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Summary

The rally in global markets is driven more by sentiment and positioning in HIDC currency markets than fundamental strength as the growth outlook in Europe and the United States remains very weak. As such, this is a reluctant and fragile rally and we believe investors should position to buy Emerging Markets into any weakness arising from an eventual correction in the HIDCs, particularly given that Emerging Markets are expected to grow some 6 per cent in real terms this year.

Global

Recent positive trends in global markets continued over the past week. The S&P500 rose to new post-Lehman highs of 1520, up 55bps on the week and approaching the pre-Lehman high of 1526 from 2007. 10 year US treasury yields rose to 2.04% from 1.96% a week ago. Oil prices ended the week higher as well, though just $1 higher at $118. Equity volatility – as measured by the VIX Index – dropped below 13 from 13.40 at the start of the week. In Europe, Italian 10 year bond yields declined from 4.75% to 4.39%. This broad positive sentiment in the global markets, however, occurred on the back of very little concrete news in terms of data or policy changes. A number of key uncertainties remain unresolved, particularly the upcoming US spending sequester, Cyprus, and the approaching Italian election, but these events are largely ignored by the market. Instead, the main driver of global sentiment remains the unrelenting push higher is USDJPY, which gained further momentum last week from supportive comments from the US treasury and Bundesbank President Jens Weidmann plus weaker than expected GDP data from Japan. Based thus on currencies, which are notoriously volatile and fickle, particularly in the current global constellation of fundamental weakness in the HIDCs and inflated asset prices due to Quantitative Easing (QE) policies, the rally is a very reluctant one. We believe that Japan's attempt to weaken its currency has provided pretext for much of the QE money trapped in the global financial markets to switch from the EURUSD trade to the USDJPY trade, especially since Draghi reduced some of the downside in the EURUSD with his program of intervention in European sovereign bond markets last year. EURUSD ended the weak marginally lower on the back of very weak German and French GDP prints. In Emerging Markets, external debt rose by a modest 11bps in the face of rising treasury yields. Protected by a fatter spread cushion, Corporate High Yield rose by 24bps. Emerging Market currencies were flat on the week, while Local Currency bonds rallied 34bps. The strongest performing asset class in Emerging Markets last week was the Equity market, which rose 36bps.

Latin America

Mexico's central bank issued a broadly dovish statement following its monetary policy committee meeting even as gross fixed investment rose 5.4% yoy, higher than expected. Venezuela devalued the Bolivar by some 30% in a bid to balance the political costs of devaluation with the positive impact on the fiscal balances in the heavily oil export dependent economy. Meanwhile, President Chavez's health remains the chief source of risk in the country. Colombia announced a reduction in its foreign borrowing program of $1bn, meaning that it will only tap global markets for $1.6bn in gross terms this year. Jamaica announced that it will conduct yet another domestic debt restructuring. Core inflation in Chile for January was a modest 1.4% yoy. Peru raised the foreign currency limit for domestic pension funds. In Brazil, the central bank intervened to weaken the currency after Finance Minister Guido Mantega said that the floor for USDBRL was 1.85.

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Asia

China surpassed the US to become the largest trading nation in the world, according to official figures. **India's** exports recovered in January, rising 0.8% yoy after a fall of 1.9% yoy in December, but industrial production weakened in December. The government announced that it intends to take a tough line in the upcoming budget talks. January wholesale price inflation was lower than expected at 6.62%. In **Indonesia**, the current account deficit widened, but was more than covered by inflows on the capital account, so that the overall balance of payments improved sharply. Bank of Korea left rates unchanged at 2.75%.

Eastern Europe, Africa, and Middle East

Turkey's current account balance was significantly stronger than expected at –USD4.66bn versus –USD5.4bn expected. **Hungary** issued more than $3bn of 10 year and 5 year hard currency sovereign bonds as GDP and inflation both turned out lower than expected. **South African** retail sales rose by 2.3% in December versus expectations of a rise of 1.6%. The IMF concluded its mission in **Ukraine** by praising the government's progress and will return to Kiev in March. **Ghana** published worse than expected fiscal numbers as the central bank left rates unchanged at 15 per cent. **Russia's** central bank left rates unchanged at 8.25%. **Romanian** GDP was stronger than expected at 0.3% yoy versus 0.2% yoy expected.

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