

Market update



Are we entering the endgame?

*Markets are pricing in the increased probability of a recession as economic data deteriorates. Meanwhile, investor confidence is fragile because of the glacial pace of progress being made by Europeans in responding to the region's financial crisis. In this update, **Bill McQuaker**, Deputy Head of Equities at Henderson Global Investors, posits that the market turmoil may be the mechanism that forces authorities to act and ultimately sow the seeds for a recovery.*

This week in financial markets there have been some further developments that have been taken badly in equity markets and elsewhere. I think there are two main issues about which investors are concerned. The first is that, on the economic front, the probability of recession appears to be increasing, certainly as far as western Europe is concerned. New orders and the like have softened quite considerably, and we're getting data that is marginally, but consistent with a recession.

Elsewhere there have also been some developments, particularly in Asia where Asian currencies have fallen really quite sharply. Possibly that's to do with risk appetite, and a desire to seek the safety of the dollar. However, another possibility is that it is telling us something about export demand, and the picture adds up to a growing risk of recession, and that's certainly weighing on markets.

Alongside that, one of the other big issues of the day is what's happening in Europe. I think investors are deeply uncomfortable with the deafening silence from politicians over the last few days. There are still considerable issues to be faced up to, and at the moment it seems like progress is happening at a glacial pace, and that's not comfortable for financial markets.

In terms of where that leaves us from an outlook perspective, I think the recession risk issue is something that could be resolved. Certainly, if there's going to be a recession that could be resolved in quite short order. There's a lot of data out over the next week or two, and if that comes in negatively I think people will, quite quickly, accept that there is a recession in the West and the only unanswered question then will be, is it going to be a western economy recession or a global recession.

On the political front, if markets continue to behave badly, that is actually a mechanism that increases pressure on politicians to start to take some decisions to ensure the safety of the financial system, and ultimately European economies. And so if there's a silver lining to the price action we've seen, it is that it ups the ante and encourages – almost forces – a political response.

If we put those two things together, if the coming period is going to be about either a recession or us reaching an endgame with regard to the European financial crisis then I think, inevitably, that's not a comfortable world for asset markets in the short run.

However, if that comes to pass then it may actually lay the seeds for a powerful recovery in asset prices. Markets are well aware of this recession risk and have gone a long way to pricing it, and a powerful policy response where no holds are barred could see a recapitalisation of the European banking system, I think. That would be very encouraging for financial markets and those two things in combination could see markets turn quite significantly.

The only thing is, neither of those points in time have been reached yet and so there's more uncertainty before we get the chance for a turnaround in asset markets.

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Important Information

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