



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.

## Alphabet Recovery

Investors' appetite for risk appeared to be temporarily satisfied last week as stock markets took a breather following their long rally – the FTSE All-World Index is up 53.1% from its March 2009 low point. Whilst the weight of evidence continues to build a case for global economic recovery, some of the economic data released last week caused a few doubts and gave short-term traders an excuse to take some profits. Here in the UK, the Governor of the Bank of England, Mervyn King, said that the recovery was likely to be slow and protracted – the Bank has cut its own forecast for this year to around -4% - below the Chancellor's own prediction of -3.5%. Mr. King said that "Now the economy requires a period of healing. That will take time. The economy will eventually heal but the process may be slow. This is not like the typical business cycle in the post-war period". But the governor did reinforce growing hopes that the worst of the recession is over, pointing to "promising signs that the pace of activity has moderated". Questioned about the Bank's decision to implement quantitative easing - whereby the BoE buys up gilts and corporate bonds as a method of increasing money supply and keeping interest rates low - Mr. King said it was too early to assess the success of this policy.

There has been much speculation in the press about the 'shape' of the recovery – observers use alphabet descriptors such as 'V-shaped' all the way to 'L-shaped' and also include the chances of it being 'U, W or even WW-shaped'. The likes of Merrill Lynch favour a sharper recovery, with the economy growing quickly once it hits bottom – the classic 'V-shape'. Their outlook is supported by Credit Suisse whose analysts are forecasting growth in Britain of 1.8% next year – up from 1% and higher than the Chancellor's recent forecast. "The first phase of the recovery is likely to be driven by an end of the inventory rundown and a possible inventory build-up" according to the bank's economist, Robert Barrie. The other most likely option according to analysts is the 'W-shaped' recovery where, after an initial upswing, economic activity slows once more before embarking on a sustained growth path. One possible drag may be the property market where prices are still under pressure, causing consumers to rein back their spending plans.

**The Sunday Times** looked at some of the signals to weigh up what they might say about recovery prospects. Stock markets – which usually act as a lead indicator, some six to nine months ahead of the real economy – are up significantly, with the FTSE100 up almost 25% from its low of 3512 in March. The cost of credit is down with wholesale borrowing costs (where banks fund mortgages) back to levels seen before the collapse of Lehman Brothers: three-month interbank rates are down from 5.8% a year ago to 1.37% currently, according to Savills Private Finance. Retail sales rose last month at their fastest pace in three years, the British Retail Consortium said last week – up 4.6% on a like-for-like basis. And the housing market is more active, with the number of loans approved for house purchase up to 39,000 in March and research from Hamptons International showed the number of sales rose 27% in April compared with a year earlier. Behind the demand are first-time buyers who have rushed to join the bargain hunt, according to the Council of Mortgage Lenders (CML), who said new mortgages for this group were up 36% during March. But the immediate outlook for prices remains poor as both unemployment and home repossessions rise sharply (up 50% in the first quarter according to the CML) and many analysts still expect prices to fall further before they begin to recover. On the employment front, BT announced another 15,000 job cuts for this year as the company struggles to cut costs.

## Green Shoots Still Delicate

Of course, it's not just here in Britain that the nascent green shoots of recovery still need careful nurturing, as some of last week's economic data reminded investors. In the US, Wall Street was given a sharp reminder that an early revival may be further away than thought, following news that American consumers spent less in shopping malls for the second month in a row. US retail sales fell by 0.4% in April, following a 1.3% drop in March and many economists had expected sales to be flat. However, consumer confidence is higher this month, taking it to the highest level since before the collapse of Lehman Brothers. Other official US data showed that, whilst industrial production slid last month, the pace of decline slowed; producer prices rose slightly and unemployment continues to rise – claims for benefits rose to 637,000 reflecting car plant shutdowns from Chrysler's bankruptcy.

In the eurozone, Germany has been dubbed the 'sick man of Europe' by **The Times** following a record fall in the country's GDP – down 3.8% in the first quarter of this year and the largest drop in nearly 40 years. The poor figures dragged down the rest of the eurozone economy, although official data from *Eurostat* showed that the weakness was

widespread across the region. Being heavily reliant upon manufacturing Germany has been hard hit by weak exports – visible, according to **The Financial Times**, at factories on short-time working, in the lightly loaded industrial barges on the Rhine and the lines of unsold luxury cars at motor plants. However, it is not all doom and gloom – forward looking surveys such as the *Ifo* business confidence index suggest the pace at which the economy – the world’s third largest – is contracting has already slowed. Economist Dirk Schumacher of Goldman Sachs said the first quarter “is water under the bridge. It [the data] doesn’t take anything away from the rebound we have seen in the indicators”.

So by the end of the week it became clear, that whilst there are signs of recovery across the globe, there will inevitably be setbacks along the way and investors’ short-term worries were reflected in Western stock markets, where prices fell back a little. But in the Far East, where economic growth is picking up - especially in China – stock markets fared better with the Shanghai Composite index rising. In commodity markets, US crude oil prices briefly breached the \$60 per barrel mark before retreating after the International Energy Agency said global oil demand would record its sharpest annual drop this year since 1981. However, rising demand for raw materials pushed the Baltic Dry index (watched closely by economists as a lead indicator of global demand) to its highest level this year.

As to capturing any further rally in shares – which inevitably will not be in a straight line - **The Times** cautioned readers about getting too excited by a number of ‘structured’ products which offer investors some of the potential returns (often capped at 50%) but the capital is guaranteed (but with caveats). The paper took the view that any new bull market is likely to rally more than 50% and that investors are likely to be better off taking the risk themselves and investing in products that allow them to keep all the returns.

### **In for the Long Term**

With over forty years of investment experience, fund manager John Hodson explains why, taking a long-term view, he feels now is a good time to invest. “We have been saying for some while that equities offered good, long-term value and this fact has at last been recognised by investors, as evidenced by the recent strong rally in global stock markets. Of course this has yet to feed into the real economy but clearly the work of central banks in recent months has stabilised the financial system including bond markets, where spreads have narrowed. Businesses have been able to raise money from the markets – the HSBC rights issue and cash-raising by Wells Fargo and Bank of America are a good example of increased investor confidence in the banking system. Regulators in the US have been thorough with their recent stress tests where they have *marked* the banks’ loan books themselves to determine the quality of lending and assess future potential write-downs. The policy of quantitative easing is a vast experiment and, whilst it may hold down borrowing costs, is inflationary and at some point the Bank will have to implement an exit strategy. When economic recovery comes, interest rates will need to rise to combat the ensuing inflation so

I expect to see CPI [the official measure of inflation] to rise to 4%-5% in three to four years, with gilt yields rising too.

So from here I would expect banks to begin to return to their normal business of lending and, over the next two to three years capitalise on the fact that whilst interest rates have fallen sharply, it has given them scope to increase their profit margins. Their ability to lend more will help the housing market too – in the US there are signs of a nascent recovery and I would expect capital values to bottom out soon. In the UK I suspect there is further to go – houses are still unaffordable for many so there will be natural attrition over the next few months as lower values work through. On the commercial side, property companies too have been raising cash. One company, Brixton Estates is a good example, where its proposed sale of a quality industrial portfolio yielding 8.4% is, unsurprisingly, attracting significant interest. As for equity markets, institutional investors are gradually using some of their cash - current cash levels remain historically high - to invest in shares just as we have been doing in recent months.

Within the portfolio we are now seeing a recovery in financials - amongst others, Swiss Re had suffered hugely from adverse sentiment but following recent good results the share price has risen 40%. We’ve gradually been easing out of Japan, redirecting the proceeds into China where we see significant opportunity. For example, buying Prudential was a way of developing our insurance theme and the company has a huge presence in China with its brokerage business benefitting from the failure of AIG. On the edge we’ve added a couple of small oil stocks as we believe energy will be more interesting as a commodity than iron ore. So where we are today is that the stock market has responded to fiscal stimulus packages, acting as a lead indicator and over the coming months we would expect the real economy to follow suit”.

John Hodson is a principal of THS Partners who manage money for St. James’s Place.

### **A Wealth of Experience**

Last but by no means least, **The Financial Times** took the opportunity to highlight that St. James’s Place Wealth Management has been voted Wealth Manager of the Year for the second year in a row by readers of the Financial Times and Investors Chronicle magazine. The paper went on to say that St. James’s Place was also voted winner of the awards for Investments and Inheritance Tax & Succession planning.

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.