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MANAGING WEALTH EXPRESS

Slow and steady wins the race

As we expected, and as explained in our most recent bulletin, equity markets remain volatile as markets focus on uncertainty about the macro-economic outlook. Pricing continues to be indiscriminate and in many cases, quite contrary to business performance. So, for how long can we expect these conditions to continue?

The harsh reality is consumer confidence is likely to remain weak for some time to come – time that might be measured in years rather than months, and as a consequence interest rates will remain low. Western governments will desperately seek solutions, particularly as elections loom, but it is unlikely there are any affordable measures which will have much impact – indeed, no action by governments might well be more effective in the long-term than short-term knee-jerk reactions.

The impact of the Japanese tsunami cannot be underestimated: it has been estimated that it has reduced global GDP by around 1%, and whilst that will not resolve itself quickly, it is clearly transient in nature.

For the last few years we, and others, have been saying the West will enter a low growth era as the excesses of the past decade have to be unravelled. Investors became overly optimistic that the relatively high economic growth and growing asset prices seen in 2010 would continue. Now, investors have become overly pessimistic that the recent weak data will continue. Our view is investors need to be more realistic that whilst we are not going to see economic growth at levels prior to 2008 we should continue to see sustainable growth, albeit at lower levels. The contraction of 'balance sheets' for both consumers and governments is necessary in creating stability, and the consequence is lower growth.

However, there are positives, which in our view are not sufficiently factored into the outlook: companies are generally in strong positions, having been managed cautiously for the last few years. As a consequence they are enjoying relatively high margins and low funding costs. We have focused on the large and mega-cap businesses selling to global markets, which continue to enjoy strong growth.

Taking the longer-term view we believe good quality investment income is not being appropriately valued: for example, the average dividend yield on the large/mega-cap high yield funds, that form the core of our equity portfolios, is now circa 4.5%, which is likely to be sustainable over the long-term and indeed benefit from growth broadly in line with inflation. If government and investment grade corporate bond yields, along with interest rates, remain at such low levels, premium value will ultimately be attributed to such investments. This principle would also apply to good quality commercial property benefitting from strong leases and strong tenant covenants, underpinning our syndicated property investment strategy.

So, for the time being, we believe it is appropriate to maintain a steady course and not overreact to the noise in equity markets, much of which is driven by market-makers' trading fears rather than the investment fundamentals.

By Bob Woods, Chairman

Investment opportunities

Structured products - we currently have three very attractive plans available but these are due to close over the next two weeks. Two are structured with Morgan Stanley, the Global Giants Plan and the Developed Markets Kick-out Plan, which are based on global equity markets and should provide good income and kick-out opportunities. The third plan, structured with Walker Crips is a kick-out plan based on the Chinese, Brazilian and Russian equity markets. These plans are now great opportunities in the light of recent equity markets falls.

Clients invested in the Investec Guaranteed 5-year FTSE 100 Kick-Out Plan 5 – Option 1 saw their investment mature on 7 September with a 16% return on a two-year investment. This plan was structured as a deposit, so capital was secure in terms of both stock market falls and depositor protection (up to FSCS limits) at all times. The maturity of the plan was a great result, especially in the context of current market volatility. This is an example of what we aim to achieve by using structured products in client portfolios.

Syndicated property investment - our recent syndicated property at King's Lynn was quickly fully subscribed, and we are currently working on new opportunities.

Equity markets - Asian income funds are looking particularly good value - watch this spot!

Review of the week

- **Jackson Hole Economic Policy Symposium**

The Jackson Hole summit includes most of the world's central bankers along with leading academics and bankers. Following the volatile investment markets and weakening economic data we have seen over the past month, the speech by the Chairman of the Federal Reserve (Fed), Ben Bernanke, was much anticipated. It did not bring a new round of quantitative easing as many had hoped, but it did suggest that the Fed will take a more detailed look at whether more help is required to support the US economy by extending the next meeting by a further day. Bernanke also noted that whilst the Fed will do what it can, "most of the economic policies that support robust economic growth in the long run are outside the province of the central bank". In other words, Washington needs to get its act together and do its bit to support the economy. Markets reacted fairly positively to the speech and the continued commitment of very loose monetary policy from the Fed.

- **Brazil surprises by lowering interest rates**

The Brazilian central bank lowered the main interest rate by 0.5% to 12% in an unexpected move. Their reasoning was that "the advanced economies may be subject to the constraints for longer than previously anticipated" and that "the global outlook will have a disinflationary bias going forward". They emphasised that their next move will depend on the global economic environment. The Brazilian economy has slowed over the last few months with annual growth to the end of the second quarter slowing to 3.1% from 4.2%, largely due to a slowdown in exports. Despite the weaker economic growth, the service sector grew, which accounts for 2/3rds of the Brazilian economy, and domestic demand expanded by over 4% over the last three months. Brazilian policymakers have been using various tactics to cool growth and

inflation, which has resulted in a 17% fall in the Brazilian stock market (year to date) but the most recent actions are a sign that they have started to reverse this position, which should help asset prices.

- **US data**

This week, the Institute for Supply & Management's indicator slowed but continued to grow and was more robust than estimates. The employment data released on Friday gave mixed messages. The press focused solely on the non-farm payroll employment report, which showed flat growth for August payrolls, against an expected modest gain. There were some one-off effects that had an impact, but even without these, the report was much weaker than expected. However, the household survey of employment (used for the official unemployment rate) was quite healthy with a gain of 331,000 jobs. The unemployment rate remained the same at 9.1% due to an increase in the labour force. The Fed, as mentioned above, now has a difficult decision in its September meeting to gauge whether economic data has deteriorated enough to justify the risks associated with another round of quantitative easing.

- **UK housing**

The August Nationwide House Price Index registered the first decline in UK house prices since April. UK house prices now stand 0.6% lower than they did in August 2010. The public sector cuts, squeeze in real earnings growth and a constrained mortgage market are putting pressure on the demand for housing stock.

By Ben Wattam, Investment Research Manager

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