Investment Solutions
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Professionals' View June 2011

Sell in May?:

We've all heard of the old adage "Sell in May and go away, don't come back 'til St. Leger Day". Well, last year it was pretty well spot on, with Markets in general selling off and sitting in the doldrums all Summer before picking up quite spectacularly from September through to January. This year is shaping up to repeat at least the first leg of that pattern but of course past performance is no guarantee of future performance.

To be fair, Markets have been remarkably resilient in the face of some pretty major events – the North African/Middle East revolts which are still rumbling on and which saw the oil price spike (again); the recurring problem of huge debt levels in Greece, Spain, Portugal and Ireland and its effects on the rest of the Eurozone (again); the monthly debate about inflation and whether interest rates are set to rise (again).

Maybe there's a clue to be found here. With the use of the word "again" we are basically saying that these are old problems, old worries, which are being recycled and about which Markets are fretting over, again. In other words they are problems that are not going away, but are at least "known" unknowns, and through previous examination we have concluded that this sort of unknown is less serious than others.

Range-bound:

It is probably because of this reason that the Market (FTSE 100) has been range-bound for a fair while now. It seems to be bouncing around between 5700 and 6200. So as one of these worries raises its head the Market sells off, but then realises that it has worried about this previously, and worked out at that point that the world won't end. It then re-focuses itself on the reality that interest rates remain low and gilts and bonds look relatively dull or even risky. However, a return is necessarily demanded and equities offer the opportunity of obtaining that return. Then, when the Equities have risen, one of the worries returns to remind us that this return is not without risk, that the problem hasn't been totally dealt with, so we'd best not get carried away. Consequently, the market dips back again. Then the cycle repeats. So, as a range doesn't last forever, which way is it likely to break out? Up or down?

The answer will depend upon whether your vision is that of a glass half full or a glass half empty, but on balance we're erring towards the half full option – eventually – and this is why.

Half Full Argument:

At the core of the argument is that global recovery is still under way. Have you noticed how the double-dip expression has all but disappeared? Concern over deflation has too, to be replaced by inflationary worries. But it wasn't long ago that everyone seemed to think that a bit of inflation was not a bad thing.

Commodities have had an overdue sell-off – but is the China expansion story over? Surely not.

Emerging Markets quite rightly captured the investing public's imagination, but developed economies have not stopped altogether. Cheap can be cheap for a reason, but there is such a thing as ***too*** cheap. So, looking at the FTSE All share, the current P/E ration is around 11. At the height of the dot.com boom in 2000 it was 20. It fell to 6 in 2008. The average is around the 13 mark, so at 11 it is not bargain

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bucket standard, but it is cheaper than the average, at a time of rising corporate profits. This, together with interest rates appearing unlikely to leap dramatically (and thus continuing to deliver a negative real risk-free return on capital) seems to suggest that there is potential for capital gain by investing in equities from here.

Add to this the fact the number of FTSE 350 companies with net cash on their balance sheets is significantly higher now than it has been at any time since 2000 – 140 now compared to 70 in 2002 for example – and it begs the question, "what will they do with the surplus cash?" We'd expect it to either be paid as dividends (good for shareholders), used to buy back shares (good for shareholders) or be used for merger and acquisition activity (good, in general, for shareholders). Whichever way you look at it, there are a number of latent positives which, when the storm clouds clear, will act as a trigger to push equity prices higher than the range in which they are currently trading. (Unless, of course, they get a lot cheaper first.)

Risk Worth Taking?:

In 2010 we saw 158 of the FTSE 250 companies rise by 30% or more in value. So far in 2011 we have seen 6. Obviously these things don't necessarily get repeated year on year, but if the fundamentals are right you can expect movement at some stage.
(Source: Standard Life)

Timing is more a matter of luck than judgement. The key is to be ***in*** a market that breaks upwards before it actually does so. Our view at the moment is that being in it, and waiting, is a risk worth taking but, as ever, you need to be able to change your mind quite quickly if an "unknown" unknown strikes.

If you or your clients would like to review your holdings, please do not hesitate to contact us.

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