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Global Round of Central Bank Easing

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Five Central Banks eased monetary policy this morning following the Federal Reserve's decision to extend its "operation twist" through year-end 2012. What is notable about the easing moves today is their geographical reach: BoE (Bank of England), ECB (European Central Bank), The PBoC (People's Bank of China), Denmark and Kenya - all engaged in easing monetary policy.

To some extent, monetary easing has been accommodated because of stable to lower inflationary pressures. For example, China's inflation rate which is now at 3% has declined from 4.5% at the start of the year and from 5.5% one year ago. A similar story is found with Denmark's inflation rate which is now at 2.1% vs. 2.8% at the start of the year and 3.1% one year ago. The broad decline in commodity prices since the start of the year has also helped pave the way for a broad easing of monetary policy.

Another important message that may be taken out from today's easing moves is that there is now a heightened Central Bank awareness of global economic and financial market linkages. This may be why the ECB and the BoE acted in tandem today with China to help defray any further fall out from Europe's banking crisis.

We know that lowering interest rates alone will not stop vigilantes from attacking sovereign debt markets. Today, we see the ECB lower interest rates, yet we find Italian 10-year yields up 20 basis points (bps) and Spanish 10-year yields up 35 bps. The lack of a coordinated effort to purchase sovereign debt has clearly impacted sovereign debt markets. It is our view that more needs to be done and that Central Banks globally need to get more aggressively involved.

The European Stability Mechanism (ESM) should act quickly to recapitalize Europe's weak banks. By doing so, it would take immediate pressure away from European sovereign debt markets and re-direct capital to those institutions that are most in need.

Market implications from today's easing moves should be positive for global equities and possibly for European sovereign debt markets, in particular the debt of Spain, Italy and Portugal.

In the US, investors should continue to focus on the lower quality sectors of the debt markets (high yield, private label MBS and lower quality municipals). It is also our continued view that equities will outperform debt markets over the balance of the year, in part aided by a broadening of Central Bank easing. Financials, Industrials, Consumer Discretionary and Technology should be favored over the safety of Utilities, Telecom and other high dividend paying stocks.