Recap on 2Q investment outlook

Not everyone has time to read the lengthy, boring letters that I write, so I thought I'd summarize and simplify.

Current economic data is indicative of a global synchronized slowdown. Looking behind the numbers we find a more healthy US economy, a recovering UK economy, a chronically ailing Eurozone, and slowing emerging markets. The US economy has seen some short term weakness, most of it coming from a slowdown in government expenditures; the private sector economy continues to grow at not 2.5% but closer to 4% YOY. The UK economy is emerging from recession after taking austerity earlier rather than later, and lower corporate tax rates. The Eurozone has a chronic structural problem with the EUR which is failing to allow for price discovery in factor markets. Emerging markets struggle with capacity constraints, productivity limitations, mostly as a result of technological limits. Japan's QE is the latest in the world and the first in a long time domestically, hence it is reaping economies of scale and is likely to ignite a self sustaining recovery. China's economy I have discussed in previous posts, the latest export data is not only highly dubious but corrected for FX arbitrage volumes is quite poor.

I like US and UK equities. I like US housing even after it has risen as strongly as it has in the past year. I don't like China and the Germans are levered to China.

Bonds look overvalued, especially investment grade. High yield trades more like equity and so is preferred. Given the volume of issuance, defaults will be postponed for some time. Companies are paying dividends and buying back stock releasing cash to investors who are seeking returns and who therefore are likely to redeploy to to equities, and given the resulting reduction in float, is likely to push equities higher. In fixed income I like bank loans for their seniority and floating rate coupon. I also like US RMBS for the housing exposure and security of good collateral.

Industrial metals are likely to suffer as growth redistributes to more efficient producers. Agricultural commodities are likely to do well on current dietary and demographic trends. Technicals are also supportive.

Gold remains a conundrum but which now reveals much about other asset markets. Gold is a hedge against QE but not any kind of QE, it is a hedge against unsuccessful QE. If QE is successful, gold is a less useful hedge as risky assets begin to react to improved fundamentals. The great rotation, may be out of gold.