

Investments

Monthly Review



October 2009

Highlights

- Equity markets continue to climb.
- Bond markets end the month about where they started.
- Japan's new prime minister takes office.

UK

A third straight positive month for UK equities - rounding off one of the best quarters on record - ended with the FTSE All-Share index rising 4.7%. Nearly all sectors finished ahead, with the food producers leading the way in the wake of Cadbury's approach from US rival Kraft. With investors interpreting data releases as further evidence that the worst of both the economic and financial crisis has now passed, appetite for risk remains healthy. The All-Share has now risen 23% since the start of the year.

While economic data released during the month was devoid of calamities, the market's buoyant mood was not entirely shared by the Bank of England governor, Mervyn King. He warned that any recovery would be "slow and protracted". The UK manufacturing PMI survey, having moved back above 50 for the first time in July, was back below that key level in September, suggesting the sector has stagnated rather than rebounded (as might have been expected given the fall in sterling). Retail sales were also down slightly in August following two months of increases, and housing data was mixed.

The monthly data released by the Nationwide Building Society saw house prices increase again, up 0.9% in September. Turnover remained well below normal levels, calling into question the sustainability of the recovery in the housing market. Unemployment also continues to rise, with the Office of National Statistics registering an increase in the jobless count to 2.47 million in the three months to July (the highest level since 1995). BAE Systems added to the gloom by announcing it would cut over 1,110 jobs and close down an aircraft factory in Cheshire.

Capital-raising was an eye-catching feature of the month, with housebuilders Barratt and Redrow noteworthy among those coming to the market for fresh capital. Liberty International surprised investors with another cash call, having already raised fresh capital earlier in the year.

Summary

- Equity markets rise a third straight month.
- Bank of England governor warns of "slow and protracted" recovery.
- Capital-raising continues apace.

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US

US equity markets experienced a dip in the early days of September on the back of disappointing economic data. But better-than-expected jobs figures sparked a rally that continued until the middle of the month. The S&P 500 index was ahead 3.7% in dollar terms.

All ten of the index's core sectors advanced during September. Industrials and consumer discretionary (up 6.6% and 5.2% respectively) were the best performers, health care (up 0.9%) and utilities (up 1.1%) the worst.

Investors were left to mull over comments from Tim Geithner, the Treasury secretary, that the US financial system no longer needs some of the government's support measures. Equities also received a boost after a rousing speech by President Obama on the subject of financial reform. He asked the financial sector to support "the most ambitious overhaul of the financial system since the Great Depression".

The market's positive response to Mr Obama's comments overcame worries about a possible trade war between the US and China. The row began after the US announced plans to impose special duties of 35% on tyre imports from China. The Chinese parried the blow by beginning an investigation into US exports of car parts and chicken products. Bullish remarks from Ben Bernanke, chairman of the Federal Reserve, that the recession is "very likely over" went down very well with traders, although he did warn that recovery would be slow.

There was also an increase in merger and acquisition activity during September: Xerox, the world's largest maker of colour printers, announced a \$6.4 billion cash-and-stock deal to buy Affiliated Computer Services, a business outsourcing firm. Elsewhere, consolidation in the pharmaceuticals industry continued apace after Abbott Laboratories bought Belgian rival Solvay, bringing to a close a five-month takeover tussle.

Summary

- President Obama announces intentions to overhaul US financial system.
- Fed chairman claims recession is "very likely over".
- Merger & Acquisition activity increases.

Europe

The European equity market rally showed no signs of abating in September. The main drivers were ongoing improvements in the global economy and confidence that the extraordinary policy initiatives implemented by central banks since the collapse of Lehman Brothers would remain in place for months to come. The financial sector built on its recent gains, as liquidity continued to flow freely through the market. A rights issue by banking group BNP Paribas - one which will allow it to pay back the French government's bail-out money - was also greeted with enthusiasm. A number of other banks look certain to follow suit. Overall, the FTSE Europe ex-UK index was up 3.5% in local currency terms.

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Elsewhere, economic and consumer confidence in the eurozone hit their highest levels in a year, adding to expectations that the 16-nation region was about to emerge from recession. According to the monthly survey by the European Commission, overall economic sentiment rose sharply in August, even beating analysts' forecasts. But behind the numbers lay marked regional variations, suggesting any growth would remain fragile well into 2010.

Meanwhile, the German elections saw Angela Merkel, the incumbent centre-right leader, hold on to the chancellorship. Her Christian Democrat party will now govern under a coalition with the pro-business Free Democrats. Many in the market cheered the news, believing the new alliance would now commit to the reforms that are essential for long-term economic growth. The result also led to a strong performance in German utilities, particularly EON and RWE, which now expect the government to grant extensions to their nuclear energy programmes.

Summary

- Equities deliver further strong returns.
- Economic climate improves further.
- Chancellor Merkel wins German elections.

Japan

Japanese equities got off to a slow start in September: exporters were pummelled by the advancing yen and there were concerns about the health of the financial sector. Later in the month, investors turned their attention to politics, as the new Japanese Prime Minister, Yukio Hatoyama, took office and announced the members of his cabinet. The Topix index finished the month down more than 5% in local currency terms.

Financials were under pressure in early September amid increased investor anxiety over the strain on the US banking sector. Meanwhile, shares in Daiwa, an investment house, tumbled after its banking partner Sumitomo Mitsui Financial revealed that the two companies are in talks aimed at ending their alliance. Mitsubishi UFJ Financial was the next to fall, after JP Morgan cut its rating from overweight to neutral. Confidence in the rest of the sector also suffered in the wake of the broker reducing its overall rating to slightly bearish. Another dip followed after the securities firm Nomura Holdings announced plans to issue up to \$5.6 billion in shares. Investors also fretted about plans by the new banking minister, Shizuka Kamei, to help small companies by proposing a moratorium on their loan repayments. Mid-September saw the yen climb close to a year-high against the dollar, causing shares in exporters such as Honda, Sony and Canon to decline.

September's economic data proved mixed. A report revealed that capital spending fell for the ninth quarter in succession, as companies try to slash costs. In contrast, a government survey showed that Japan's manufacturers were less pessimistic - despite the strength of Japan's currency.

Summary

- Yen reaches seven-month high against the dollar.
- Manufacturers less pessimistic.
- Yukio Hatoyama takes office as prime minister.

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Emerging Markets

It's rare to see an asset class recording two consecutive double-digit quarterly gains. Yet that is what emerging markets have achieved in the six months between April and September.

The past month has seen strong performances across the board. Latin America was the best performing geographical region. It delivered price growth of 12% in US dollar terms, buoyed by lower interest rates, a resurgence in investor risk appetite and global growth updates. Brazil was particularly strong - ahead 15.1% and boosted by its finance minister's assertion that the economy was recovering faster than expected. The latest economic statistics seem to back him up.

Asia-Pacific (ex-Japan) was ahead 9.4%. This would be seen as a healthy increase by most standards, but it was lower than the emerging markets average and was held back by continued worries over Chinese policy tightening. China itself was only 4.2% ahead. After months of index gains, it was the laggard of the BRIC countries, and has suffered marked volatility on fears that the consumer credit was to be reined in. India was ahead 10.9%. During the month its central bank said the benchmark interest rate would be held at 4.75% until it was sure that the economic recovery had taken hold in the country. Russia rose 15%, the strongest price performance of the EMEA countries.

Summary

- Emerging markets record another double-digit quarterly gain.
- Latin American stocks perform particularly strongly.
- China's market remains subdued over exit strategy rumblings.

Bonds

Government bond prices oscillated throughout September, reacting to a raft of often contradictory economic data. However, bond markets finished the month roughly where they started. At the beginning of the month, worse-than-expected US employment and factory orders data sent 10-year yields lower in the US and UK, and in Europe close to a four-month low.

Thereafter, a flurry of improved economic statistics - which included increased growth forecasts from the European Central Bank and strong US retail sales figures - produced an improvement in investors' appetite for risk. As a result, investors temporarily deserted government bonds for equities and corporate bonds. By mid-month, even though the equity market rally showed no signs of abating, government bond prices began to rise once more. As one analyst put it - "markets are behaving weirdly".

Most probably, they rose in the expectation that quantitative easing and other stimulus measures adopted at the height of the crisis will remain in place for some time to come. Some are describing the government bond markets as a pressure cooker for the financial system, with QE as the lid preventing yields from exploding.

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Corporate bonds continued to benefit from investors' growing appetite for risk, with indices hitting highs for 2009. The rally levelled off, though, towards the end of the month. There were signs of some investors making the most of recent gains and taking profits.

Property

Here is the good news: capital values in the commercial property market have reached rock bottom. After a series of moderating monthly declines earlier this year, the latest IPD data finally gave investors what they had been waiting for. Prices rose by 0.2% in August, bringing the 25-month peak-to-trough decline to 44.2%. This is in comparison to the last recession, which saw a 27.1% decline over 43 months between October 1989 and May 1993.

Despite the apparent optimism, though, questions remain over the sustainability of a recovery, given that positive investor sentiment - rather than strong fundamentals - is driving the market. Restricted bank lending and weakness in the occupier markets remain significant concerns for investors and continue to put the brakes on a full recovery. While the rate of decline in rents has been slowing in recent months, August still registered a further fall of 0.48%. Vacancy rates also reached a new record high during the month at 12.3%.

That said, after a painful two-year downturn investors are rightly encouraged by evidence that the property market is over the worst. And in the current environment of low valuations and high initial yields of 7.9%, property remains an attractive investment option relative to other asset classes.

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