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Is global risk appetite turning more discerning?

Risk appetite is back.

After February's correction sparked by fears over Greek debt, U.S. bank regulation and Chinese monetary tightening, equity and credit markets have bounced back. But risk appetite is starting to show signs of becoming more discriminating, as the global growth picture diverges. European risk assets look set to lag behind.

Fears of a new systemic crisis have clearly receded. The VIX stock-volatility index, traditionally a gauge of investors' fear, has returned to its January lows. Credit spreads have resumed tightening and corporate-bond issuance, including by junk-rated companies, has picked up. And the cost of insuring European sovereign debt against default has fallen sharply. Commodities prices have rallied.

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But, unlike last year's almost uniform rebound from the March lows, not all risky assets are recovering. The euro remains in the doghouse against the dollar. German and French stocks are trailing—the Xetra DAX and CAC-40 indexes remain slightly down—while the S&P 500 is up 2.5% on the year now. The trend is clear in the bond markets: 10-year U.S. Treasury yields have risen around half a percentage point since October 2009 to reach 3.75%, but 10-year German Bund yields remain locked around 3.2%, reflecting continued risk aversion. European credit, too, is proving slower to rebound.

This suggests investors are becoming more focused on the differing prospects for growth and profits. J.P. Morgan, for instance, forecasts that U.S. gross domestic product will grow 3.4% in 2010, while the euro zone limps along at 1.6%—with recent data painting a gloomy picture for Europe.

If risk appetite holds up—not a given since sentiment remains fragile— then there is scope for further modest gains. Equities, while not cheap, still aren't expensive valued on next year's earnings forecasts, and credit spreads are in line with long-term averages, meaning they offer protection as default rates fall. But the gains are unlikely to be as uniform as last year, and Europe looks like the loser.

—Richard Barley