



The Global Month Ahead - September 2010

Outlook

Key Issues

United Kingdom – Fixed Income

- The minutes of the Monetary Policy Committee highlights that there is beginning to be a disagreement in whether to raise rates or not.
- The Bank of England (BoE) has revised down its growth forecasts and boosted its inflation forecasts ahead of the VAT rise in January.
- Despite the doom and gloom (including here in past months) the budget is beginning to show improvements as tax revenues pick up.
- Professor Jeremy Siegel of Wharton said that cash flow into bond funds is looking like the flows into TMT funds during the 1990s tech bubble.
- Morningstar data indicates that investors are piling into emerging markets, junk bond and corporate debt and selling domestic equities.
- Bank of Scotland is closing its Irish operation with the loss of 830 jobs. BoS was one of the most reckless lenders during the Irish property bubble.

- Andrew Sentence is a one voice voting for a rise and seems unlikely to win out for the rest of 2010 as government cuts begin to bite on the economy.
- Any steps the BoE takes to boost GDP, e.g. quantitative easing, will also be inflationary. Its priority is inflation, so no action is likely to boost growth.
- The improvement in the budget is due to better corporation tax receipts rather than due to spending cuts or tax rises, which are still in the future.
- With gilts close at 2.9% and RPI inflation at 4.8% it is difficult to see the attraction of bonds unless an investor is expecting deflation in the future.
- Morningstar data tends to be a coincident indicator at best, or even lagging, but does give some backing to Professor Siegel's comments.
- It is not so much that the UK high street banks are not lending, but that once active foreign banks are pulling loans in the UK, like BoS is in Ireland.

United Kingdom – Equities

- Takeover bids, or approaches, for Brit Insurance, International Power, Cairn, Aviva and Dana shows there remains interest in the UK stock market.
- Income investors in the UK have been hit over the last few years by big dividend cuts at high profile companies like BP, RBS and Lloyds.
- The big banks got adverse headlines and critical comment by returning to profitability in the first half of the year. Would commentators prefer losses?
- Despite past difficulties for dividend investors, the FTSE 100 now yields more than the 10 year Gilt. A good buying signal for equities in the past.
- BHP has bid \$39bn for Potash Corp, the Canadian producer of potash which is widely used in fertiliser. The initial bid has been rejected.
- The FTSE 100 rebalances quarterly, with smaller companies ejected and fresh blood in. This may lead to buy/sell pressure as tracking funds adjust.

- The M&A in the UK market shows that there is value in the UK market and that financing is available to the credit worthy at home and overseas.
- There may be some respite for income investors as companies like Prudential raise their dividends and the big banks return to profitability.
- By most measures, such as return on assets or return on equity, 1H2010 profits were poor. There may be more upside in bank profitability yet.
- Buying equities for income can be a risky, but investors who bought the last time yields crossed in 2003 called the bottom of the equity market.
- Many see the bid as too high and BHP's share price has been weak. The prospect of a higher bid could lead to further share price weakness.
- Candidates to go into the FTSE include ITV and GKN and candidates to go out may be Segro, a property company, and Home Retail, owner of Argos.

North America

- Some Bush era tax breaks on dividends, income tax and capital gains are due to expire in December. Tax rates could go up for nearly all Americans.
- Monetary tightening is firmly off the table as the US unemployment rate remains fixed around 9.5% and GDP growth slows down.
- The US dollar had been rallying against the Euro, but weaker economic growth the prospect of QE2 has led to the US dollar sinking.
- A number of companies, such as Cisco Systems, Sara Lee and Kohl's are guiding analysts' EPS estimates lower due to the weak economic outlook.
- General Motors, owner of brands including Chevrolet, Cadillac, Vauxhall and Opel has filed papers to IPO as it emerges from bankruptcy.

- Tax rises at a time of economic weakness could put the US back into recession. It is important that a deal is struck after the mid-term elections.
- Not only will interest remain low at 0%-0.25% for a while, but there are calls for the Federal Reserve to re-launch quantitative easing (QE2) again.
- There is a feeling that the US administration may be talking down the USD as this will boost the export sector and assist GDP and jobs growth.
- This is not good for the stock market, Cisco fell 10% on the day it cut EPS estimates, and indicates further weakness over the months ahead.
- There are a few large potential IPOs possible including GM, Facebook, LinkedIn and Twitter. Timing will depend on market conditions.

Europe ex UK

- Fiscal retrenchment has caused mass protest in Spain and Greece. Now 7 French trade unions are calling for a strike to protest pension reforms.
- Germany GDP surprised on the upside as have German tax revenues, driven by corporate tax receipts, helping bring down the national deficit.
- Companies with world wide exposure like Siemens, VW and ThyssenKrupp are reporting good results as exports pick up after last year's recession.
- Nokia's share price stands at €7.1, a long way short of its high in June 2000 when it hit €65 and its more recent high in 2008 when it almost hit €29.
- Ireland was downgraded AA-, with a negative outlook, by S&P, the well known rating agency, causing more existential angst in the EU.

- Such unrest will continue and maybe cause political tension, as high cost, and often unearned, benefits are cut to reduce large state deficits.
- A similar story to the UK, unfortunately deficit surprises are more negative in Ireland and Spain suggesting further Euro instability in the future.
- Good for equities and commodities if growth is maintained. Leading export markets are slowing though – most notably China and the US.
- Nokia was once dominant, but new entrants like Apple, HTC and RIM are taking market share. Capitalism in action in the mobile phones sector.
- Ireland has not yet stopped the red ink in its banking and property sector. Until it does Ireland, and the EU, will be plagued by uncertainty.

Other markets

- 15 of the 32 central banks covered by merchant bank Morgan Stanley have started raising rates, most recently Israel, Brazil, India and NZ.
- The Japanese economy slowed to a crawl in 2Q10 growing at just 0.4% annualised, well below 1Q10, which grew at 4.4% annualised.
- A part of the reason for the weak growth in Japan is the high level of the Japanese Yen against its trading partners, especially the US dollar
- Bharti Airtel of India acquired the African telecom assets of Zain of Kuwait for \$10.7Bn and has earmarked \$2.5Bn for further African acquisitions.
- The price of wheat has been racing ahead, due to droughts and fires in Eastern Europe, sparking investor interest in agricultural futures and ETFs.
- Malaysia liberalised offshore trading in its currency, the Ringgit.

- Central banks globally want to raise rates after cutting them aggressively in 2008/09. This is to head off inflation and prevent asset price bubbles.
- This may force the government's hand into doing something, anything, to boost domestic demand including spending packages and QE.
- The authorities are beginning to talk the Yen lower suggesting they may intervene in the FX markets, or introduce QE, to take the currency down.
- Indian companies are increasingly acquisitive overseas (Corus and Jaguar bought by Tata), but will these acquisitions add value to shareholders?
- Buying single commodities is seen by some as speculative as investors are often betting without a clear idea of supply, demand or future cashflows.
- With more regulation worldwide, this is a welcome step the other way.

	Present Situation	Next Meeting	Expectation	Source
Bank of England	0.5%	9 September	Continue to monitor, but likely on hold for a while	http://www.bankofengland.co.uk/monetarypolicy/decisions.htm
US Federal Reserve	0%-0.25%	21 September	No Fed Funds change for a considerable period	http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm#2868
European Central Bank	1.0%	7 October	7 October	http://www.ecb.int/events/calendar/mgscg/html/index.en.html

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