Standard Chartered
Private Bank

# Standard Chartered Private Bank – The Journey

## Emerging Markets Are Facing "Headwinds", U.S. Equities Benefiting From "Tailwinds"

Most money in 2010 was made by investing in emerging markets. In 2011, however, the best stock market opportunities globally exist in U.S. large cap stocks.

Since the beginning of the year, U.S. equities have outperformed many emerging markets and we expect this trend to continue for at least the first half of 2011, and potentially even beyond that.

The emerging economies' stock markets have outperformed the U.S. significantly over the last 18 months since March 2009. Now, however we are entering a period in which the more mature economies, like the U.S. and Europe can outperform emerging markets for the foreseeable future.

While 2010 was the year of the "*Tale of Two Worlds",* a sluggish West and a buoyant East, 2011 is different.

In 2011, it is the West that is short-term outperforming as inflation and interest rate normalisation concerns overhang many emerging markets, in particular India and China.

Growth in emerging markets is slowing down from previously higher levels and growth in the U.S is improving and rising from previously low levels. This is having major implications for your wealth and portfolio strategy.

The emerging markets are facing "headwinds" due to rising inflations concerns while the U.S. equities market is supported by "tailwinds". Most investors, however do not seem to be positioned for this.

Historically, when U.S. stocks assumed global stock market leadership, emerging markets tended to underperform.

Most emerging markets are experiencing significant up ticks in inflation and it is being countered by Central Bank tightening of monetary policy. Higher rates are now beginning to put pressure on Asian stock market valuations that have risen significantly due to U.S. quantitative easing.

The U.S. equity market is currently trading around 13 times next year's earning and in the middle of its historic range. The S&P 500 is still -16% below its all time high in early 2000 in nominal terms. After adjusting for price inflation, it is down about -35%.

The interesting story is now the U.S. and American equities, especially U.S. large caps with a high proportion of sales to emerging markets, offer the best relative value today.

Emerging markets are suffering from the "Law of Unintended Consequences". Too much money printing by Ben Bernanke led to inflation and asset bubbles in emerging markets. Domestically in the U.S., however this unprecedented money printing avoided the so called “double-dip” or another recession. In the U.S. you don’t have any tightening bias yet, so what is happening is that you are getting the full benefit of upside to global economic growth.

Standard Charted Global Research recently upgraded its full year 2011 GDP forecast for the U.S. to +2.9% from previously +1.9%. This is happening at the same time when we are revising lower forecasts for Asian GDP growth in 2011. The net impact is that in the first half of 2011, U.S. large cap stocks offer globally the best value in equities.

One of the other key reasons why we favour U.S. large cap stocks in the first half of this year is due to our friends in China and their new strategic initiatives. The Chinese leadership, partly due to pressure from Washington, has decided to partly re-balance their economy not only by letting the RMB (Chinese Yuan) appreciate but also by reducing the trade surplus by being a massive buyer of U.S. goods.

China realised that the record US$2.68 trillion of reserves are becoming a domestic problem that sparks inflation. Similar to the Japanese in the late 1990s, China is beginning to re-cycle excess reserves into U.S. assets.

Last month in the White House, President Obama and Hu Jintao, President of the People’s Republic of China signed a historic US$ 45 billion trade agreement that is expected to re-balance the world economy post double-dip subprime related global recession.

After a fractious few months that have brought differences to the fore over currency manipulation, arms build up and other issues, Hu Jintao and Obama were at pains to stress the benefits of the relationship among the two most important economies and signed deals worth US$ 45 billion including US$ 19 billion for 200 Boeing aircraft.

China needs to shrink its trade surplus and boost its spending. Chinese consumer spending currently amounts to only 13% of U.S. GPD. A 20% rise in Chinese consumption might well lead to an extra US$ 25 billion of American exports. That would create over 200,000 American jobs. Eventually, this extra spending will help the world’s largest economy return to full employment.

China’s need to rebalance its economy away from predominately export driven growth to domestic consumption led growth is now giving an extra boost to the U.S. large cap rally. Investors should increasingly consider to “*overweight”* U.S. equities.

2011 is the year where U.S. stocks are in the “sweet spot”.

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