Global Strategists Are Abandoning Bearish Views

By Michael Patterson and Inyoung Hwang - Feb 2, 2012

Strategists at the biggest banks are capitulating on their bearish forecasts after the best start to a year for global stocks since 1994 and gains of more than 7 percent in emerging-market currencies.

Just two weeks after saying that investors should “remain cautious,” Larry Hatheway, the chief economist at UBS AG (UBSN), raised his recommendations on global shares and high-yield bonds in a Jan. 23 note to customers entitled, “Wrong, but not too late.” Royal Bank of Scotland Group Plc (RBS) and Benoit Anne, the global head of emerging-markets strategy at Societe Generale (GLE) SA, said their estimates for developing nations were proven wrong.

The MSCI All-Country World Index (MXWD) climbed 5.7 percent in January, surprising strategists at Bank of America Corp. (BAC), Goldman Sachs Group Inc. (GS) and Barclays Plc (BARC) who had forecast first-half losses because of Europe’s debt crisis. JPMorgan Chase & Co. (JPM) and Citigroup Inc. (C), which predicted the rally in stocks, say it will continue as the U.S. housing market rebounds and China eases lending restrictions to bolster economic growth.

“In hindsight, everybody was so beared up at the end of last year,” Mary Ann Bartels, the New York-based head of technical and market analysis at Bank of America, who predicted on Dec. 27 that the Standard & Poor’s 500 Index would probably fall about 15 percent in the first half before recovering, said in a Jan. 31 phone interview. “There was nowhere for the market to go but up.”

ECB, Fed

Investor confidence improved after the European Central Bank announced a three-year lending program for banks, the Federal Reserve said it will keep benchmark interest rates low through at least 2014 and reports showed a stronger U.S. labor market and slower Chinese inflation.

Last month’s advance in the MSCI All-Country index, which tracks equities in 45 developed and emerging countries, is the best performance during any January since 1994, data compiled by Bloomberg show. The gauge, which sank 9.4 percent last year, added 0.3 percent at 11:45 a.m. New York time today.

An index of global high-yield and emerging-market debt compiled by Bank of America rose 3.1 percent last month, the biggest January increase since 2009.

India’s rupee, Brazil’s real, the Mexican peso and the Hungarian forint all strengthened more than 7 percent against the dollar as investors added about $7.7 billion to emerging-market equity funds during the past month, the biggest inflows since the four weeks ended April 27, data compiled by Bloomberg and Cambridge, Massachusetts-based research firm EPFR Global show. All four currencies weakened at least 11 percent in 2011.

Emerging Markets

“Most people were positioned for fairly weak markets, a continuation of last year,” Tim Ash, the global head of emerging markets research and strategy at RBS, said by phone on Jan. 30.
The London-based strategist had anticipated a “difficult” start to the year, with emerging-market assets rallying closer to the middle of 2012. Ash wrote in a Jan. 27 note that the rally suggested the timing of his previous forecast was wrong and he predicted emerging-market currencies will continue to strengthen.

SocGen’s Anne wrote in a November research note that emerging markets would face “severe weakness” before rebounding after the first quarter. He said in a Jan. 26 report that “we have been proven wrong so far” and the rally may extend as economic data improves.

**Goldman, Barclays**

David Kostin, a New York-based strategist at Goldman Sachs, and Barry Knapp, the head of U.S. equity strategy at Barclays in New York, were among forecasters who predicted U.S. stocks would begin the year with losses. Kostin raised his three-month estimate for the S&P 500 to 1,275 in a report to clients today, up from a November prediction of 1,150.

Bearish projections for stocks may still prove prescient should Europe’s debt crisis worsen and slow global economic growth.

The S&P 500 fell for a fourth day on Jan. 31, the longest slump since November, as Greece negotiated with European officials over the terms of a second rescue package and a report showed American consumer confidence trailed estimates. The U.S. economy expanded 2.8 percent in the fourth quarter, Commerce Department figures showed on Jan. 27, less than the 3 percent median estimate of economists surveyed by Bloomberg.

“We suspect stocks are due for a near-term correction,” Gina Martin Adams, a New York-based strategist at Wells Fargo & Co. (WFC), wrote in a Jan. 30 report. “Day-to-day economic releases may move from market tailwind to market headwind.”

Martin Adams advised in a Jan. 4 interview on Bloomberg Television to own “defensive” stocks and predicted a “rocky climate” for investors to start the year.

**Relative Value**

The S&P 500 may slip to between 1,200 and 1,250 in the next two months, though the index is unlikely to drop to last year’s low reached in October, Bank of America’s Bartels said in the Jan. 31 interview. Equities will probably resume gains in the second half, she said.

Valuations on stocks, high-yield corporate bonds and real-estate investment trusts are “attractive” and these securities will probably outperform government debt as emerging nations loosen monetary policy and the ECB’s lending program lowers the risk of a financial crisis in Europe, according to UBS’s Hatheway, who sets the firm’s asset-allocation recommendations.

China reduced the amount lenders are required to keep in reserve for the first time since 2008 in December and central bankers in Brazil, the Philippines, Thailand and Chile have all cut benchmark interest rates this year. The MSCI All-Country index trades for 13 times reported profits, compared with an average of 21 times during the past 15 years, according to data compiled by Bloomberg.

**‘Stars Aligned’**

Hatheway lifted his rating on global equities to “overweight” from “neutral” in the Jan. 23 research note.
Improving U.S. economic data and “the turning point in the policy cycle in the emerging economies will both tend to diminish some of the concerns people have had,” Hatheway said in a Jan. 31 phone interview. “I still think the consensus is quite cautious.”

Developing-nation assets will probably extend their gains should figures due on Feb. 3 show U.S. payrolls and employment in January exceeded economists’ estimates, SocGen’s Anne said in a Jan. 30 phone interview from London. U.S. employers probably added 145,000 jobs last month as the unemployment rate held at 8.5 percent, according to the median estimates in a Bloomberg News survey.

**Too Bearish**

“I got stuck with my defensive views for too long,” Anne said. “If we do get confirmation that the payroll number is a decent number, no shocking surprise to the downside, then presumably all stars will be aligned for another leg of the rally.”

Any declines in emerging-market equities are a buying opportunity, Geoffrey Dennis, the global emerging-market equity strategist at Citigroup, said in a phone interview on Jan. 30. The New York-based strategist, who wrote in a December report that stocks would probably gain at the start of the year, predicts that the MSCI Emerging Markets Index (MXEF) will climb to 1,225 this year, about 20 percent above its current level.

“We do think Europe will survive this year, the global economy is doing fine and the next obvious piece of good news may be when China cuts banks’ reserve requirements again, which may happen any day,” Dennis said on Jan. 30.

The S&P 500 will probably climb to 1,430 by the end of this year from 1,312.41 on Jan. 31, according to Thomas Lee, the chief U.S. equity strategist at JPMorgan in New York.

His estimate is 6 percent higher than the average forecast of 12 strategists compiled by Bloomberg on Jan. 30. While the rally may face a short-term “pause,” it will resume this year as investors purchase shares of companies most tied to economic growth, Lee wrote in a Jan. 26 report.

“Investors had gotten just too bearishly positioned,” he said in a phone interview on Jan. 30. “Investors need to go from defensive to cyclical exposure. That’s going to be something that takes time.”

To contact the reporters on this story: Michael Patterson in London at mpatterson10@bloomberg.net; Inyoung Hwang in New York at ihwang7@bloomberg.net

To contact the editors responsible for this story: Laura Zelenko at lzelenko@bloomberg.net; Nick Baker at nbaker7@bloomberg.net

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