



Don't try to call every short term trend in sentiment

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With a trend to weaker economic data during the second quarter, markets have been faced with yet another growth scare, similar to what happened in mid-2010. The pace of recovery in the US labour market, which had been quite strong, has faded during the past few months and the main monthly business surveys have rolled over in most economies. So-called "soft patches" are not unusual within economic cycles and especially in the early stages.

Data can be volatile and there is the added uncertainty about the short-term effect of the Japanese earthquake on the global supply chain. The importance or otherwise of transitory factors should become clear over the next few months and it may be that, with the fading effect of policy stimulus, a more prolonged slowdown has begun. However, it is our base case that the recent soft patch in the US is mainly the result of temporary factors, such as Japan-related disruption in auto production, although we are not especially bullish on longer term growth prospects.

Over the next few years we expect a period of higher macro volatility than in pre-recession era, with sentiment swinging regularly between optimism and pessimism and worries about inflation followed by worries about deflation.

Our core expectation for most developed economies (including the US and the UK) is a choppy post-crisis recovery around a lower growth trajectory than might have been expected after such a deep recession.

This economic backdrop argues for lower risk asset valuations and although at current levels we see equities and credit as good value relative to the main alternative assets of cash and government debt, we think it's important to hold a broad mix of assets, rather than become more active in switching between assets, in a vain attempt to call each and every short-term trend in market sentiment.

Source: rlam as at 7th July 2011 unless otherwise stated.

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