Weekly Stock Market Report

by Edmund Brandt
Investment Director
J.P. Morgan Asset Management

17-23 July 2010

US

Wall Street rallies on strong earnings

- Wall Street stocks rallied sharply last week as encouraging second-quarter earnings boosted confidence in the recovery. The Dow Jones returned 3.2%, almost erasing its loss so far in 2010, while the broader S&P 500 rose 3.5% and the tech-biased NASDAQ was up 4.1%.
- Of the 149 companies in the S&P 500 to have reported second-quarter earnings so far, around 85% have beaten average analyst estimates, according to Bloomberg. Oil services company Halliburton exceeded expectations due to an increase in onshore drilling, while the strong performance of the technology sector was helped by robust earnings from Apple, which reported record quarterly revenue on demand for the iPad and the new iPhone.
- Upward revisions to full-year forecasts sparked hopes that a double-dip recession will be avoided. United Parcel Service, which is seen as a leading indicator for economic activity, reported better-than-expected net income and raised its full-year forecast, citing expectations that volumes in the US will continue to recover.
- In the financial sector, Goldman Sachs fell after reporting a drop in earnings to the lowest level since the end of 2008 as trading revenue declined more than analysts estimated. However, rival investment bank Morgan Stanley strongly exceeded expectations as its revenue surpassed that of all five of its biggest competitors.
- The strong start to the earnings season helped investors to shrug off mixed economic data. Initial jobless claims jumped by 37,000 to 464,000 in the week to 17 July, adding to fears that high unemployment will restrain consumer spending for some time.
- Housing data continued to be clouded by the expiration of a tax credit for first-time buyers at the end of April, with no clear picture emerging of the direction of the market. Confidence among homebuilders slipped for a second consecutive month in July, while housing starts fell more than expected in June, dropping 5%.
- However, new building permits – an indication of future construction – rose 2.1%. Existing home sales fell by a smaller-than-expected 5.1% in June versus the prior month, while house prices rose by a seasonally adjusted 0.5% in May.
- The Conference Board's index of leading economic indicators – a measure of the economic outlook for the next three to six months – fell for the second time in three months in June, dropping 0.2%.
- In his semiannual testimony to Congress on monetary policy, the chairman of the Federal Reserve, Ben Bernanke, contributed to caution on the economy, saying that the outlook remains 'unusually uncertain'. However, Mr Bernanke said that the Fed stands ready to act if the recovery stalls, with a return to quantitative easing among the potential measures.

EUROPE

Economic data restores faith in the recovery

- Unexpectedly strong economic data and better-than-feared results from bank stress tests contributed to strong gains for European equities. The MSCI Europe Index returned 2.6%.
- Among the major markets, Spain's IBEX was strongest, jumping 4.0%, followed by a 3.1% gain for France's CAC 40 and a 3.0% rise for the UK's FTSE 100. Italy's FTSE MIB rose 2.2% and the German DAX returned 2.1%.
- The week got off to a nervous start as Moody's Investor Services cut Ireland's sovereign debt rating by one level to Aa2, following its downgrade of Portugal in the prior week. Moody's said the downgrade reflected a 'significant loss of financial strength' in Ireland and the cost of propping up the country's ailing banks.
- However, a batch of particularly strong economic data boosted sentiment, suggesting Europe's recovery remains intact despite persistent sovereign debt concerns. Munich's Ifo institute reported a surge in German business confidence to a three-year high this month as the weaker euro strengthened the outlook for exports.
- The eurozone composite purchasing managers' index rose to 56.7 in July from 56.0 in June, versus expectations of a decline, indicating improved activity in both the manufacturing and service sectors.
- The UK economy grew at its fastest pace in more than four years in the second quarter, helped by rebounding construction, services and manufacturing sectors. GDP grew 1.1% from the prior quarter, versus expectations of a 0.6% expansion. UK retail sales also showed unexpected strength, rising 0.7% in June.
- Encouraging corporate earnings and M&A activity also contributed to the positive mood. Italian carmaker Fiat reported its first profit in three quarters, while French hotel chain Accor reported a rise in sales and said it was continuing to see strong bookings.
- UK personal goods maker SSL International received a GBP 2.5 billion takeover approach from Reckitt Benckiser, while the Canada Pension Plan Investment Board and Onex Corp. said they were considering a bid for Tomkins Plc, a maker of auto parts and building materials.
- On Friday, the European Union published the results of stress tests on 91 of the region's largest banks. Seven banks failed the tests, including Germany's Hypo Real Estate Holding, the Agricultural Bank of Greece and five small Spanish savings banks.
- The publication of the test results should help to improve sentiment and market access for regional institutions because of the disclosure of sovereign debt holdings, which should help banks evaluate counterparty risk and so free up interbank lending.

PACIFIC

Australia calls general election for 21 August

- The MSCI Pacific Index rose 0.5% as the major Pacific markets broadly underperformed other regions.
- The TOPIX edged ahead 0.1%. A monthly report issued by Japan's Cabinet Office kept its assessment unchanged, stating that the Japanese economy is 'picking up steadily'. However, the report did recognise that the economy remains in a difficult situation, with high unemployment hindering a pick up in domestic demand and the export-led recovery at risk from any renewed slowdown in the global economy.
- With exports also coming under pressure from currency movements, Japan's vice finance minister stressed the need to 'avoid excessive gains in the yen' to help ensure Japanese goods remain competitively priced abroad. Domestically, economic data was weaker, with the Bank of Japan reporting that demand for business loans had fallen to a five-year low in July.
- In Australia the All Ordinaries rose 0.9%. New prime minister Julia Gillard called a general election for 21 August, with the strength of the economy expected to feature strongly in the campaign. Gillard's Labour Party hopes to trade off a growing jobs market and rising consumer confidence, while the Liberal opposition has vowed to scrap a planned tax on iron ore and coal companies.
- Taiwan's TWSI climbed 1.3%. Taiwan's industrial production climbed more than predicted for a tenth month in a row in June, rising 24.3% from a year earlier. Improved orders for PCs, mobile phones and television screens have spurred factory production and reduced Taiwan's jobless rate.
- Hong Kong's Hang Seng was up 2.8%. Property companies remained in focus, with Sun Hung Kai Properties, the world's largest property developer by market value, reporting strong demand for luxury apartments.
- South Korea's KOSPI rose 1.1%, while Singapore's Straits Times nudged ahead by 0.5%.

EMERGING MARKETS

China buoyed by policy easing speculation

- The MSCI Emerging Markets Index rose 3.0% compared to a 2.6% gain for the MSCI World Index.
- The MSCI China Index climbed 4.0%. There was speculation the Chinese government will soon ease policies put in place to cool the housing market and that it may also increase investments in low-income housing, providing a boost for domestic consumption in the face of weaker export demand.
- China passed the US as the world's biggest energy user last year and this year it is also set to be the world's biggest market for initial public offerings, with over 170 companies tapping the country's financial markets in the first six months of 2010.
- Russia's RTS gained 4.3%. Russian retail sales rose the most since November 2008 in June, up 5.8% year on year and advancing for a sixth consecutive month. The unemployment rate also fell for a third straight month, to the lowest level in 20 months.
- Elsewhere in emerging Europe, the Polish WIG rose 3.0%. Poland's industrial output grew for an eighth month in June, at a faster-than-anticipated pace. The Czech PX-50 added 1.2%. Credit rating agency Moody's said it may increase the country's credit rating if the government adheres to its budget cutting targets.
- In contrast, the Hungarian BUX dipped 2.5%. Ratings agencies Standard & Poor's and Moody's both threatened to cut Hungary's credit rating after talks fell apart with the International Monetary Fund and the European Union over budget targets for 2011.
- In Latin America Brazil's BOVESPA surged 6.4%. Brazil's central bank surprised analysts by increasing the benchmark interest rate by 0.5% instead of the 0.75% predicted. The country's consumer prices fell for the first time in four years in the month to mid-July. Mexico's BOLSA was up 3.2%. Mexican retail sales climbed more than expected in May, up 5% compared to consensus expectations of a 3.4% rise.

Source for information: JPMorgan Asset Management, Datastream, Financial Times.

Any forecasts or opinions expressed are those held by JPMorgan Asset Management at the date of this document and are subject to change. The views expressed herein are not to be taken as advice or recommendation to sell or buy shares. This material should not be relied on as including sufficient information to support an investment decision. The information in this document is based on our understanding of law and regulation at the date of this document. Issued in the UK by JPMorgan Asset Management Marketing Limited which is authorised and regulated by the Financial Services Authority. Registered in England No: 288553, Registered address: 125 London Wall, London EC2Y 5AJ.

J.P.Morgan
Asset Management