



Newsflash

5th August 2011

News Briefing: Crisis or Opportunity

Warren Buffet said "Be fearful when others are greedy, and greedy when others are fearful."

This seems a particularly valuable insight following the selloff of the last couple of days across global markets.

Crisis

There have been a number of factors that have caused these market falls. The biggest is the concern that governments will be unable to manage the enormous sovereign debts that they have accumulated.

The sovereign debt issue has been widely documented well before even the original Greek crisis of last year. It may seem strange too, that markets held up fairly well over the last few weeks as the US teetered on the edge of a default, something that would have been inconceivable until very recently.

However there have been a number of catalysts for the falls.

- Recent economic data has been poor. The Purchasing Managers Index (PMI), which estimates economic activity through a survey of purchasing managers, reflected a significant slowdown in growth in the US and UK manufacturing sectors for August.
- Jose Manuel Barroso, European Commission President, amplified market concerns warning EU leaders that there is a real risk the debt crisis may affect European nations other than just the smaller peripheral countries. Italy and Spain are looking increasingly vulnerable. Spain is often described as the "key domino".
- The Japanese government intervened in markets as a result of economic concerns, selling Yen in order to lower its currency's value and make exports more competitive. The European Central Bank also intervened in markets, buying Portuguese and Irish bonds to try and suppress yields, but exacerbated concerns by refusing to buy Spanish and Italian bonds.

Opportunity

Despite the gloomy macro economic outlook there are reasons to be positive.

We held our weekly Investment Management Committee Meeting on Wednesday and voted for a +4 score for equity as an asset class, meaning we expect equities to outperform our average assumptions over the next 18 months. We feel equities could deliver annualised returns of 14%.

There are a number of reasons for this positive outlook. Future Price / Earnings (PE) ratios, which show how long it will take for company earnings to cover their market price, are around 10. Though this is based on earnings expectations and therefore subject to change, it still represents good value relative to a long term average of around 14. With recent market falls prices are lower and so PE's should reflect even better value.

In addition, fundamentals are much improved since the credit crunch in 2008. Large companies have increasingly high cash levels and dividends are now higher than they were pre credit crunch.

Strategy

We therefore saw the recent market volatility as an opportunity. In March this year, following the Japanese earthquake, the FTSE 100 fell to 5,700. We bought HSBC FTSE Allshare tracker and HSBC Japan tracker within our standard portfolios at relative market lows.

Following Greece's approval of the austerity measures, markets rallied and the FTSE closed above 6,050 on 7th July. We took this opportunity to bank gains, selling HSBC FTSE Allshare tracker.

On 3rd August with the FTSE 100 at around 5,650 we repurchased HSBC FTSE Allshare tracker. At the same time we reduced property holdings, placing around 3% in cash. This gave us the option to react quickly and add to equity if markets continued to fall, which unfortunately they did. Trades were placed today to invest this cash in a HSBC FTSE 100 tracker.

We plan to sell more property and fixed interest to increase available cash. This will provide liquidity should clients require funds, and will allow us to supplement equity if markets suffer significant further losses.

As markets rise we will look to sell this equity in order to take the profits from these decisions.

Focus

Though we have increased our equity positions we have been very selective about the type of equity.

By overweighting funds that invest in large companies who pay high dividends, we have tried to minimise the downside risk. Whilst this strategy has detracted from performance for most of this year it is now working well.

Invesco Perpetual Income is a great example. This fund had suffered a period of underperformance. However, we backed our convictions and, as the below graph demonstrates, the fund has provided excellent protection in the recent downturn.



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To again quote Mr Buffet "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."

When headlines scream of “trillions being lost” it is hard to keep emotions at bay, however we have our “sound framework” and are therefore sticking to strategy.

Let’s hope the headlines and markets have overdone it and that we will see a strong bounce back from these lows.

Whatever happens we will keep you updated as events unfold and if you have any personal concerns, questions or queries then please do get in touch.