



This weekly Briefing Note aims to pick out some of the key financial and economic issues touched on in the press over recent days and from time to time includes the views of some of our independent fund managers.

## Equities march on

Global equities recorded their first weekly gains since the start of August as US economic data countered fears of a double-dip recession. **The Independent** reported that the US employment data for August revealed that private sector jobs increased by 67,000, far exceeding the forecast of 41,000.

**The Times** reported Barack Obama's reaction to be, "That's positive news and it reflects the steps we have taken to break the back of this recession." The jobs report, on top of better-than-expected data from China on Wednesday, sparked the biggest one-day rally in equity markets in two months. Across the globe, stock markets saw a significant rebound from the falls of the last three months. In the UK, the FTSE 100 closed the week 4.3% higher than the level at which it began, while in the eurozone, European stocks gained 3.6%. A host of merger and acquisition speculation globally added to economic optimism, with US markets closing with gains of 3.2%, with financial and industrial stocks especially boosted.

## BHP v PotashCorp

One of the largest hostile takeovers around the world today is BHP Billiton's bid for Canada's PotashCorp. Potash, derived from mineral deposits, is used almost exclusively as a fertilizer and the demand for food is set to keep demand high for years as the global population continues to increase. BHP felt that the company was significantly undervalued. But as **The Mail on Sunday** pointed out, by turning the spotlight on the company it is trying to take over, BHP has ensured that it is no longer undervalued to the same extent that it was previously. The result of this may be that BHP finds it very difficult to succeed in its bid for control. The paper speculated that PotashCorp could have been permanently revalued for a number of reasons. China consumes about three million tonnes of potash per year, a figure that will only rise, while the Russian wheat export ban will only serve as a reminder of the value of potash.

BHP shares rose last week to close at 1936p, which has caused speculation that the market does not expect the company to succeed and therefore spend any cash. The mining company has offered \$130 per share, but after they had alerted investors to the value of PotashCorp and its role in the global economic picture, the stock closed the week at \$149 per share, an all-time high. China is the world's largest consumer of commodities and **The Times** reported on the potential for the country launching a bid of its own to derail the BHP plans. However, opinion is still divided over whether a rival bid would come from state-owned Sinochem, or from a consortium behind a Chinese sovereign wealth fund. **The Financial Times** was of the opinion that the Chinese government was actively backing a counterbid in an attempt to secure global resources. Mining analysts were of the opinion that the size of BHP's \$39bn opening offer was always going to be the largest stumbling block, because very few private companies can match that sort of financial strength. However, Chinese government-owned companies have access to a far deeper pool of funds, either through soft loans by state banks or via access to sovereign wealth funds.

## The bigger picture

Depending on who you listen to, or which papers you read, the US economy is either booming or collapsing, and Britain has either the best prospects for economic growth in Europe or is about to sink into recession. It is almost no wonder that global stock markets have seen increased volatility over the past three months. However, **The Sunday Times** encouraged its readers to look at the bigger picture. The International Monetary Fund expects global growth of 4.6% this year and 4.3% in 2011. These figures are heavily weighted towards emerging economies such as China and India at around 6.5%, but growth is still there in most parts, with the US and Britain at around 2.5%. Even Europe, the area perceived as having the most short-term problems, has had its predicted growth rate raised to 1.6% for this year. The paper pointed out that recovery has never gone in straight lines. There will be months when data will seem weak, and there will be months when it is strong, while pockets of extreme weakness will always exist, much like the American housing market currently.

The article also asked why businesses are so keen to downplay economic recovery. The first reason they cited was that chief executives in statements rarely shout from the rooftops about the state of the economy, for fear that they undermine their own efforts. Secondly, and more importantly, businesses think of recovery in different terms than economists. For companies, it is not about when the economy lifts off the bottom, but when order books and trading activity gets back to normal. Only when this happens will chief executives start to acknowledge a real economic recovery, which could realistically take a further two years or more.

The paper opined that a real recovery indicator was that thoughts are already turning to rising interest rates. One member of the Bank of England's Monetary Policy Committee, Andrew Sentance, has already voted for a rise in each of the last three months. While it is expected that interest rates will remain at 0.5% this week, and indeed for months to come, the fact that discussions have begun on an exit strategy is a significant "straw in the wind". Whilst such a decision would mean the 18th consecutive month without change, the Governor, Mervyn King, has repeatedly stated he would feel more comfortable with base rates at normal levels. **The Sunday Telegraph** opined that while the general consensus is that 0.5% will be the base rate for the foreseeable future, when they do start to rise they will do so quickly. Sir John Gieve, the former Bank of England deputy governor, said last week he expected rates to rise at a quicker pace, stating, "I am expecting a recovery, and when that is strongly established, rates will rise quicker than the market expects. I wouldn't be surprised to see rates at 2.5% a year from now."

### Outlook for equities

**The Financial Times** discussed how equities are currently viewed by investors looking for long-term solutions for their money. Price to earnings ratios are two and a half times cheaper than they were 10 years ago, dividend yields are higher than 10-year Gilt yields, which rarely happens, but investors are still in some cases wary of equity investment. As the paper pointed out, global equities have only returned 4% total in sterling terms, while government bonds have delivered 103% over the same ten-year period. During this time, investors have had to cope with two savage bear markets. Also, in a world where Japanese-style deflation is seen as a significant threat, bonds are often seen as a more attractive investment. However, the article stressed that investors shouldn't give up on equity investment. Half of FTSE 350 companies currently yield more than 10-year government bonds, and in a low-inflation environment, that will always look attractive. Also, large corporations are buying assets in the equity market and borrowing cheaply on the bond market, which will push prices higher the more it happens.

This week, research from Reuters showed that August marked the first time in five months that investors have increased their holdings in equities. As reported in **The Times**, most fund managers now seem to think a double-dip recession can be avoided, though the primary reason for equity investment could well be that real returns in cash are virtually nothing, as savers are all too painfully aware, while Gilt yields are being pushed lower due to the necessity of further issuance by the government.

The fund manager of the St. James's Place UK Growth portfolios, John Innes of RWC Partners, recently commented on his outlook for UK equities in particular. "The latest market rally was on much thinner volumes than during the falls in the early summer. For the technical analyst, the market is therefore still troubled after the breakdown. For the fundamental analyst, however, the bear stories are being knocked over one-by-one. The global economy has not melted down into a 1930's depression, nor has inflation taken off despite all the quantitative easing. The 'climate of fear' was re-created with a credit market-inspired attack on the Euro and Sovereign Debts, but this has been countered by the huge €750 billion support package agreed in May. The new UK coalition government has also avoided any sterling crisis by a new-found emphasis on deficit reduction. Corporate results have generally been much better than expected, including the banking sector, and the threatened regulatory strait-jacket has been considerably loosened. Corporate M&A activity has also materially picked up, suggesting an increase in corporate confidence and bank willingness to support soundly financed deals. Other than the normal worries over global terrorism, Iran etc. there remain two major economic concerns. The most obvious is the current "soft patch" in the US economy and in particular the lack of rapid improvement in the jobs market.

The other concern is whether the planned slowdown in China develops into something more severe. The fund is still positioned with a more optimistic view of the equity market and the global economy so the portfolio remains invested to benefit from a cyclical improvement in economic activity from a very low level and from a continued reduction in stress in the financial markets. We remain fully invested in recognition of the overall cheapness in the equity markets, both on an absolute basis and especially relative to government bonds and cash."