July 2013

IdahoTrust

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Market Insights

A periodic newsletter from Idaho Trust

Market pessimism in Japan has rattled Japan's currency and stock markets. Uncertainty about the Federal Reserve's monetary policy and expectations of tapering down its bond-buying program has fueled concerns in global financial markets and prompted capital outflows in emerging markets.

Developed Markets

New Japanese economic policies have been met with mixed reviews. New Prime Minister Shinzo Abe has championed an aggressive economic-stimulus strategy to boost Japan's economy after two decades of stagnant growth and falling prices. This new economic policy attracted hedge funds and overseas buyers to Japan's stock market which rose 80% since mid-November to May as one of the steepest bull markets in history. During this time the Japanese yen fell nearly 23% against the U.S. dollar which helped boost prospects for Japanese exporters and increased the value of their overseas earnings. Despite the initial surge, in May the Japanese stock market fell into a roller coaster type of market due to the lackluster reception of the new Japanese economic policies. Since that time, the Japanese stock market has declined 23%, into a bear market. However, more recently, the yen has reversed and has risen sharply, potentially hindering Japan's exporters. First quarter Japanese GDP figures offer a positive outlook forecasting 4.1% growth. The World Bank increased their Japanese GDP forecast for 2013 to 1.4% from an earlier projection of 0.8%. The Bank of Japan, Japan's policy setting central bank, recently released their 10-year growth plan. Some economists have stated that Japan's long-term strategy fails to address the structural issues prohibiting effective long-term growth. Other economists are optimistic that Mr.

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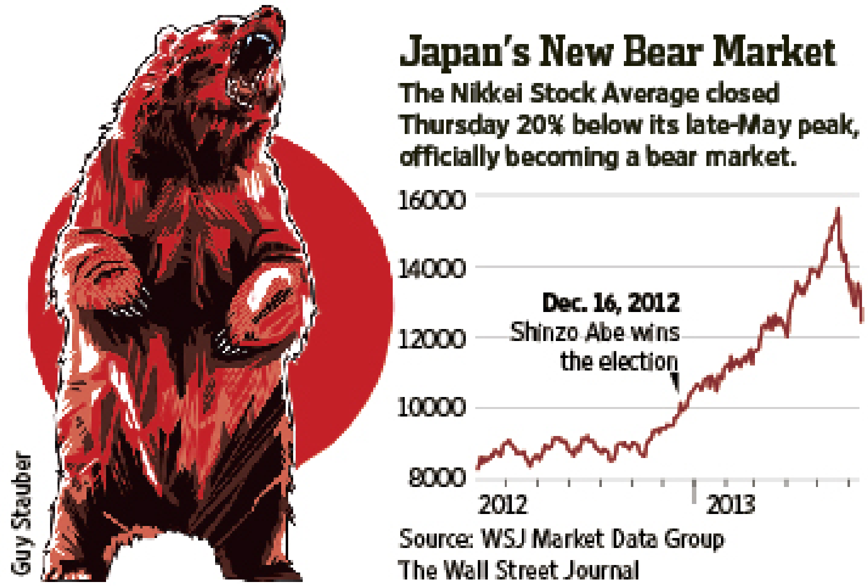
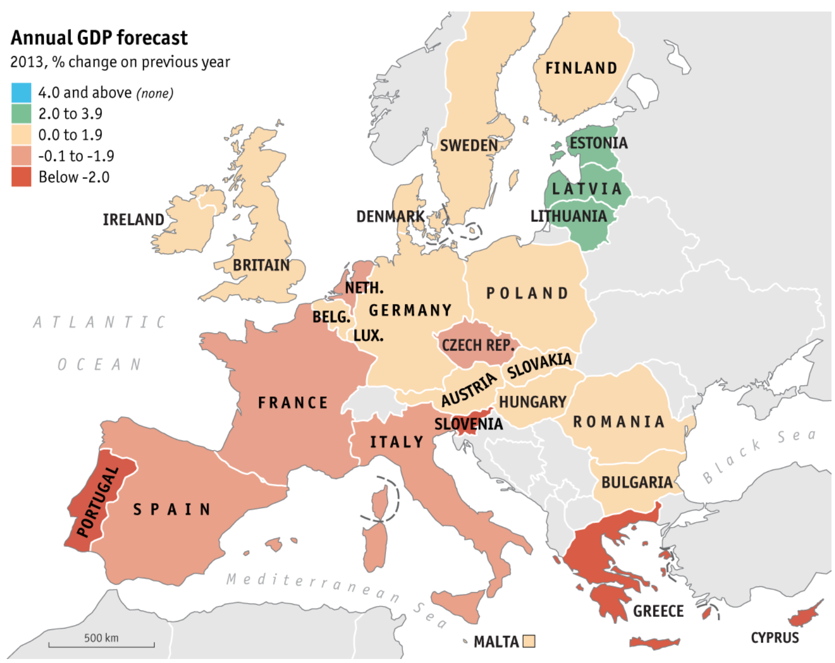


Abe's economic strategy is starting to have the intended positive effects on the economy.

Euro zone growth is expected to be modest for 2014. Europe remains in its longest recession experienced in decades stemming from weak business and consumer confidence, high levels of debt that may continue to take years to pay down and new mandated fiscal austerity. Last July, the European Central Bank (ECB) president, Mario Draghi, stated the ECB would do *"whatever it takes"* to hold the euro zone together including making unlimited government bond purchases if necessary. The purchasing program known as Outright Monetary Transactions (OMT) has come under scrutiny by Germany regarding the program's possible infringements with the European Union's primary law. OMT is expected to remain in operation because Mr. Draghi is arguing that it is necessary to eliminate the *"reversibility risk"* that bond yields may rise once again on speculation that the euro zone would disassemble.

This month, speculation that the Federal Reserve will begin to taper down their bond purchasing program has caused euro zone bonds to be sold off and European yields to start climbing which will end



Source: The Economist

the most recent rally in European bonds. Germany's 10-year government bond yield, a measure of the German government's borrowing costs, rose to its highest level since February, but still remains below other countries with larger debt loads. Spain's 10-year government bonds rose to 4.87% and Portugal's to 6.41%. Prevalent debt levels remain in some countries. Greece has a debt level currently at 175% of GDP, Italy at 131% and Ireland and Portugal are both forecasted to reach 123% this year. Higher borrowing costs and disagreeing European leaders have economists hoping that European economies will shift into a higher gear this year and pursue further economic integration of the euro zone.

Emerging Markets

The economic uncertainty in Japan and market expectations that the Federal Reserve will taper down its easing monetary policies this year has triggered dramatic currency, bond and stock declines in emerging-markets. Previously, relatively lower potential investment returns in developed markets had investors seeking higher returns in emerging markets. Now that U.S. Treasury yields are rising, investors have been selling emerging market investments in favor of developed market investments. Emerging market policy makers are fighting the capital outflows and currency declines have prompted central banks to intervene against the U.S. dollar's relative appreciation. In recent weeks, India's rupee slid 7%, Brazil's real is down 9% and the South African rand fell 1.1%. Although emerging markets' growth is slowing, emerging markets are still expected to grow at a faster rate than developed economies in the future. Economists also believe that as the U.S. economy picks up, the rise in consumer spending and demand should give a lift to emerging markets.

China's economic growth has slowed more than expected, dropping to 7.7% annually in the first quarter of 2013. Industrial output and exports have also slowed. Capital inflows into the Chinese economy from foreign investors have declined creating a need for additional capital in the Chinese economy. The lower foreign currency inflows and short-term liquidity needs have contributed to higher Chinese interest rates. China's central bank, the People's Bank of China, has refrained from intervening, and is determined to ride out the current slowdown. To supplement capital available to the economy, the People's Bank of China may use weekly liquidity operations such as selling 91-day bills. Despite the slowdown the Chinese government has shown little indication of launching a new stimulus plan. The slowdown has raised concerns for the possible need of new innovative economic policies from Chinese leadership.

Conclusion

The recent surge in volatility across financial markets has Asian and European governments pumping money into their economies to support their ailing growth. The Federal Reserve appears ready to modify their monetary policy now that the economic recovery is strengthening. Despite emerging markets' recent decline, long-term GDP forecasts for emerging markets are offering a positive outlook.

S&P 500 Index

3 Month	2.91%
Year-to-Date	13.82%
1 Year	20.58%
3 Year	18.45%
5 Year	7.01%

MSCI EAFE Net Index

3 Month	-0.74%
Year-to-Date	4.54%
1 Year	19.34%
3 Year	10.76%
5 Year	0.06%

Barclays Aggregate Bond Index

3 Month	-2.33%
Year-to-Date	-2.44%
1 Year	-0.69%
3 Year	3.51%
5 Year	5.19%

As of 6.30.2013

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