
Professionals' View May 2011

Still looking through the fundamentals

Last month we touched upon improving fundamentals for companies around the world with markets beginning to refocus on these. This has been borne out recently in the US with the Dow Jones Industrial Average hitting its highest level since before the financial crisis (source: Telegraph.co.uk) and the Standard & Poor's 500 Index rising to its highest level since June 2008 (source: Bloomberg)

A host of America's biggest companies including UPS, Ford, 3M, Apple, IBM, and Intel have exceeded profit expectations. The performance of UPS, the world's largest package-delivery company, is particularly significant as it is considered a proxy for global economic growth. On the technology side, Intel's forecast of second-quarter sales that may top analysts' estimates is interesting (source: Bloomberg). With booming demand for machines that deliver computing over the Internet, everything else now going mobile, and the popularity of tablets (not the type that the doctor prescribes) technology stocks are back in favour.

One note of caution in the US is the possible ending of quantitative easing, and the effect that this may have on the market. The US economy is now in much better shape than when the Federal Reserve introduced its second round of easing in November (otherwise known as QE2) with employment and other indicators improving.

There is some concern that the market might decline, not because of worries about growth prospects, but rather because of the end of the supply of easy money that was helping to support share prices. Hopefully the Federal Reserve will start this process by ending any new easing programmes and not looking to unravel QE2 by starting to sell off the assets.

Where are interest rates going?

Members of the Bank of England's Monetary Policy Committee (MPC) voted to keep interest rates on hold again in April. In the minutes subsequently released, the split was 6-to-3 in favour of holding them at 0.5%, and they also said there was a "significant risk" of inflation climbing above 5% (source: Daily telegraph).

Previously, the Governor of the Bank of England, Mervyn King, had talked about moving from the NICE decade (non-inflationary, constant expansion) into the VILE decade (volatile inflation, low expansion) and we are most certainly there now. No one, let alone the MPC committee, seems really sure of whether the current spike in inflation is a temporary blip or a more lasting problem, and therefore whether action is required at this juncture or not.

For example, M&G's fixed interest manager, Jim Leaviss is quoted as saying "It would be mad to put up rates now. The MPC lacks some credibility right now and it needs to sit on its hands. I am nervous about the way money has been printed, but I only look at wage growth and therefore I am not worried right now" (source: Investment Week). James Foster, manager of the Artemis Strategic Bond fund, takes the opposite view "Mervyn King is starting to lose the plot and he needs to get rates back up again or inflation will become embedded in the system and then it is much harder to get rid of." (source: Investment Week). Neither of these two well respected bond managers seem to be fans of Mervyn King and the MPC, but ultimately one of them will be proved right.

No such dithering in Europe with the European Central Bank (ECB) doing what's best for Germany and raising rates by 0.5%. Quite where this leaves the P.I.G.S (Portugal, Ireland, Greece, and Spain) is anyone's guess. According to fund manager James Gledhill "It is ironic that the country most in need of a rate hike (Germany) is

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perhaps the least sensitive to changes in floating rates while countries such as Spain and Ireland, which need a hike like a hole in the head, are most sensitive.”(source: Hendersons)

All that glitters...

Gold has hit another record of \$1,510 an ounce while silver reached \$46.16 an ounce for the first time since 1980. It seems as though Gold and Silver are being bought for three reasons, Firstly, as a hedge against inflation, particularly oil price inflation, secondly, because investors are still fretting about the fiscal positions of many developed economies, and thirdly, because of weakness in the US dollar.

However, a word of caution. In our January newsletter we said *“Max King of Investec makes the point that “the final stages are often the steeper stages” for prices of assets in a strong bull market and we agree with him that gold is still a good place to be, but with an eye keenly scanning for clues as to when to make for the exit before the rush begins.”*

Putting the weaker dollar to one side, to justify further price rises from here, there may have to be rampant global inflation, and a significant deterioration in the fiscal positions of major economies, the very things that are not conducive to the current optimism towards the stock market.

Bank error in your favour?

On the face of it, the ruling by the High Court in London to reject the British Bankers' Association attempt to get a judicial review of the regulations in respect of Payment protection Insurance (PPI) looks like good news for long suffering bank customers.

PPI is designed to cover debt payments if the policyholder is unable to work but has been subject to thousands of complaints. In fact, since

the Financial Services Authority took over the regulation of PPI in 2005, there have been more than 1.5m complaints made against providers (source: Daily Telegraph). Speculation that compensation claims for mis-selling could cost the banking industry as much as £4.5bn (source: Daily Telegraph) may be wide of the mark but this ruling will undoubtedly prove costly as banks will have to apply the new PPI rules retrospectively and contact all customers with the insurance to ask them to make a complaint if they think they have been mis-sold their policy.

The sting in the tale for customers may be that banks may look to maximise profits elsewhere in order to recoup these losses, so look out for higher bank charges!

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