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Bumpy Road Predicted as 'Fizz' Comes Out of Equity Markets

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Despite a late January wobble, many leading equity indices recorded their best starts to a year in around two decades—although many market participants believe that the global economy is not out of the woods quite yet.

In the U.S., the S&P 500 recorded its best January since 1997 while the FTSE 100 in London posted its best start since 1989. However, last Thursday's announcement that the U.S. economy, the main driver behind January's bullish optimism, unexpectedly shrank in the fourth quarter by 0.1% slightly took the gloss of an excellent start to 2013.

"After an effervescent start to the year, it was expected that some of the fizz would come out of global equity markets at some point," said Simon Reynolds, a fund manager at Octopus Investments, a U.K. investment manager.

"That point duly arrived, following some mixed economic data release emanating from the U.S."

Although the macroeconomic picture appears to be settling down slightly, with early signs of stabilization in U.S. and European markets, many are warning that it will not be plain sailing from here.

"The numbers out of the U.S. shocked people on Thursday," said James Ryan, vice-president, institutional sales and trading at WallachBeth International in London, a brokerage firm specializing in ETF trading.

"The U.S. was the turnaround growth story with all the policies by the [Federal Reserve], job numbers were climbing, the housing market was coming back a little bit and the economy has been slowly growing.

"But the U.S. economic figures have given pause for thought. To a lot of Europeans this was the model for how to turn round and stay out of recession. Now the U.S. has had a little hiccup."

Some, though, believe the early January momentum may be curtailed.

"With this slightly deflating end to January, the Fed may well reach for the economic jump leads again," said Marcus Bullus, trading director at U.K. stockbroker MB Capital.

"There's every chance we'll see some of January's gains go up in smoke. For every step the U.S. economy takes forward, it seems to take one step back. Like other developed economies around the world, it just can't seem to maintain momentum.

"The extremely weak export numbers offer an insight into why: the U.S. economy is dependent on demand from other economies, but too often that demand just isn't there. Or if it is there, it's not strong enough.

"In January, we've had weak GDP, weaker than expected jobs growth and the best start to the year for the S&P since 1997. There's neither rhyme nor reason in the market at present.

"The bulls will argue that this minor reality shot could actually be what's needed to allow investors on the sidelines the dip they need to get in and set us up for a more positive year. But then that's perhaps a leap of faith many investors aren't prepared to take."

However, a perceived reduction in tail-risk—as the health of the eurozone appears to be picking up and the threat of the U.S. falling off the 'fiscal cliff' fades for now—is one of the main reasons for this recent bullish market talk.

"I don't want to say worst is over, but the storm has passed," said Ryan at WallachBeth. "It is certainly not without challenges and it is not going to be a straight line up; there will be pitfalls along the way. Everything is slowly starting to turn around but then again, it only takes one black swan event—whether that be Syria, North Korea, Iran or Israel. It is a very fragile recovery, I am not sure it's on the firmest of footing yet."

Reynolds at Octopus Investments added: "The market wobble perhaps reflects some recognition in markets that whilst sentiment has been strong, the pick-up in economic activity continues to be much more muted. Recovery will, in our view, continue to be a bumpy ride."