



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.

Road to Recovery

After a shaky start, the G20 summit culminated in much fanfare and a six-point recovery plan for the global economy with world leaders pledging to restore confidence, growth and jobs in the months ahead. The most eye-catching aspect was the \$1.1 trillion recovery plan which is aimed at bringing economic stability to those countries facing the greatest threat of economic collapse but also serious political unrest as a result. This latter point reveals the concern the G20 has for the political stability of Eastern Europe and emerging markets in the Far East. The plan will see increased resources for the International Monetary Fund (IMF) from \$250bn to \$750bn to allow it to help ailing countries. G20 leaders also agreed to \$250bn in a new issue of the IMF's so called special drawing rights (SDRs) which effectively allows it to print more money. There was another \$100bn in new loans for poor countries coupled with a promise of \$250bn to finance export trade.

As **The Daily Telegraph** explained, this last aspect means world trade has been given a shot in the arm to support banks that provide vital finance to importers and exporters, but also a commitment to stamp out protectionism. The falling demand for goods during the global slowdown has been exacerbated by growing protectionist measures and a withdrawal of trade credit. One of the other pledges, which formed part of the G20 statement, was the commitment to undertake an unprecedented and concerted fiscal expansion that will, by the end of next year, amount to \$5 trillion. This last point led to economists cautioning against seeing this as more new money because, in fact, this figure has already been earmarked for spending around the world by various governments before the end of 2010. Collectively, this sum will raise output by 4% and is the central plank of the G20's hope to preserve millions of jobs.

So should the global village begin to feel more optimistic? Leading economist Anatole Kaletsky writing in **The Times** said the main thrust of the G20 response to the crisis has been absolutely right. Although criticised in some quarters, the decision by governments to borrow and spend may seem counter-intuitive but is in Kaletsky's view, absolutely the correct response. With signs already emerging that previous stimulus packages are beginning to work with some stability returning to the US, Asian and British

economies, he argued that we may be witnessing the clearest empirical demonstration that Keynesian demand management really can stabilise the market economy and protect capitalism from its own excesses.

Green Shoots?

Over in **The Sunday Times** economist David Smith also felt that the G20 pledges gives us less reason to wallow in the gloom. Concerted action by the world's wealthiest economies, even if imperfect, has come out of the dramatic synchronised global downturn of recent months and should be viewed positively. Aside from the financial pledges, Smith also welcomed the commitment to greater financial regulation of banks and their ilk which should create a robust global financial system. As to immediate outlook, Smith pointed to the flurry of news and data in the past week or so that suggest the recession may not be over but that it is at last easing its grip.

Last week figures released showed an improvement in the Purchasing Managers' Index for manufacturing following a similar message emanating from Britain's service sector. The CBI also said that British companies are reporting tentative signs that the credit crisis could be easing. In its latest survey the CBI said companies were less negative about the availability of new and existing credit as the combination of easier monetary policy and the Government's measures to support the banking sector may be having an impact. In the services sector, the closely watched Purchasing Managers' Index showed the pace of decline slowing for the fourth successive month. Even the housing market is showing signs of life, with the latest Bank of England figures showing mortgage approvals up in February and 39% up on last November's low point. There were, however, some contradictory messages on capital values though – mid-week the Nationwide said prices had risen 0.9% in March but the next day the Halifax said values had fallen 1.9%.

In the world's largest economy there were encouraging signs too, although jobless levels continue the inexorable rise, with unemployment rising to a level not seen since 1949 – 5.1m jobs have been lost since December 2007. Unemployment, though, is a lagging indicator, albeit painful, so news that whilst shrinking again in March, the rate of decline for manufacturing output had slowed, brought some cheer. The sub-index for new factory orders rose to its highest level since last August according to **The Financial Times**, giving investors a fillip. Economists also point to surprisingly solid retail sales, which suggest consumer spending grew by more than 1% in the first quarter of 2009. US home sales look to be bottoming although house prices remain in decline on some measures. In Europe, decisions by the likes of Germany to offer

incentives to buy new cars has led to a 40% surge in car sales – many hope that Chancellor Darling will introduce similar measures in this month's Budget.

Investors Give the Thumbs Up

The G20 communiqué won many plaudits in global stock markets too, with investors reacting positively to the pledges made. Initially the week got off to poor start when shares wobbled on news that President Obama was taking a firm line with two of Detroit's car makers – General Motors and Chrysler. Mr Obama warned the companies that he would not hesitate to put them into bankruptcy if they didn't slash debt and hit other targets. This hard line policy gave investors the jitters and sent share prices down sharply. In the UK sentiment was not helped by news that the Dunfermline Building Society had effectively failed and that its viable parts were to be taken over by the Nationwide, who promised to keep branches open and staff in jobs. The 140 year old society had exposed itself to £1bn of toxic debt and this liability will be taken on by the Government.

However, within 24 hours investors were back with a vengeance, snapping up shares they thought oversold enabling the major indices to recoup all their losses. As the economic news improved and expectations of a G20 accord rose, markets grew more confident as risk appetite improved. In London the leading index of blue-chip companies rallied 9.6% in three days enabling the FTSE100 to break through the 4,000 level for the first time since February. It was a similar story elsewhere with Far Eastern markets surging alongside Wall Street where the S&P500 index increased its gains to 30% from the low point registered at the beginning of March. The turn in equities is, according to **The Financial Times**, being lauded by some analysts as a sign that the global economy is about to reveal the green shoots of recovery that will be firmly established in the second half of the year.

West End View

The events of the last week will no doubt be judged by history but in the meantime professional investors will be making up their own minds about the ramifications of the G20 policies. Fund manager Mark Evans of THS Partners, based in the heart of London's specialist investment community, gave his initial reaction to the pledges made. "The G20 initiative may not save the world but it was necessary for leading nations to show they understand the gravity and seriousness of the current situation we are facing. The newly announced SDRs for emerging markets could make a big difference because investors are looking at these markets to provide a significant part of world growth going forward and effectively lead the global economic recovery.

Whilst the pledges made are welcome it was the individual actions by policymakers – the cumulative \$5 trillion figure talked about – that are important. Economies were in my view already primed for recovery following these substantial fiscal stimulus packages so any signs of improvement were bound to

unleash investor buying – hence the stock markets' reaction. Those sectors which were most distressed – particularly financial shares – will do best as their outlook is reassessed. Inflation may result from the increased demand being pumped into the global economy. However, I'm of the view that the recent destruction of demand experienced to date will be enough to absorb the inflationary effects of increased government spending so far.

Inflation takes a long time to become ingrained and there are no signs currently of this happening. And with sterling so cheap any rise hereon will help head off some of the inflationary pressures going forward, as the cost of imports fall. If one is worried about inflation then buying shares now whilst they are so cheap is actually a good each-way bet because equities have always been a hedge against inflation. In the meantime, yields are very attractive and from these levels the prospects of capital growth look encouraging. We are likely to see a rebound in inventory orders because stocks have been run down hugely in recent months and at some point businesses will have to re-order. This aspect has been overlooked by many and when it happens then it will act as a second booster-stage to the recovery in the markets. So yes, the G20 action was pretty good but it complemented a recovery already beginning."

A Question of Income

With interest rates having crashed in the last six months it is hardly surprising that investors are looking to replacing some of that lost income. One solution, as part of a diversified approach, is to think about investing in equity income funds which have historically stood investors in good stead. George Luckraft of AXA Framlington manages UK equity-income funds and at a recent meeting gave his views on the outlook. "Last year was a difficult year for investors and managers alike – my preference for owning stocks in the small and medium cap part of the market was always going to have headwinds as the market fretted about potential excessive leverage and vulnerability in these sectors. However, with the economy at a possible turning point following the end of de-stocking and government action to avoid deflation, I'm confident that the portfolio is well positioned for recovery. The portfolio yields about 6.5% [net of basic rate tax liability] and this allows for likely dividend cuts looking ahead and the stocks held have great overseas exposure, giving opportunity for growth. I own the likes of Vodafone, BP, Shell and GSK because they have helped the overall income yield. So, in terms of the shape of the portfolio, I've increased exposure to oil and gas but remained underweight in commercial goods and financials. So from here I am positive that the outlook is improving and that the opportunities for income and growth are very compelling."

Both THS Partners and AXA Framlington manage funds for St. James's Place.

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

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