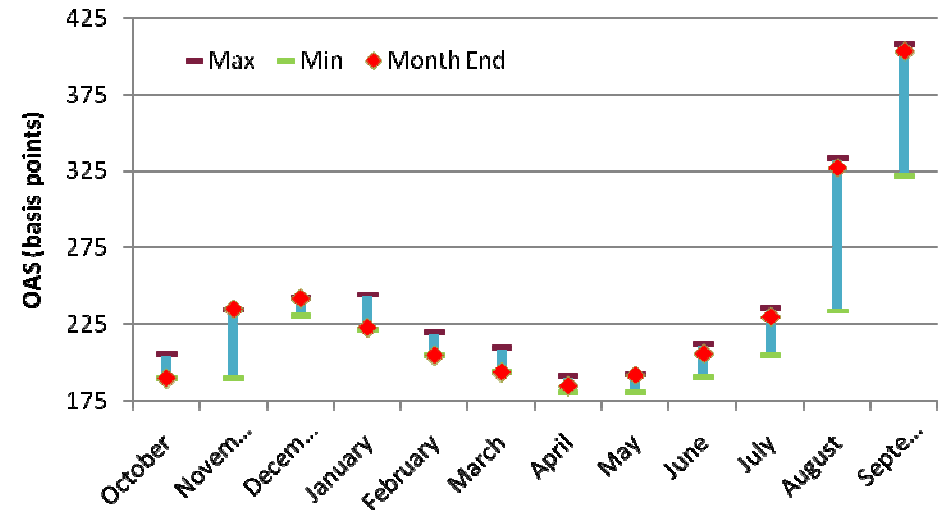


# A risk Averse Environment in Financials

## € Denominated Financials Debt Issuance



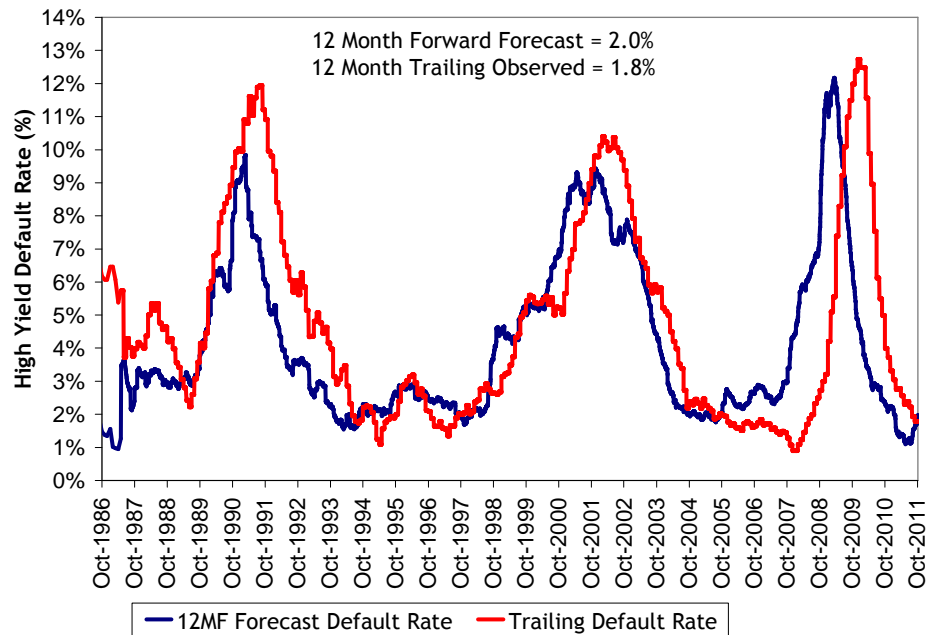
## Merrill Lynch Broad Corporates Index Spreads



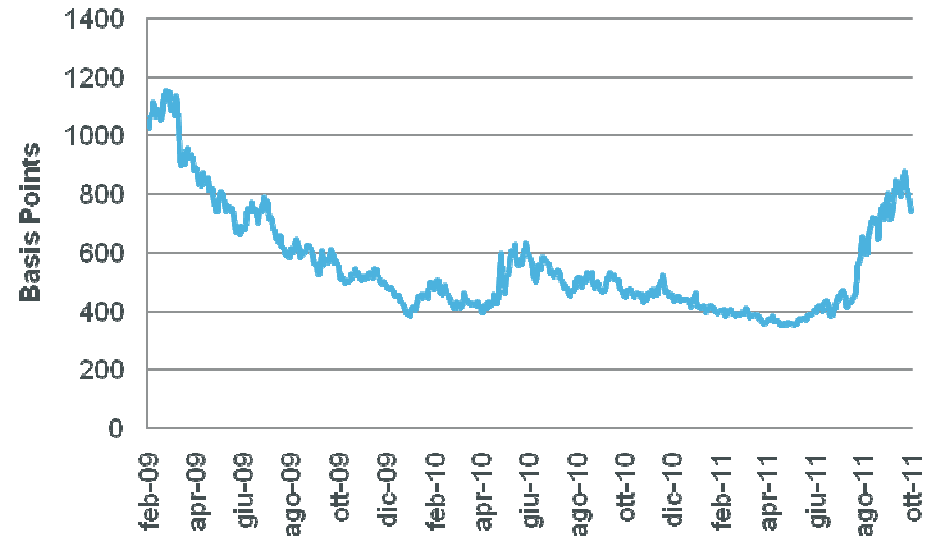
- Banks have faced increasing funding costs as investors worry over exposure to peripheral sovereigns
- This has prompted action from the ECB
  - Buying bonds of troubled sovereigns
  - Restarting the covered bond buying program with an initial target of €40 billion
  - Making available two 1 year Long-term refinancing operations

# Insight into the Default Cycle aids our Credit Risk Premium Valuation

## High Yield Default Forecast

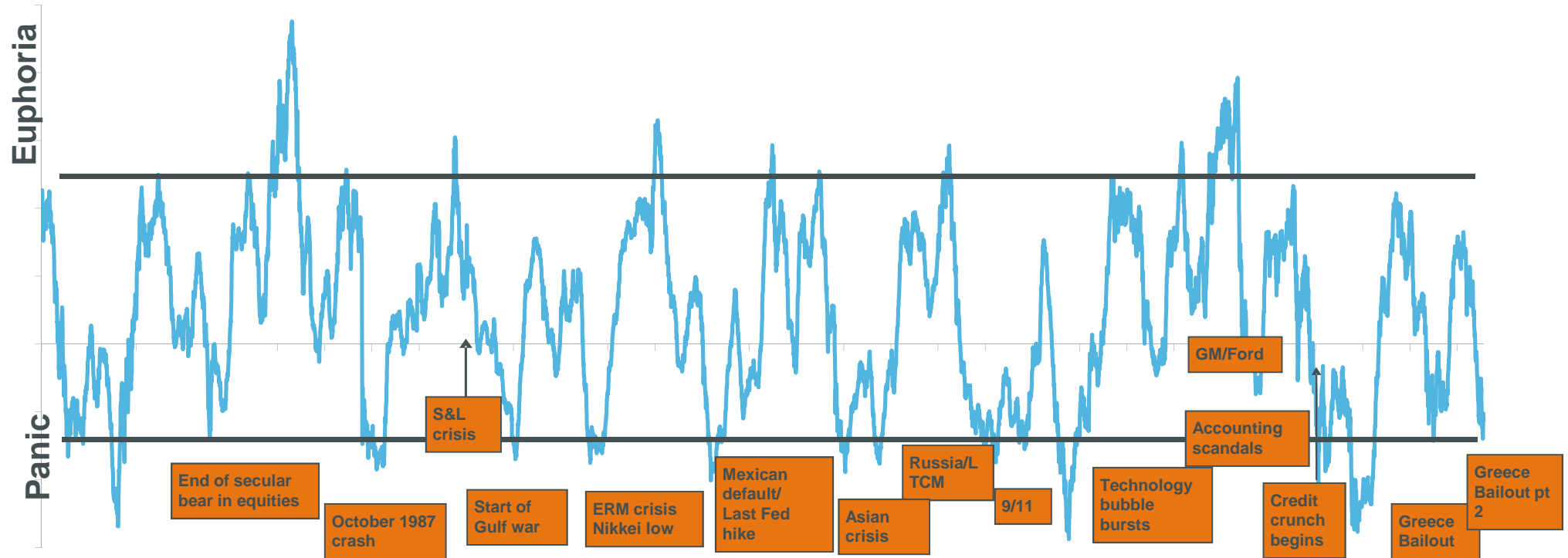


## High Yield Spreads



- In terms of Fundamental indicators, risky Corporate Credit looks attractive
- Low actual and forecast defaults over the next 12 months
- Spread widening mostly reflects increased risk aversion and a lack of liquidity

## Risk Appetite has been falling sharply, indicating an environment ruled by fear

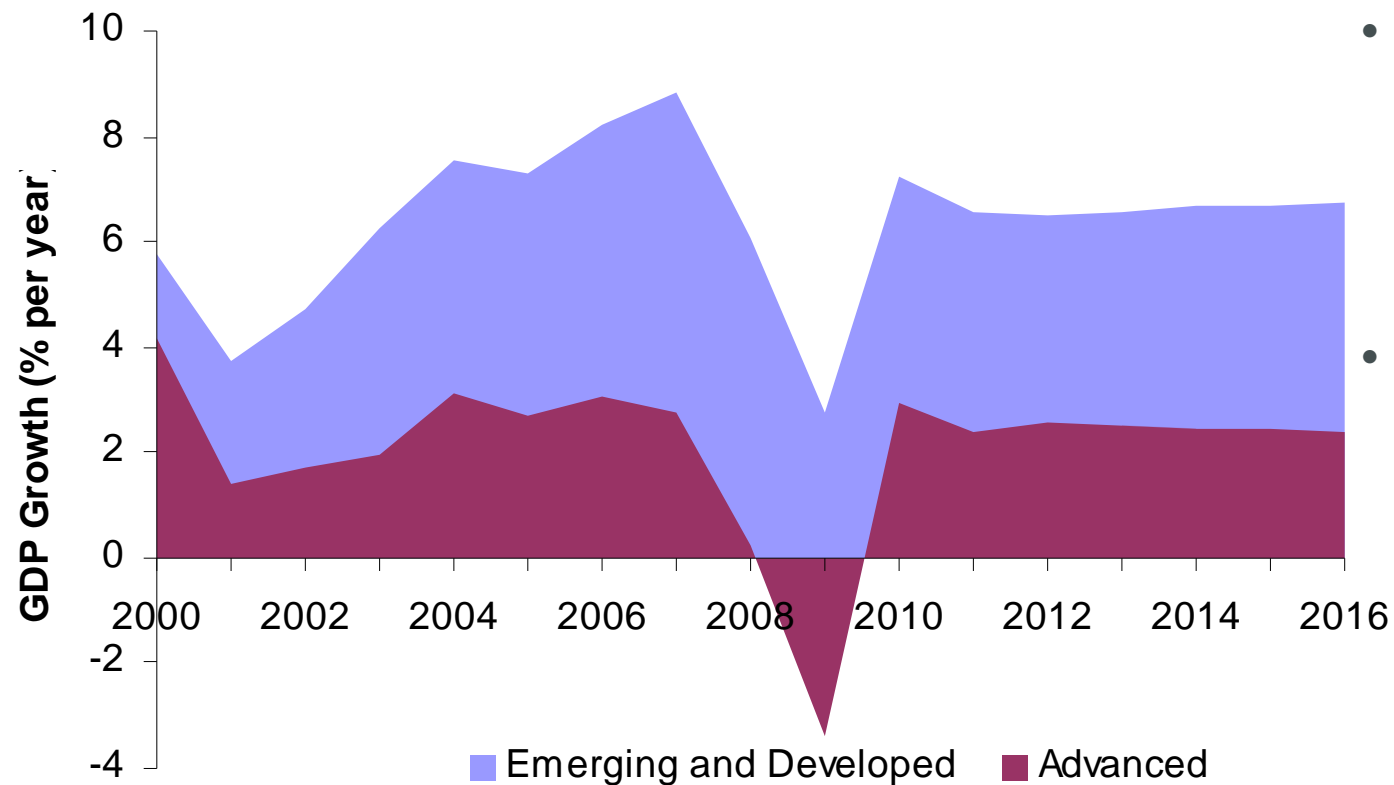


Source: Credit Suisse, BlackRock

- Risk appetite has collapsed in the current environment
- Approaching levels seen in 2008
- Whilst liquidity in markets remains low

## What can we expect from the emerging economies?

- As the engine of growth for the world economy...helping to pull the world out of recession



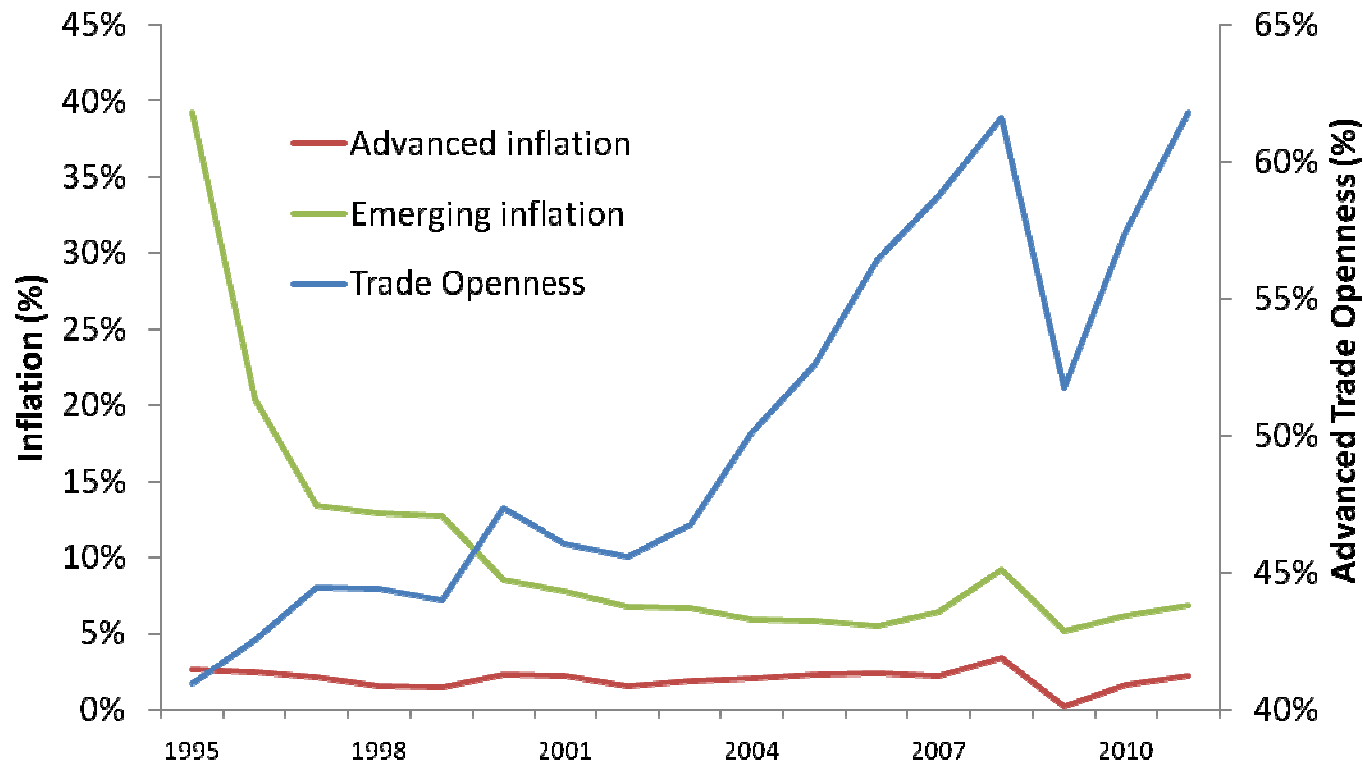
- 2009 GDP growth:
  - -3.7% Advanced economies
  - +2.4% Emerging and Developing economies
- 2010 GDP Growth
  - 3.0% Advanced economies
  - +7.3% Emerging and Developing economies

Source: IMF

## What can we expect from the emerging economies?

- As the producer of last resort to keep Developed Economy inflation low

**Inflation Rates and Advanced Economy Trade Openness  
1995-2011**

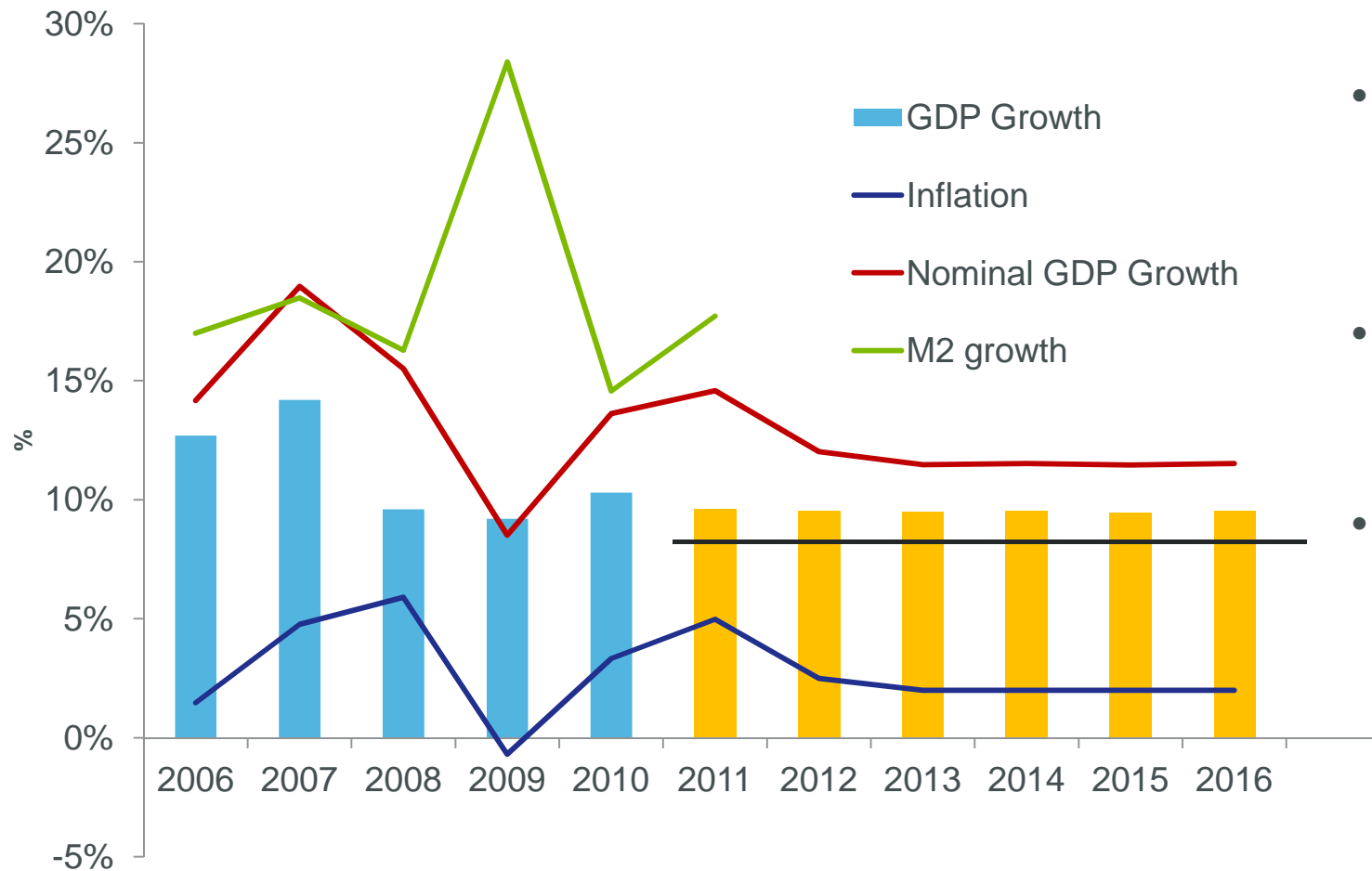


- World inflation has fallen structurally since the early 1990s
- Advanced Economies have become more open to trade over the same period
- Emerging economies have played a role in keeping Advanced Economy inflation low and stable

Source: IMF

# In China, long term growth is likely to be slower and inflation higher

## China: Growth, inflation and Money Growth (annual %)



- Emerging economies face their own capacity constraints
- China may grow above capacity for the next 5 years
- And may act as a source of inflation, not deflation, in the world

Source: IMF

## Emerging Market spreads look relatively attractive, but we should proceed with caution



- Spreads have widened in response to lower risk appetite and illiquidity
- Inflation risks are significant in some emerging markets – a test of their macro policy frameworks
- The long term case for a strategic allocation to emerging market debt is as strong as ever

Source: Markit-CDX

## Conclusions

- Global growth most likely to remain positive, but below potential, especially in the Euro Zone
- The latest Euro Zone proposals are a step in the right direction – more needs to be done quickly
- Long term structural weaknesses in the Euro Zone remain
- Non-core markets have been driven by lower risk appetite and poor liquidity
- Investment Grade credit offers value compared to fundamental indicators, as does emerging market debt

*Source: BlackRock*

# Disclaimer

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