News from CFALA

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Structural Problems Still Underlie Global Economic Recovery, Top Investment Strategists Say at CFALA Forecast Dinner

LOS ANGELES – Emerging markets assets are likely to outperform comparable investments in the Western world this year as developed nations continue to struggle with high debt loads and slow economic growth, four top investment strategists told several hundred attendees at the 2011 Economic and Investments Forecast Dinner presented by the CFA Society of Los Angeles (CFALA).

"Today's world is divided into two parts – emerging nations with low debt and developed nations with very high debts," said Stephen King, Chief Group Economist and Global Head of Economics and Asset Allocation Research at HSBC Bank PLC in London.

"Emerging nations are extremely dynamic in response to global policy stimulus while developed nations are very sluggish. What in effect has happened is that policy stimulus has stimulated the wrong part of the world – we're seeing too much growth and inflation in emerging markets, while at the same time rising commodity prices have reduced the chances of a decent recovery in the developed nations."

King said high debt levels among developed nations would dominate the global economic picture for some time to come.

"Emerging market assets should outperform, while the Western world will have to think about the relationship between creditors and debtors, he said. "This has already sparked a crisis in the Eurozone, which is a dress rehearsal for problems at the global level, where the biggest creditors are China, Russia, Saudi Arabia and others and the biggest debtor is the U.S. As emerging nations continue to grow, they may spurn the dollar, and its status as the world's reserve currency is in danger of becoming tarnished."

Emerging market debt, particularly bonds issued by foreign companies but denominated in U.S. dollars, remains attractive for investors, said Luz M. Padilla, Senior Portfolio Manager, Emerging Markets Fixed Income, at Los Angeles-based DoubleLine Capital LLP.

"When you look at the underlying credit fundamentals of emerging market corporate credits, they tend to have better credit metrics than their comparably rated peers in the developed markets," she said. "However, they still trade at wider levels, even though they have the potential to migrate up to higher ratings."

Ms. Padilla recommends that investors in emerging markets credits focus on sectors that are vital to the host country's economy.

“The sectors we like are ones we think are strategic to the local economy – sectors that have to be operating efficiently in order for the economies to function,” she said. “Examples would include banking, natural resources, utilities, telecom – where in times of trouble the local government is more likely to be supportive of the companies in these sectors. We’ve been investing in this area for more than 16 years and we’ve lived through crises in emerging markets, and those sectors are where we’ve seen support from government in the past.”

Jordan Kotick, New York-based Managing Director and Head of Technical Strategy at Barclays Capital, noted that his firm expects continued bearish pressure on fixed income instruments.

“In the U.S. fixed income markets, November 2010 was a reversal month for both two-year and five-year yields, implying an end to the bullish rates cycle,” he said.

“We believe those technical signals marked the point at which investors concluded that the evidence for global growth coming from equity and commodity markets could no longer be ignored. An attempt to normalize rates will not be easy given continued quantitative easing programs; however, we expect bearish pressure on bonds to be a notable theme for 2011. Although we expect further gains for risk (assets), we do not envisage a return to the heady days of 2006. The U.S. equity market can push 15-18% higher this year, but it is unlikely to revisit its 2007 high, and later in the year, downside risks could increase. Overall, we see the risk recovery off the 2008/09 lows as a corrective move: a cyclical recovery rather than the resumption of the secular equity uptrend, but still a move that has further to run.”

The strategists’ panel discussion, which took place Thursday at CFALA’s annual forecast dinner, held this year at the Wilshire Grand Los Angeles, was moderated by Maria Fiorini Ramirez, President & Chief Executive Officer of Maria Fiorini Ramirez, Inc. (MFR), an independent global economic and financial consulting firm. MFR, which has offices in New York, Miami and San Francisco, expects U.S. GDP growth of about 3.5% for 2011, with that growth slowing to about 2.3% in 2012. The highly respected firm also anticipates a doubling of the core inflation rate to 1.3% in 2011 (on a q4/q4 basis), albeit from a very low rate of 0.6% in 2010. MFR believes that while there are still some attractive opportunities in the distressed areas of fixed income globally, quality spreads have narrowed substantially, the best of bond returns are history in a rising rate environment the next few years, and equities returns will easily out -perform bonds.

This year’s dinner was organized by CFALA’s Kerry Gawne, Vice President at Los Angeles-headquartered Payden & Rygel, one of the nation’s largest independently-owned global investment management firms.

“We are pleased to make the wisdom and insights of our panelists available to CFALA members and to the public again this year,” said CFALA President George Dennis, who has been chairman since launching the widely followed forecast event nine years ago. “As we enter our 80th year, CFALA continues to be the premier professional organization for the investment industry in Southern California and a highly respected source of information, as evidenced by the quality of our annual forecast dinners.”

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