

DIAM Special Report: Background to the Worldwide Abrupt Rally in Stock Prices, and Future Outlook

DIAM Co., Ltd.
Asset Allocation Group

1. Background to the worldwide abrupt rally in stock prices

- From the start of the week, investors' risk-averse stance softened due to factors including the reporting of the IMF's preparation to support Italy and strong year-end sales in the US. The announcement by 6 US, European, and Japanese central banks of coordinated policy to expand the supply of dollar funds, in addition to China's lowering of its deposit reserve requirement ratio (-0.5%) for the first time in 3 years, was well received by investors yesterday, and US and European stock markets rose sharply: S&P500 +4.3%, DAX +5.0%, the FTSE MIB Index +4.4%, etc. US economic figures announced yesterday (ADP National Employment Report, Chicago PMI, Existing Home Sales, etc.) all exceeded market forecasts, another factor lifting stock markets. In bond markets, while government bond yields fall in Italy, Spain, France, Germany, and other euro bloc countries, government bond yields rose in the US and UK, where buying had taken place on flight to quality. In FX markets, while falling across the board against major currencies, the dollar temporarily fell to the low ¥77 range against the yen, and the euro temporarily recovered to the \$1.35 range. Affected by these movements in overseas markets, in Tokyo the market began with a rise of over 2% in the Nikkei 225.
- The main content of the coordinated policy on expanding the provision of dollar funds is as follows: (1) The interest rate on dollar funds provided through swap arrangements will be lowered by 0.5% from December 5, 2011 with the deadline extended to February 1, 2013; (2) a multifaceted swap arrangement will be formed for the loan of currencies other than US dollars only; (3) central banks will lower their add-on rate above market interest rates by 0.5% when providing dollar funds to private banks; and (4) criteria will be relaxed for the collateral put forth by private banks when receiving dollar funds from the ECB. In response to the excessive tensions appearing in international financial markets due to the ongoing solvency crisis continuing over the end of the year, the above aims to prevent bottlenecks in private banks' financing, and, implemented by 6 major central banks, appears to have succeeded in providing some degree of security to market participants. While the expansion of the safety net can be lauded, only a small portion of financial institutions receive dollar funds from central banks. Accordingly, we see the measure as merely one to buy time, a point that was noted in the press conference by the Governor of the Bank of Japan.

	2011/03/31	Most recent closing price	Percentage change on 2011/11/30	Percentage change 2011/04/1-2011/11/30
Nikkei 225	9,755.10	8,607.57*	2.1%*	-11.8%*
TOPIX	869.38	740.76*	1.7%*	-14.8%*
Dow Jones Industrial Average	12,319.73	12,045.68	4.2%	-2.2%
S&P500	1,325.83	1,246.96	4.3%	-5.9%
DAX	7,041.31	6,088.84	5.0%	-13.5%
Hang Seng Index	23,527.52	18,881.35*	5.0%*	-19.7%*
KOSPI	2,106.70	1,914.66*	3.6%*	-9.1%*
yen / dollar	82.88	77.63	-0.2%	-6.3%
dollar / euro	1.4191	1.3461	0.9%	-5.1%
10 Year US Treasury	3.47	2.07	0.08	-1.40
10 Year German Bonds	3.35	2.28	-0.05	-1.07
10 Year Italian Bonds	4.82	7.02	-0.22	2.20

* Most recent closing prices and percentage changes as of 11:00am, December 1, 2011

2. Future Outlook

- Although private banks' concerns over year-end financing have retreated due to the coordinated policy on dollar fund provision, with the rise in yield (i.e., fall in price) of euro bloc government bonds underlying the worsening of private banks' credit situation, the policy can not be considered a fundamental remedy. With the closely-watched Italian government bonds facing a large volume of redemptions between February to April 2012, deflating the concerns over euro bloc government bonds will depend on the actualization of policy, such as whether government bond purchases under the ECB Securities Market Programme will reach large scale, whether loan-based support from the ECB to the IMF will become possible, and whether an agreement is reached on the expansion of the scope of the EFSF. A number of additional uncertainty factors exist, including the possibility of upward revision in the roughly €100 billion in additional capitalization required for banks that was announced in October, uncertainty over the extent to which private banks will agree to write off 50% of the face value of their Greek government bond holdings, and incipient assumptions that CDSs will no longer function as insurance against future losses. While there is a possibility that stock prices will maintain strong movement for the time being, it is difficult to foresee a continuing monotone increase.
- From a medium-term perspective, the situation is likely to call for ongoing caution, in light of factors including the following: (1) Asset reduction, including banks' tightening of loans with the aim of achieving strict capital requirements, may continue for the time being; and (2) countries' efforts toward financial soundness are very likely to place pressure on future economic conditions. The situation calls for caution even in the US, where the economy is relatively strong. Whether bills concerning the reduction of fiscal debt, as well as economic and employment measures, reach agreement and Congressional approval will be a major factor influencing future economic movements.
- For FX markets, regarding the euro, volatility continues backed by an ever-changing current political climate. We expect an ongoing heavy topside against a background of future uncertainty factors as noted above, predictions of additional interest rate reductions by the ECB, and so on. Regarding the yen, further appreciation has been halted through massive yen-selling intervention by Japanese authorities. However, the sustainability of intervention is limited and the risk of the yen advancing again calls for caution.

The following are major upcoming items of note: 12/1: November ISM Manufacturing Report (US); 12/2: Financial Statements Statistics of Corporations by Industry: Jul-Sep (Japan) and November employment indicator figures (US); 12/5: November ISM Non-Manufacturing Report (US); 12/7: October industrial production (Germany); 12/8: Governing Council of the ECB (Europe), BOE Financial Policy Committee (UK), October machinery orders (Japan), November Economy Watchers survey (Japan); 12/9: EU Summit (Europe), Second Preliminary Quarterly Estimates of GDP: Jul-Sep (Japan); 12/12: November retail sales report (US); 12/13: FOMC (US).

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