



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.

Markets Spring into Action

One could be forgiven for thinking last week that stock markets know something we don't. On the economic front the news remained predictably gloomy – in the UK, official figures confirmed that factory production is plummeting, with output down 6.4% in the three months to January. Economists are predicting that GDP is set to fall 1.8% in the first quarter of this year against 1.5% in the previous quarter. Of course it's not a problem peculiar to Britain – Japan clocked up a record current account deficit in January, its first since 1996 and the largest since records began in 1985 – as falling global demand and a stronger yen have taken their toll on the country's export-dependent economy. And as **The Times** reported, the global financial crisis has finally caught up with the world's fastest growing economy, China, where exports too have suffered. The country's slowdown is causing concern for the authorities who last week announced that it will reduce export taxes to zero and give more financial support to exporters as it tries to increase its share of global trade during the current downturn. **The Financial Times** observed that the government's obsession with restoring high growth leaves it little choice but to revive the export sector.

Global stock markets though were undeterred by the gloom and responded instead by rallying sharply, which enabled equities around the world to enjoy one of their best weeks this year, with many indices – including the S&P500 - chalking up gains of as much as 10%. On Tuesday, London's blue-chip FTSE100 index soared by almost 5%, as investors reacted positively to news that America's leading banks may not be as sick as many thought. News that US banking giant Citigroup had returned to profit in the past two months was sufficient to propel stocks higher on Wall Street. Another fillip came when Barney Frank, chairman of the US House of Representatives' Financial Services Committee, said that a key stock trading ruling that hinders short-selling [in the hope of buying stock back at a lower price] may be re-imposed. The feel-good factor rippled across the globe as this new found sense of optimism about the financial sector pervaded the markets and as **The Financial Times** noted, hopes that the US consumer

could prove more resilient than feared offered a further buying incentive.

By the end of the week the big question for investors centred on whether the events of last week were the first signs of recovery in the equity markets or just another bear market rally. **The Daily Telegraph** posed the question to a number of stock market experts, including investment guru Anthony Bolton, who commented that all of the things he looks for to be in place for a market bottom occurred last week, adding that a new bull market could have started. "My strong message [for investors] is don't give up now, you're giving up you know, really at the last fence". He went on to add "I'm not saying there isn't going to be any more negative news but it should be much better by the second quarter". But as **The Financial Times** pointed out, Mr. Bolton made the same call last year before a renewed sell-off in the market, which highlights how even experienced investors have been wrong-footed by the current downturn. As the paper went on to say though, there is good reason for wanting to pick the bottom of the market. The rewards of buying close to the nadir are very high because some of the best days of a bull market occur at the start of a new trend. But Anthony Bolton has not been alone in trying to call the bottom of the market and it illustrates the advantages of 'drip-feeding' money into the market over a period of months rather than trying to time a single entry point to catch what appears to be a low point.

QED?

After much fanfare, the Bank of England started its plan to 'print money' last week as part of its quantitative easing policy – QE for short or, as **The Daily Telegraph** mischievously suggested to HM Treasury, it should be colloquially known as *queasing*. The plan involves the BoE buying up government debt in the form of gilts plus some corporate debt too in return for 'new' money – it doesn't need to physically print it of course, merely electronically credit accounts. The hope is that banks, pension schemes, sovereign funds and their ilk will sell debt in return for cash and then lend this money for mortgages, invest in enterprise or to take up rights issues thus helping the consumer and business. Last week, investors piled into gilts following the first official auction of £2bn worth of government paper, in what economists deemed to be a success, with the Bank receiving offers for more than five times the amount it sought. Whilst early days and with not everyone agreeing with the policy, it does appear to augur well for the scheme and experts are of

the view that the BoE should have few problems implementing its plan to boost the amount of cash and credit flowing through the economy by £75bn over the next three months.

One immediate outcome was that gilt prices rose and yields fell – the yield on a ten-year gilt dropped to about 3% and this should help keep the cost of borrowing down. But it also means annuity rates are impacted upon and is likely to put pressure on those seeking to retire when funds are used to buy an income in retirement - a point picked up by the personal financial press. **The Financial Times** also commented that QE should also have an uplift on corporate bond prices, with yields coming down, meaning that investors could see lower income but capital gain. The paper said that whilst the longer term implications of QE are unknown, for corporate bonds QE should be a positive thing. Sovereign funds are not just interested in converting gilts into cash though – they might end up using the money to buy British commercial property it seems. According to the property specialist Savills, the sovereign funds are looking at buying, as are Middle Eastern buyers and German funds, as prices get close to the bottom. **The Sunday Times** reckons the German funds are at the front of the queue. Having lost confidence in their own economy, the arbitrage between the euro and sterling is starting to look compelling even if absolute bottom hasn't been quite reached.

In Pursuit of Value

Stock market falls have left share prices at very depressed levels – so much so that Mark Evans of THS Partners, who manage funds for St. James's Place, believes some shares offer extraordinary value for medium term investors. "Following the market lows in autumn 2008, stock markets tried to stabilize and indeed succeeded in staging a brief recovery at the start of 2009. However, as this year has progressed, further negative economic news and some disappointment with President Obama's US recovery programme, have caused renewed weakness and produced fresh lows. Confidence is now at rock bottom and it is hard to exaggerate the awfulness of the economic statistics that are being produced. But, however difficult it may be to believe now, periods of such weakness always come to an end, and brave investors who recognise the potential of severely depressed valuations usually profit handsomely.

Indeed a significant proportion of the weak economic statistics are due to a vicious inventory cycle in response to the lack of credit. As inventories are run down, these figures should automatically improve. In the meantime, global policymakers are trying to replace some of the lost demand with their fiscal stimulus packages and thereafter they plan to tighten policy and reduce debt. For this reason I do not believe that recent actions will ultimately lead to inflationary problems, although there are those who may disagree. Of course, the solution if one has concerns over inflation is to buy equities which historically have done well in such times because it gives companies some pricing power. As to

the latest policy of quantitative easing, I see this as a conventional idea. Rather than buy gilts - which may force those who have to own them, such as pension funds, to panic – the money should be spent on buying equities as they did in Hong Kong in the nineties which was very successful.

But here and now, valuations are now at extremely low levels; even solid, defensive companies have succumbed to market weakness. Vodafone, for example, which is a heavyweight FTSE 100 company with very little debt, a global presence and good growth exposure to major emerging markets such as India, is available at a P/E ratio of 6.7 and pays a dividend of seven per cent (which like all UK dividends is paid net of basic rate tax). British property companies have also been hugely affected by the downturn and the biggest company within the sector, Land Securities, is no exception. Its shares have fallen from over £20 to £3.60, in spite of the company taking early evasive action. The shares are now trading at a 50 per cent discount to the most recent book value, have secured their financial position with a rights issue and currently have a dividend yield of over 7.5 per cent.

The funds own shares in many other companies which are similarly solid, cheap and offer an attractive dividend. The travails of financial companies worldwide are well known. The funds own a selection of banks and insurers that we believe are survivors, and if we are right, based on current valuations, these companies should produce some very strong returns in future. These holdings include BNP, Deutsche Postbank and Allianz. At the moment, investors value security and liquidity very highly, but inevitably, at some point, the very low rates available for safe investments will drive some of the large amounts of savings on the sidelines into other asset classes".

Taxing Times

As we approach the end of the tax year the press reminded readers that time is running out for last minute planning. **The Financial Times** said that it is still worth using savings and pension allowance – the personal ISA (Individual Savings Account) allowance is £7,200 and growth is free of Capital Gains Tax so using the ISA to hold asset-backed investments makes sense. Tax relief at one's highest marginal rate is still available on pension contributions – it's one of the few areas where the government will help you fund the cost of future retirement. So for every £1,000 invested basic rate tax relief brings the cost down to £800 and £600 for a higher rate taxpayer. With the Budget delayed until April 22, experts are advising that investors should still make the most of current allowances.

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