VAKIFBANK GLOBAL ECONOMY WEEKLY

The US stock markets direction in the upcoming period...

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27 June 2011

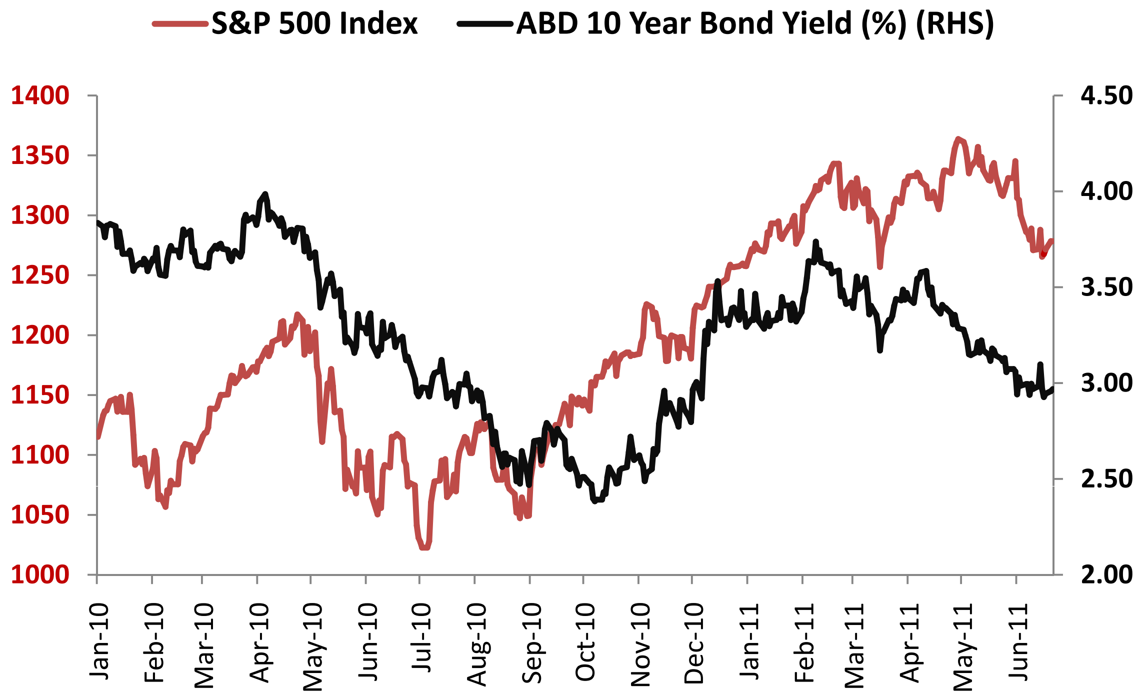
No: 23

Vakıfbank Economic Research

Introduction…

Due to weak macro economic data releases and unstable housing sector, the market recovery ,which started in October 2010 and picked up in April 2011, give place to a downward trend in May 2011. However, we believe that investors would see this current skepticism as an opportunity, and market rebound would again start in the forthcoming months. In this framework, the key drivers behind a possible rebound in markets are analyzed in this study.

Despite decreasing bond yields and sales in equities, a market rebound is foreseen in the coming period...

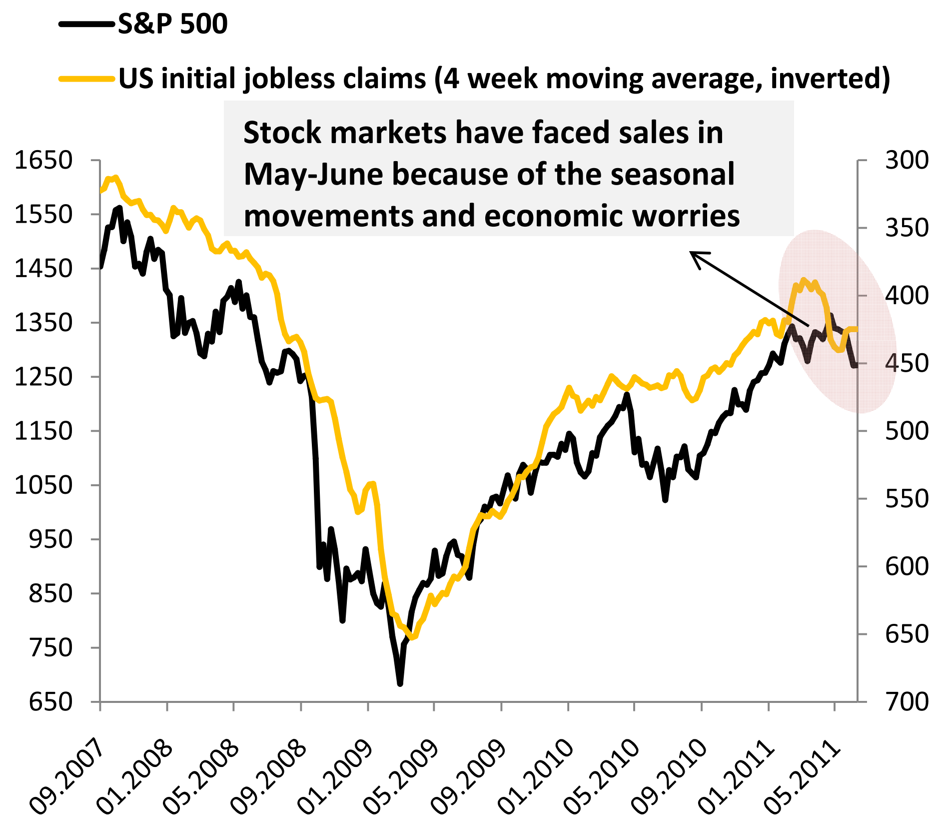


Source: Bloomberg

- Investors rushed into safe-haven US bonds and bond yields decreased, also equities fell down in May 2011 due to weakening macro economic view, seasonal effects and the investor fear towards the end of QE2.
- Moreover the concerns about Eurozone debt crises surged and confusion in Middle East accelerated the fall in yields.

- After seasonal factors ended in the coming months a market rebound is expected, in this respect the key drivers behind a possible rebound are analyzed under three headlines.

1-Macro economic outlook...



Source: Bloomberg

- The recent data released in the US have not met the expectations. In addition to this, QE2 will expire at the end of the June and all these increase the market fears toward the US economy.
- Thus, macro economic outlook will become more important than before as the QE2 ends in the near term.
- The end of QE2 has already been priced in the stock markets. In addition to the seasonal movements, sales in the stock markets in May-June reflects this situation.
- Thus, after the QE2, positive economic data released in US will support the stock markets.

- As it can be seen from the chart above, there is a high correlation between the US initial jobless claims and S&P 500 index. Therefore, the recent recovery in US initial jobless claims will support the upward trend in equity markets is the coming months.

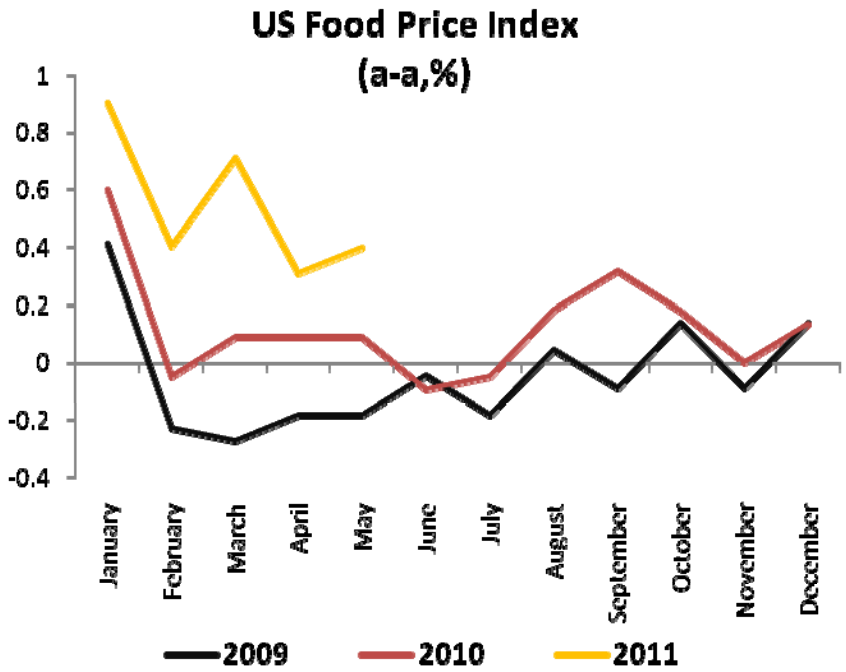
-ISM manufacturing index signals upward movement in S&P500 in July and August...

ISM (Peak)	ISM	-1m	+1 m	+3 m	+4 m	+5 m	+6 m
Dec 61	64.2	0.3	-3.8	-2.8	-8.8	-16.7	-23.5
Mar 65	64.9	-1.5	3.4	-1.1	1.2	4.4	7.3
Apr 68	58	8.2	1.1	0.2	1.3	5.2	6.0
Jan 73	72.1	-1.7	-3.7	-7.8	-9.5	-10.1	-6.7
Feb 76	61.5	-1.1	3.1	0.5	4.6	3.7	3.2
Jul 78	62.2	5.4	2.6	-7.5	-5.9	-4.5	-0.7
Nov 80	58.2	10.2	-3.4	-6.6	-3.2	-5.5	-5.6
Dec83	69.9	-0.9	-0.9	-3.5	-3.0	-8.7	-7.1
Dec 87	61	7.3	4.0	4.8	5.8	6.1	10.7
Sep 91	54.9	-1.9	1.2	7.5	5.4	6.4	4.1
Oct94	59.4	2.1	-4.0	-0.4	3.2	6.0	9.0
Jul 97	57.7	7.8	-5.7	-4.2	0.1	1.7	2.7
Nov 99	58.1	1.9	5.8	-1.6	7.9	4.6	2.3
Jun 02	53.6	-7.2	-7.9	-17.6	-10.5	-5.4	-11.1
May 04	61.4	1.2	1.8	-1.5	-0.5	0.8	4.7
Mar 10	60.4	5.9	1.5	-11.9	-5.8	-10.3	-2.4
Feb 11	61.4	3.2	-0.1	1.4			
Ave		2.3	-0.3	-3.1	-1.1	-1.4	-0.5
Sources: Bloomberg, VakıfBank							

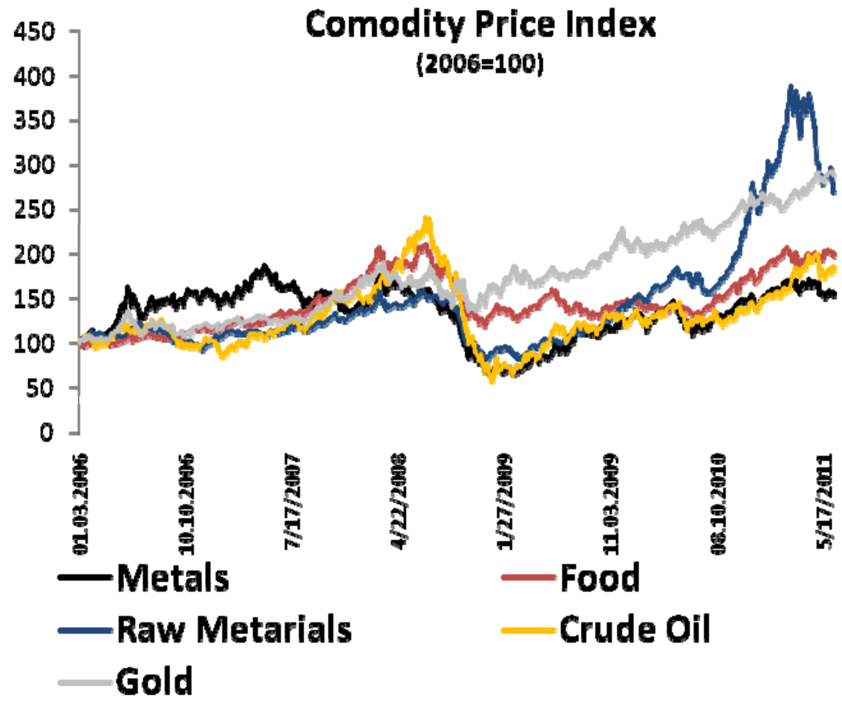
- Historically, the peak in ISM was followed by weak equity market performance. During 3 months after ISM peaked, market weakness accelerated. When we look at the performance of the S&P500 in third month after ISM peaked, S&P 500 increased only 5 times in the past 17 times and the index decreased by 3.1% on average .

- However, the consolidation in S&P 500 ended up after 1 quarter and S&P 500 gained the upward momentum again after 1 quarter. The upward movement in index became more clear after 5 and 6 months.

- ISM has peaked at 61.4 in February 2011 and S&P 500 has started to decrease after February. According to our analysis, consodilation in S&P500 may reverse in July and August which are the fifth and sixth months after ISM peaked.



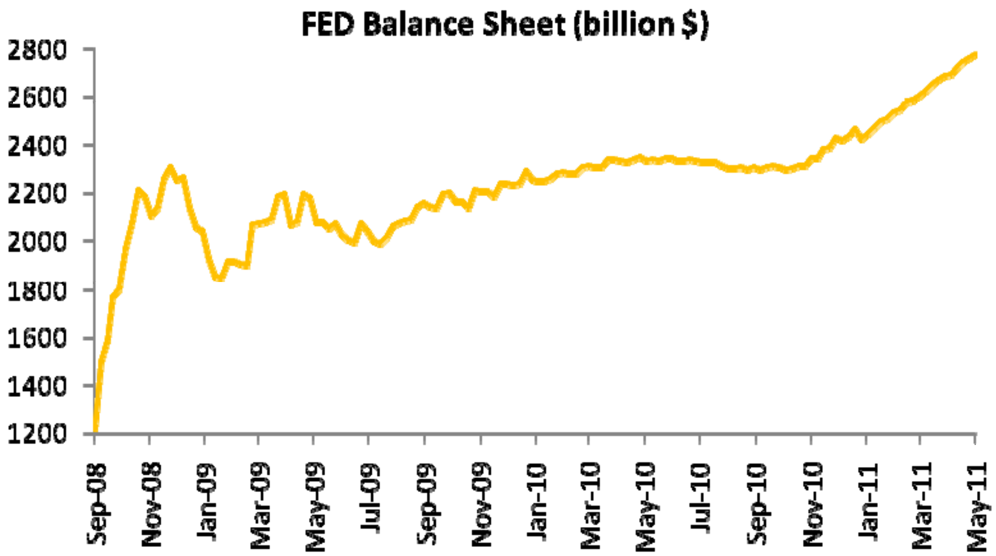
Source: Bloomberg



Source: IMF

- Another factor that can affect the direction of stock markets will be the U.S. inflation rate.
- Thanks to the good weather conditions in the coming months, food prices movement may reverse and food prices may be a source of decrease in inflation.
- Moreover, commodity prices have started to stabilize. To illustrate, crude oil prices increased to $120 per barrel in April and fell sharply in May, but have stabilized since then. Prices have decreased to $107 per barrel recently. Therefore the effects of high commodity prices on inflation would be less than expected in the coming months. This supports the upward movements in stock markets.
- However, if commodity prices continue to decline, stock markets increase will be limited due to decresase in energy sector prices.

The end of QE2 is another factor that would be effective on US inflation...



Source: Bloomberg

- When QE1 and QE2 periods are analyzed, it is seen that inflation preassures are increased due to possitive growth expectations and increasing demand. With increasing risk appetite stock markets increased based on purchases and bond yields decreased based on sales.

- Different scenarios for the end of QE2 are discussed in the markets. Markets fear of a potential selling driven by the end of QE2. However, as the end of QE2 has already priced in, a potential selling is not expected after the end of QE2. The QE2 contributed to a significant USD weakness, which drove speculation in commodities and lead to a pick-up in EM inflation. Therefore, the end of QE2 should not be feared as it would lead a stabilization in commodity prices and inflation preassures in EM countries.

- In this respect, the end of QE2 would not be negative for equities and an upwrad trend may be seen in stock markets.

Moderation in inflation may postpone tightening policy in EM ...

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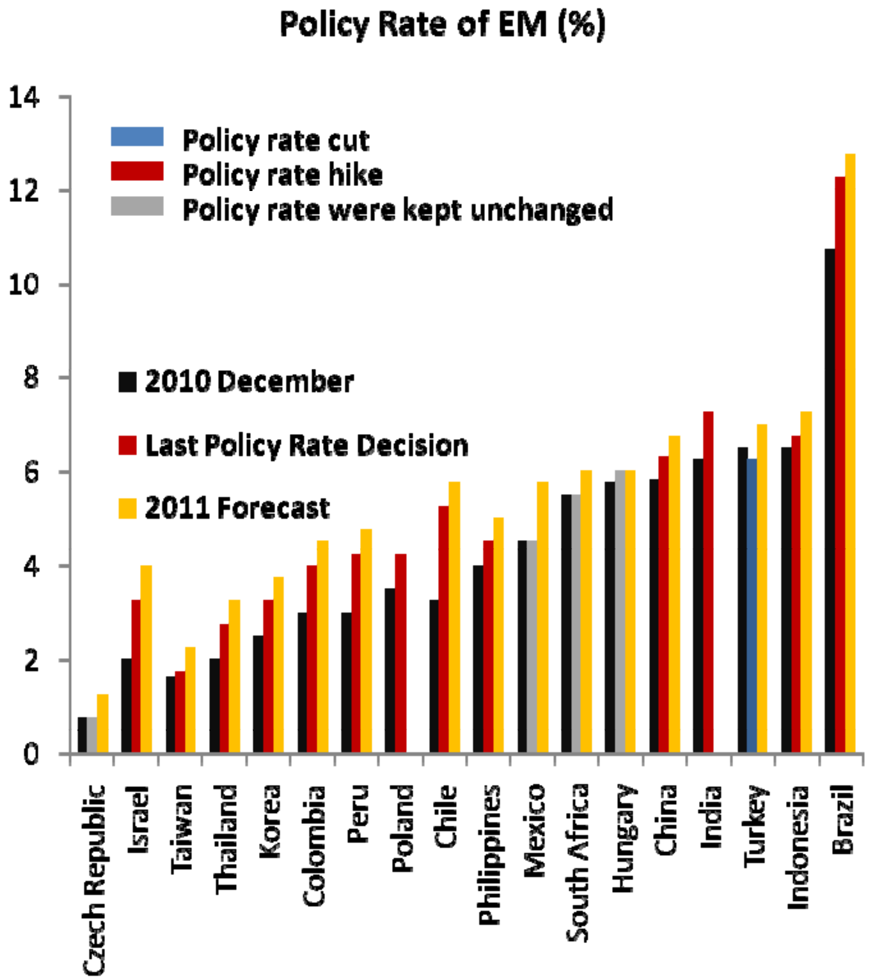
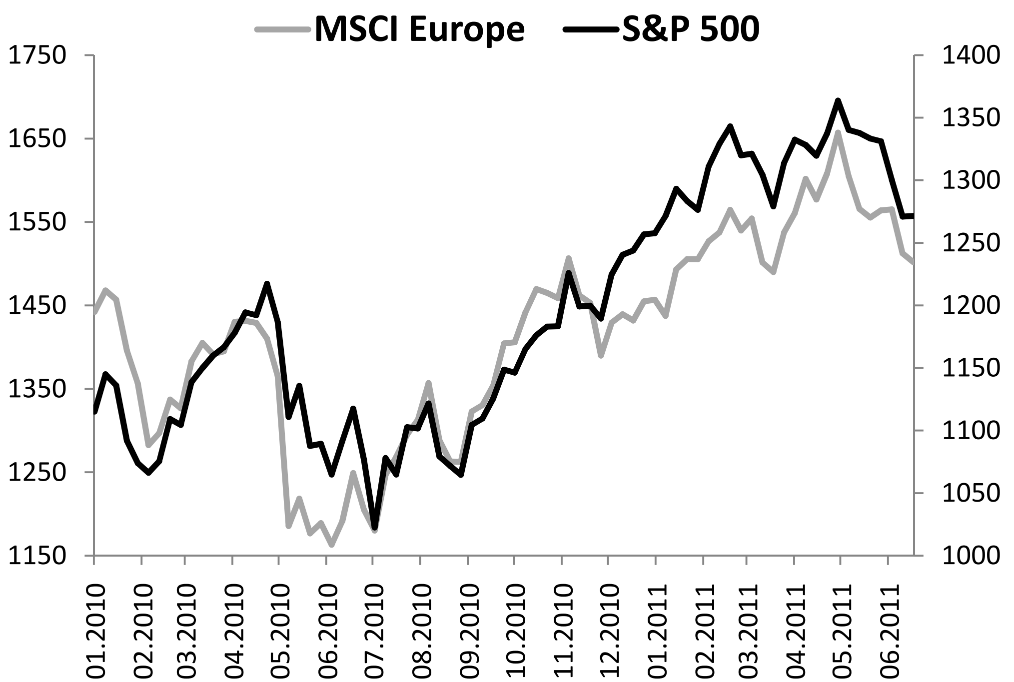


Source: Bloomberg

- EM countries which have more dynamic growth performance than Developed Markets (DM) after the crisis, have recently witnessed high inflation rates.
- Continuity of increase in commodity prices has recently forced central banks to hike policy rates. Moreover, World Bank announced that Asian and Latin American countries may face with high inflation, and they have to tighten monetary policy more quickly to curb inflation pressures.
- However, good weather conditions in the coming months may be a source of maderation in inflation rates and this make Central Banks of Emerging Markets to postpone their tightening policy.
- This supports US equities as a profitable investment opportunity.

3-Sovereign debt crisis in the peripheral Eurozone countries...



Source: Bloomberg

- The debt crisis and default risk in the peripheral Eurozone countries have inreased concerns towards Euro and this has negatively affected the stock markets.

- Considering the syncronization of the S&P 500 and MSCI Europe Index movements, debt crisis in the peripheral Eurozone countries can limit the increase in stock markets in coming months.

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