



This Bulletin highlights some of the key issues from last weeks press and from time to time includes the views of some of the St. James's Place fund managers.

14th June 2010

All Eyes East

After the recent volatility, global financial markets steadied last week with investors' nerves soothed somewhat by positive economic data from both China and India, together with reassuring noises from US Federal Reserve chief, Ben Bernanke. Not that there weren't some surprises and concerns though. BP's share price plunged to a 14-year low at one point as President Obama launched a scathing attack on the company's chief executive, Tony Hayward, leaving many investors fearful that BP would bow to political pressure and cut its dividend. Such a move would hurt many pension funds – both here in the UK and in the US – as the company accounts for around 12% of all dividend income from the UK market according to **The Financial Times**. On top, as a major constituent of the UK index, its share price fall has accounted for around 250 points of the FTSE100's recent decline.

BP's share price rallied significantly as the week progressed though and accounted for around 14% of total stock market turnover for the week, as sellers were matched with buyers. "At these levels the company is on our radar screen and we will be thinking about whether to take a position" commented UK fund manager Richard Oldfield of Oldfield Partners. He added "There is no rush though in my view. The possibility of BP not paying a dividend is high and this may lead to further selling by American investors and UK income fund managers". At the weekend, **The Sunday Times** reported that BP is considering putting several billion dollars into a ring-fenced clean-up fund to appease American concerns over the soaring cost of the Gulf of Mexico oil spill. But Mr Hayward wasn't the only CEO in the limelight last week: angry investors called for the resignation of Prudential's Tidjane Thiam at the company's AGM following the abortive bid for AIA and in a surprise move, Tesco's Terry Leahy unexpectedly announced his decision to stand down.

Fortunately, there was sufficient good news on the economic front to offset these headwinds. Last month, Chinese exports soared by almost 50% as consumers in Europe, the US and the ten largest emerging economies rediscovered their appetite for cheap clothes and steel. Royal Bank of Scotland's chief China economist said there was anecdotal evidence that the country is capturing market share from increasingly cost-conscious consumers, which is supporting exports. Whilst imports also rose 49.3%, China still managed to produce a huge rise in its trade surplus compared to April – \$19.5bn versus \$1.68bn – a point which won't go unnoticed in Washington where there is pressure for legislative action against China. At the same time, India reported industrial production rising 17.6% year on year, up from 13.9% in March which helped keep the focus on the dynamism on the world's developing economies. According to the World Bank, developing economies will expand by 5.7% to 6.2% a year over the next three years – growth last year was 1.7%. The Bank also forecast that global growth would be 3.3% this year and next, rising to 3.5% in 2012.

Fillip from the Fed

Positive economic forecasts from the Chairman of the US Federal Reserve helped the Dow Jones industrial average to regain the 10,000 level last week - the key blue-chip index finished the week up over 2%. Ben Bernanke told the House Budget Committee that the US economy appeared to be on track to continue to grow for the rest of this year and next, as consumer and business spending made up for the government stimulus measures that were tailing off. **The Times** reported that the Fed expects the American economy to grow 3.5% this year although there is likely to be only a "slow reduction" in unemployment which stands at 9.7%. Following on from Hungary's comments last week that the possibility of the country defaulting should not be dismissed, which unsurprisingly caused a bout of nerves for investors, Mr Bernanke used Europe's troubles again to press politicians on the Committee of the need to reduce America's vast budget deficit. Failing to rein-in the deficit – which is expected to balloon to a record \$1.6 trillion next year – may hurt the economy he said.

However, Mr Bernanke's comments also coincided with news that retail sales in the US fell unexpectedly in May, breaking a seven-month run of increases.

Blue Skies

Here in the UK, in contrast to the US, retail sales bounced back last month with sunny weather giving a boost to sales of clothing and also helping sales of DIY goods. Director of the British Retail Consortium, Stephen Robertson, said "Consumer confidence has clearly improved since last year's lows. But there's still plenty of uncertainty which is making customers nervous about buying expensive goods". Overall though, Britain's output is growing at something close to long-term trend rate, according to the respected National Institute for Economic and Social Research - it estimated that GDP grew at 0.6% for the three months to May. However, the NIESR also warned that the economy still faced headwinds from the spill over of Greece's debt crisis, which has taken the edge off some of the competitiveness of British exports as the euro has weakened. There was good news last week for the nation's industrial sector, with data showing that prices of imported materials fell overall between March and April. One cloud though came in the form of a warning about the dire state of Britain's public finances from the rating agency Fitch which said the task of repairing the damage was "formidable". The comments renewed fears about the safety of Britain's AAA rating and caused a short-term wobble in the currency and stock markets.

The Big Picture

“We are not in normal times. There’s a real danger of missing the big picture – there’s just too much debt everywhere”. That’s the view of UK equity manager John Wood of J O Hambro Capital Management Group. “Whilst I think there are some serious problems, I also believe there are some very exciting long-term investment opportunities that currently exist. My strategy is very simple – it’s about buying high quality businesses that have the ability to grow during some tough economic times that lie ahead. I usually describe this as wanting *Waitrose value at Aldi prices* and from a UK stock market perspective; no-one’s shopping here. But just to recap where we are. Our current problems stem back to 2000 when the carry-trade started. Everybody bought more debt: banks, consumers and now government. The consequences are clear – the global balance sheet recession collapsed the financial system which led to an extreme policy response – low, effectively zero interest rates and massive fiscal monetary stimuli.

So where are we today? The stimulus package has had little real impact on the real economy so we need to think about what happens next. If GDP is unlikely to return to trend for a while then low growth of around 1% is a probable outcome but a 0.5% increase from this low level will have a big impact. First though, we have to understand what is creating current volatility – I call it dashboard fund management with the dials represented by the likes of sovereign debt problems, Chinese growth, changes in Libor and so on. Everyone knows what the problems are but with a herd mentality its analogous to a game of football – the ball is kicked one way and everyone rushes after it, only to turn around and dash back again when the ball is returned.

My own strategy is to identify companies that can still grow against a backdrop of lacklustre economic growth. The key component here is access to capital. In the first phase of recovery it is the smaller and medium sized businesses that are most at risk because, as they seek to roll-over existing debt, the banks are likely to only agree to part and the cost goes up. Cash is still king in a capital constrained world and the strong companies keep getting stronger as their competitors fail or stumble. These businesses have pricing power and high margins which underpin growth in intrinsic value. A good example is Travis Perkins which can access capital via bond and equity markets. It’s what I describe as ‘*Big in the middle*’ – it dominates the chain. Its suppliers are disparate and its customers likewise, small plumbers and so forth. It brings these two groups together in a structured way, has no online or supermarket threat and so cannot be disintermediated. As its competitors struggle it is able to dominate, for example it’s buying BSS which will help it increase market share. Sky is a similar example – the regulatory risk has passed, it has ownership of its customer and a recurring income stream.

These quality companies are at a discount to fair value where their intrinsic value has grown faster than their share prices. Corporate balance sheets are stronger than they’ve been for many years. My entire portfolio is, on a relative basis, better value now than back in March 2009 when the market was at its nadir. I firmly believe that UK equities are the forgotten asset class and offer potentially great investment opportunities over the medium to long-term”.

Both Richard Oldfield and John Wood manage funds for St. James’s Place Wealth Management.



ST. JAMES'S PLACE
WEALTH MANAGEMENT

The St. James's Place Wealth Management Group guarantees the advice given by its representatives when recommending any of the products and services provided by companies in the group.

Representing St. James's Place Wealth Management plc which is authorised and regulated by the Financial Services Authority. The St. James's Place Partnership and the title 'Partner' are marketing terms used to describe St. James's Place representatives.