



BREWIN DOLPHIN

Market Strategy

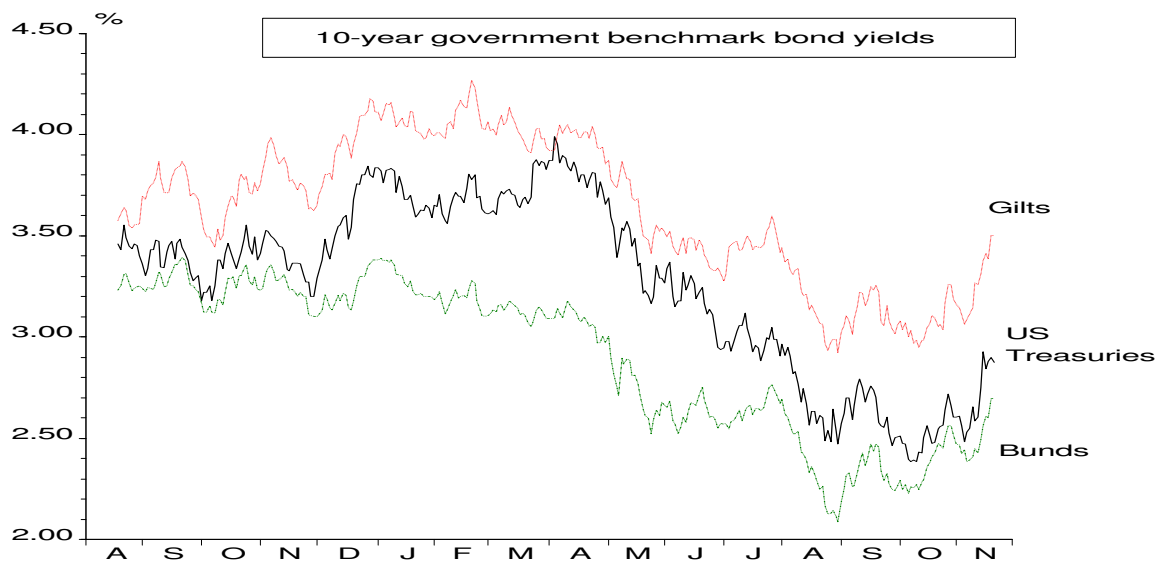
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INVESTMENT RESEARCH

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Bond and equity markets focus on reflation.



Source: DATASTREAM

With Ireland now formally seeking financial assistance – the size and terms of the bailout are under negotiation – equity markets will welcome the effort to draw a line under the Irish banking problem and will see this as neutralizing a destabilizing influence for the eurozone.

China's introduction of directives and administrative controls for ensuring supplies of agricultural produce to help ease inflationary pressures will complement central bank policy, which has just tightened again with a further 50 bps rise in the RRR (Reserve Requirement Ratio). The rise in the RRR is exerting upward pressure on money market rates and this is narrowing the gap with lending rates. Another increase in interest rates is thus likely before year-end.

While the Fed has been defending its corner on QE and rebuffing the critics, the dollar has rebounded a bit. Also, yields in the US Treasury market have been rising. At the long end they're now up some 75 bps from their August low but they have risen across the curve.

As the chart shows, yields are also up in other major government bond markets, notably bunds and gilts, thus suggesting overall that the focus is on reflation. This contrasts the position at the outset of the eurozone's sovereign debt crisis earlier in the year when the major bond markets were beneficiaries of risk aversion. It also contrasts the action in equity markets, which has been supported by the improving tone to the economic news flow.

Equity markets no longer look overbought but that's not because of lots of profit-taking. If anything their sturdiness has defied anyone looking for a decent buying opportunity. However, the major equity markets have been losing momentum and the banks have been leading the way on this. This suggests that equity markets are vulnerable to a bout of selling but with the turn of the year approaching, the typically strong seasonal effects in play combined with the positive news outlined may prevent this happening anytime soon.

IMPORTANT NOTES

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