



AAG

Market Bulletin

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This weekly Briefing Note aims to pick out some of the key financial and economic issues touched on in the press over recent days, and from time to time includes the views of some of our independent fund managers.

Confidence Rises

First, the bad news. The US economy shrank in the fourth quarter of 2008 at its fastest rate since 1982, according to revised data released by the US Commerce Department, as corporate profits fell and unemployment rose sharply. Last week's data showed American gross domestic product (GDP) contracting at an annualised rate of 6.3% - a little higher than expected but no real surprise to economists. It was a similar story here in the UK: the Office of National Statistics revised down GDP figures for the last quarter of 2008 to minus 1.6%. This is the largest quarterly fall in GDP for almost 30 years, raising fears that the country's fiscal situation is far worse than expected. Spencer Dale, the Bank of England's chief economist, admitted that "near-term prospects are bleak" but added that "the contraction will slowdown throughout this year, leading to signs of recovery" by the fourth quarter.

And the good news? Well Mr. Dale's optimism may actually be well-placed because last week economic data emerging from both sides of the Atlantic indicated that there may well be signs of a nascent recovery in some of the world's largest economies. **The Financial Times** reported last week that an unexpected rise in March's eurozone purchasing managers' indices - regarded as a reliable early indicator of trends in activity - provided the strongest clue yet that the rate of contraction in the region has started to slow. In both France and Germany consumer confidence indices seem to have stabilised and although the recession is severe, consumption is expected to rise marginally in the months ahead - attributed to the fact that euro households have been much more cautious than their UK counterparts by saving more, implying that any retrenchment will be less pronounced.

In the US, Treasury Secretary Tim Geithner said there are signs that the pace of economic deterioration may be slowing. His optimism seemed justified following a clutch of better-than-expected economic data - the number of new homes being sold last month rose by 4.7%: the first monthly increase since July 2007. Alongside this, new US mortgage applications rose by 32.2%, with observers attributing part of the surge to refinancing by borrowers as the average mortgage rate fell to 4.63%, the lowest since 1990. There were other positive numbers too. In the manufacturing sector, durable goods orders rose by 3.4% last month, the largest rise since the end of 2007 and consumers

showed that there was still life in them with spending rising for the second month in a row. Consumer spending is a key to understanding what's happening in the American economy as it accounts for two-thirds of domestic activity.

An Acronymistic Week

Back in Britain the Bank of England's (BoE) unconventional exercise of monetary policy - known as quantitative easing (QE) - will continue, according to Mr. Dale until it becomes apparent that inflation has fallen back within its 2% target. There were some conflicting inflationary numbers released last week which surprised economists. Rather than falling as expected, the Consumer Price Index (CPI) rose slightly to 3.2% in the year to February as the higher cost of imports - as a result of the falling pound - fed through. The data did at least assuage fears that the UK may be entering a period of deflation - where prices actually fall in real terms. But the broader Retail Price Index (RPI) data fell to a 49 year low of 0% - the difference between the two is that RPI includes the cost of mortgages which have fallen sharply in recent months as base rates have been slashed. The BoE's QE policy came under pressure last week following comments from its governor, Mervyn King. Mr. King said on Tuesday that he may hold back from spending the full £75bn of newly created money on gilts and corporate bonds if the economy and inflation recovered sooner than anticipated. His comments triggered the first failure of a government bond auction since 1995, which resulted in gilt prices falling sharply. The Debt Management Office (DMO) - responsible for issuing gilts - attracted just £1.67bn in bids for its sale of £1.75bn of 2049 gilts, although commentators say that this was not as serious as thought, bearing in mind the gilt did not qualify for the QE buy-back programme. Gilt prices settled down as the week progressed and the yield on a ten year gilt ended at 3.3% - back where it was before QE got under way three weeks ago.

Win, Win, Win

That was the view of Wall Street last week following the latest plan to restore the banking sector to good health announced by Tim Geithner. The plan involves two schemes - one targeting toxic credit securities and the other loans. Under the legacy securities plan [known as PPIP: the Public - Private Investment Plan] the government will authorise up to five investment managers to raise equity and then provide a dollar of equity and a dollar of debt for every dollar raised. At the same time the Fed will also offer loans to re-finance toxic securities (as opposed to new securities) for the first time. Banks, which have taken billions of dollars of write-downs, said the plan's structure was favourable to them as it gave them the last word on whether to sell their toxic assets. Whilst the plan had its sceptics, the reaction on Wall Street was euphoric, fuelling

a powerful stock market rally which saw the S&P500 index of US stocks rise 6.2% on the week.

Indeed, world equities enjoyed another bumper week as hopes mounted that the worst might now be over for the ailing banking system and the broader global economy. American shares have rallied sharply from the lows seen at the beginning of the month – the S&P500 index is up around 25% which puts it on track for its largest monthly rise since 1991. The greater sense of optimism pervaded global stock markets, enabling the major world indices to notch up further gains for investors. **The Financial Times** quoted one G7 economist as saying “The theme remains that economic figures are not as bad as feared, which reduces a major source of pressure on investor risk sentiment”. In the currency markets the dollar took centre stage following Mr. Geithner’s plan, while in the commodity markets oil ended flat and gold fell as analysts suggested its appeal as a haven from market turbulence was waning.

Having enjoyed a good week, financial markets will be keeping a close eye on this week’s meeting of the world’s twenty wealthiest nations when they meet at the G20 get-together in London. The Prime Minister is hoping that his proposal for united and concerted economic stimulation will be endorsed by the leaders of G20 and act as the catalyst for global recovery. But already leaders of the eurozone are saying that further financial stimulus packages could threaten longer-term stability and appear reluctant to support Mr. Brown’s plan. However, as economist Irwin Stelzer commented in **The Sunday Times**, the real action will be at the G2: China and the US. Stelzer opined that the two countries know they must look ahead and create a workable new world economic order by eliminating their trade balance. The Chinese will have to let their currency rise to stem exports to the US and also create a domestic safety net to encourage Chinese citizens to stimulate the world by spending more and saving less than the current 25% of their income. Optimists in the G20 crowd say whilst it will take time such an outcome is possible.

Slow Boat to China

The idea that China should take a lead role in helping the global economy is not new of course and is inevitable as its ascension to one of the world’s largest economies continues. Fortunately, opportunities come with that and the challenge for professionals is to capture these for investors. John Hodson of THS Partners, who manage funds for St. James’s Place, has recently returned from a business trip to China. “Whilst the global economy is slowing and the developed world is in recession it is important to remember that China’s economy is still burgeoning – growth is expected to be 8% this year and back-end loaded. In other words, most of that growth will occur in the latter part of 2009. Whilst this is somewhat slower than previous years, there is a huge amount of activity as they rebuild and develop their infrastructure. This massive programme was constrained throughout 2008 but now policymakers have pulled the levers, controls have been released and there are lots of high grade investment projects underway.

It’s true that exports have suffered on the back of a US slowdown and that the country remains export-driven, but there is a desire to move up the value chain, to be taken seriously as a quality producer but this will take time. In the meantime the economy can still grow, stimulated by domestic demand as people spend more. But following a global de-stocking of goods globally there are signs that demand is improving – textile orders from the US are up and as part of their plan to be less vulnerable to the vagaries of the commodity markets, they are stock building oil and copper. They plan to build a strategic reserve of oil and currently have 28 days supply, which is pretty vast. Whilst they can’t pick the bottom of the market, buying at lower levels enables them to build a supply inventory and ultimately lead to a more orderly market. So, as a consequence of our strategy to exploit these opportunities, we have increased our weighting to China via Hong Kong-listed stocks to around 8% which compares to about 1% for most global funds.

Most of the resource has come from selling-down our Japanese stocks from around 14% in the spring of 2007 to around 5% now. We have done well on our holdings – the appreciation of the yen helped of course – but the economy is in a poor state both domestically and from an export perspective. It’s true that book values [cash on balance sheet plus retained profits] look attractive, but these can shrink quickly as losses mount and end up becoming value traps. We have though bought Nintendo which is growing well, is cash-rich and yields 6% and overall the portfolio retains high levels of liquidity – around 20%. There are signs of recovery out there – the US housing market is a key indicator and the numbers are gradually improving. Globally governments are getting on with it, implementing stimulus packages and getting the financial system back in order, but from an investment perspective one needs to be patient”.

Use It or Lose It

That was the advice from **The Daily Telegraph** to its readers on whether to use this year’s ISA allowance – the end of the tax year is only days away. With interest rates so low investors looking to replace some of that lost interest might consider equity income funds and corporate bond funds where yields are higher. Two of the funds in these sectors recommended by **The Financial Times** are run by Neil Woodford, Paul Read and Paul Causer – who also manage funds for St. James’s Place. Many investors are nervous about falling stock markets, but as **The Daily Telegraph** pointed out, most investors will miss the bottom of the market by playing the waiting game – the huge rise in the S&P500 over just three weeks illustrates this point perfectly. The paper said prices could of course go lower but even if this isn’t the bottom then taking a sensible timescale will ultimately mean the chances of success are greater.

The Alexander Associates Group offers a comprehensive range of wealth management products and services.

If you would like any further information, please contact us on +44 (0) 20 7016 6767.