Citi Personal Wealth Management

Investment Digest

Japan Loosens, U.S. Brightens, North Korea Frightens

Welcome to our monthly roundup of market and economic insights. The views in this publication are those of Citi Private Bank's Global Investment Committee and Citi Investment Research and Analysis. These views should not be considered a solicitation, advice or recommendation with respect to asset allocation or any particular investment. If you would like a copy of the research reports listed below, please contact your Citi Personal Wealth Management advisor.

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"The outlook for recovery in the global economy looks more sustainable than at any point since the crisis," reckons Alexander Godwin, Citi Private Bank's Global Head of Asset Allocation, in *Market Insights* (April 5, 2013). In particular, the U.S. outlook continues to brighten. "After a prolonged period of lackluster spending, corporations in the U.S. seem finally to have the confidence to take on more debt and investment in capital goods," Godwin writes. "This, combined with rising housing prices and a steadily improving job market, will support growth going forward." The picture is not as bright in Europe. "Economic data in Europe continues to be poor, with rising unemployment and weakening manufacturing," Godwin notes. "The Italian election, and now the Cyprus bank bailout, has again demonstrated the fragility of the political and economic situation in Europe."

Recent gains in high-grade corporate bonds may not be sustainable, Michael Brandes contends in *Bond Market Monthly* (April 9, 2012). "Although we still believe that the fundamental backdrop for credit issuers is relatively strong, balance sheet improvements have reversed," he writes. "Indeed, leverage ratios have risen and issuers are increasingly taking advantage of the low rate environment to fund equity-friendly (i.e., share repurchases, dividends, et al) activities." On the other hand, Brandes has a more-positive outlook for high-yield bonds. "High-yield corporate bonds continue to benefit from low government yields, low default rates and stimulative monetary policies conducive for risk assets," he says. "The sector is still on pace to post high single-digit total returns this year."

Japan has made a "regime change" in monetary policy, Kiichi Murashima observes in *Japan Macro Flash* (April 4, 2013). Prior to the Bank of Japan's April 4 announcement that it would more than double its purchases of Japanese government bonds, the bank was more concerned about fiscal discipline and market function. The new measures "represent a 'different dimension' in monetary easing," he says. But one of the goals of the new policy, to raise Japan's inflation rate to 2%, could be hard to reach. "We think that reaching the 2% inflation goal within two years will be extremely challenging, regardless of the measures just announced," he says. "In particular, the fiscal contraction slated for 2014, which we expect to equal around 2% of GDP, is likely in our view to make it harder to raise inflation and inflation expectations."

“North Korea has overtaken Iran as the year's biggest potential flashpoint,” Tina Fordham contends in *Global Political Insights* (April 4, 2013). “The stakes have increased markedly since the last period of heightened tensions in 2010,” she writes, noting that “there's new leadership in China, a more muscular Japanese foreign policy, and a United States rapidly realigning security and trade relationships with its Asian partners, not to mention a new 20-something leader in Pyongyang.” While Fordham thinks developments on the Korean peninsula bear watching, she does not believe North Korean brinksmanship will hurt South Korean economic fundamentals. “Heightened North Korean tensions do not always have negative impacts on markets and have occasionally presented buying opportunities, but any shock that affects sentiment should not be ignored,” she cautions.

March’s disappointing jobs report “should give pause but it isn’t very likely signaling a new direction,” Robert DiClemente says in *U.S. Economics Weekly: Market and Policy Comments* (April 5, 2013). “In the absence of a significant shock or collapse in demand, it isn’t credible, in our view, to argue that payroll growth has abruptly turned off.” For example, spending on consumption, housing and business investment continues to be relatively strong. While fiscal tightening resulting from the sequester may affect the second quarter, DiClemente says “the signs that fundamentals are improving and that meanwhile Fed policy is continuing to err on the side of aggressive accommodation, suggest that a second quarter dip in growth will give way to renewed strengthening later in the year.”

Recent economic reports contain both signals and noise, Steven Wieting argues in *Morning Comments* (April 8, 2013). Among the signals is the pace of consumer spending in January and February, which was stronger than the fourth quarter of 2012 and comes in the face of a 9% jump in gasoline prices and a $133 billion annualized increase in payroll tax collections. At the same time, “it’s not credible to think there has been or will be no impact at all from these negatives,” Wieting cautions. “On the noise front, eight months of relatively ‘well behaved’ payrolls data may have once again lulled markets into complacency with the jobs report. With a 135,000 jobs per month representing just a 0.1% monthly change in the employment level, persistent accuracy in payroll forecasts shouldn’t be expected.”

an issuer’s credit rating, or creditworthiness, causes a bond’s price to decline.