Investment Newsletter
November 2011

equilibrium asset management

Reasons to be cheerful

Watching the news or reading the financial press is a depressing activity right now!

However, believe it or not, it is not all doom and gloom and there are plenty of reasons to be cheerful (or at least, less miserable) about the economy and the markets.

As the saying goes, "good news is no news" and therefore it receives very little media coverage. We have no wish to downplay the very serious situation in Europe. However, we thought we'd mention a few stories you may have missed, which show that things might not be all bad.

US Economic Growth

One of the initial catalysts for Augusts' market falls was a dramatic "re-rating" of analysts' expectations for the US economy and the markets.

Expectations were dramatically revised down. It now appears that they may have been revised down too far.

In the third quarter of this year, the US economy grew by an annualised 2.5%, better than expected and much higher than the 1.3% growth in the second quarter.

In addition, the number of unemployed also fell. Not only have new jobs been added in October, but August and September's figures have now been revised upwards. These had originally shown zero growth but are now showing new jobs added, so unemployment in the US has now fallen for three months in a row. Again, this is much better than analysts' expectations.

The USA remains the world's largest economy and Americans are the biggest consumers of goods and services. The performance of their economy is therefore vital for the world economy.

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China

The second biggest economy in the World is China, making it almost as important for World growth as America.

A concern weighing on markets over the past year or so has been that China has been growing too quickly, and has an inflation problem. The Chinese government has been trying to tackle inflation, but this has generated concern that they might over-shoot and slow their economy dramatically.

Recent data is now indicating that the Chinese economy is slowing at a more modest pace, and most analysts now believe there will be a "soft landing" and the danger of a Chinese slump is abating.

Company Profits

Many companies are continuing to report profits greater than expected by analysts.

A total of 222 out of 298 S&P 500 companies in the US that reported results since 11 October have reported profits ahead of expectations, and American companies have beaten profits estimates for the 11th straight quarter, according to Bloomberg.

According to the report on 31 October: "While more than $6.3 trillion has been erased from global equities since May, analyst forecasts imply the benchmark measure will post its biggest rally since the 1990s technology bubble."

Price targets for companies in the S&P 500 Index from more than 10,000 estimates suggest it will advance 16% in a year, say Bloomberg.

Profits are also encouraging in the troubled banking sector. For example, Citigroup in the US and Royal Bank of Scotland in the UK have recently announced rising profits. RBS has reported a £2bn pre-tax profit in its last quarter, compared to a £1.6bn loss the same time last year.

Gilt Yields at Record Lows

Whilst Italy's cost of borrowing over 10 years was being driven to more than 7% pa last week, the UK's rate of borrowing FELL to 2.1% over the same period.

Low gilt yields have some negative effects, such as decreasing annuity rates, but this fall reduces the cost of our government debt significantly. The high level of inflation, caused in part by a weaker pound, is bad for savers but it is great for borrowers, including our government. The value of our national debt is being eroded by inflation and the interest rate we're paying is reducing.

This all helps the UK government repair its balance sheet.

"Technocratic" Governments

The favoured route by Greece and Italy is to replace their current government with so-called "technocratic" ones.

Greece's new government is a "unity coalition", meaning there is cross party support for the austerity measures required to secure a bail out. Italy is looking to go down a similar route. These governments are "technocratic" in the sense that they are led by non-politicians. In theory the new leaders ought to have no interest in being populist or winning future elections, only in solving the current economic crisis.

Greece has appointed a former economist and Harvard Professor, Lucas Papademos. Italy has

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provisionally appointed Mario Monti, an economist and former head of the European Competition Commission. The appointment is likely to be confirmed with a confidence vote later this week.

The global financial system relies on confidence, and both these candidates have been chosen for their international credibility.

We hope the above helps illustrate why we don't believe it's all gloom and doom and there are reasons to be hopeful about economies and markets.

And finally...

Some more good news with a less global impact (yet)...

Equilibrium was recently named Business Adviser of the Year 2011 at the Macclesfield and Wilmslow Business Awards. Jason Lowe, Partner and Financial Planner, collected the award on our behalf. We are delighted with this award, beating some really great firms, not just financial advisers but solicitors and accountants.

Although we specialise in individual financial planning, we have a proud track record in helping business leaders achieve their goals.

This award has a local focus but the ceremony was a sizeable event with some fantastic businesses involved.

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General Economic Overview

Global economic growth is likely to remain muted. On balance we believe global recession will be avoided due to better than expected data from the USA and China, however recession now looks likely in the Eurozone. As a result, interest rates are likely to remain low for the next two years.

European sovereign debt issues will continue to concern markets for some time causing occasional bouts of volatility. Inflation may die back in the short term but we remain worried about it in the long term.

Asset class key

+	positive	+5	strongly positive
-	negative	-5	strongly negative
=	neutral (normal behaviour)		

	Outlook
Equity Markets Last month we were +4 with markets at relative lows, and positive earnings and dividend data meaning we felt equity exhibited real value. The rebound in markets together with the continuing European problems means we have reduced outlook to a +2, but this means we still expect very positive equity returns.	+2
Fixed Interest Government have rallied due to risk aversion in other asset classes, whilst high yield and bank bonds have fallen back. We expect below average returns from fixed interest in general, but some pockets of riskier debt look great value after market overreaction to the current crisis. In addition, inflation and interest rate risk has receded for the short term.	-2
Commercial Property Whilst the rental yield on commercial property remains attractive, this is diluted by high levels of cash in property funds. Capital growth is dependent on economic growth which is likely to be poor.	-4
Residential Property We believe prices are likely to remain flat over 18 months.	-5
Cash With interest rates remaining at record lows, returns on cash could remain below average for some time. However, there is a short term safe haven appeal.	-5

Balanced Asset Allocation

For a typical balanced portfolio we are overweight equity and cash and underweight the other asset classes. Based on our above scores and current tactical positions we'd expect a Balanced Asset Allocation (excluding client cash) to return approximately 8.1% pa rather than the normal 8%pa. This assumes you hold one of our ideal model portfolios. Please contact us if you would like further details

A neutral score (=) means we expect the asset class to move in line with our long term assumptions: 10% pa for equity, 7% for property, 6% for fixed interest, 5% for residential property, and 3% for cash. A +5 score means we think the asset class could outperform by 50% or more. A -5% means we think it could underperform by 50%. A negative score does not necessarily mean we think the asset class will fall.

These represent Equilibrium's collective views. There are no guarantees, although we hope to be right more often than wrong. We usually recommend holding at least some funds in all asset classes at all times and adjust weightings to reflect the above views. These are not personal recommendations so please do not take action without speaking to your adviser.