MARKET COMMENT

January 2011

Generally, the markets picked up in January where they left off in the second half of 2010, generating unexpected returns. The S&P 500 Index gained 2.26%, its fifth straight monthly gain and its strongest start of a year since 2006. The credit markets were in a more modest mood. The yields on US treasury papers which have started to climb in the last quarter of 2010 moved sideways in the first month of 2011.

Despite the positive sentiment in January, there were mainly two negative factors that might have been an obstacle for the markets. First, the protests in Egypt caused some anxiety in the markets fueling the fears that global supplies of oil produced in the region and transported through the Suez Canal would be affected. Second, investors were worried about the risk of accelerating inflation, stimulated by main emerging economies, the US deficit, and rising food, oil, and other commodity prices.

The risk aversion tone mostly related to peripherals' financing problems continued in January. Within the month the spreads for Greece, Ireland, Portugal and Spain bonds widened significantly with respect to German Bunds. Inflation expectations caused EU and US treasury curves shift upwards, especially the long end of the curves. In his speeches, Trichet talked about inflation risks and sounded hawkish for the first time after July 2008. Knowing Trichet, such a tone would be expected. However, it was an early call since the recovery is still in a vulnerable phase. We expect US and EU treasury curves would to push higher yields in the next couple of weeks.

All in all, we are not very fond of the bond space, especially the long end of the curves. Even though the core of inflationary expectations has been from Emerging Economies, the EMBI+ index decreased only 0.5% in January. Hence, EM corporate bonds still look strong, but the shorter end of the curve seems better.