



## Research Summary – February 2011

### Summary of Opinions

The following is our interpretation of various opinions and statements taken from our research and meetings. This is not meant to be an exhaustive list and the opinions do not necessarily represent the views of Equilibrium. Clients should not act upon the information in this document without consulting their adviser.

#### General

Who	What	Source
David Smith, The Sunday Times	Markets have started to anticipate higher rates, discounting a rise to 1.25% by the end of the year. Gilts have started to suffer on inflation worries. The kind of rise in gilt yields we have seen recently often presages a rise in interest rates.	The Sunday Times, 06/02/2011
Andrew Milligan, Head of Strategy, Standard Life Investments	Believes interest rate rises will not happen for some time. If they are increased too early it could cause a double dip recession.  History suggests governments will allow inflation to rise to solve debt problems.  Private sector employment is increasing, and is expanding at about the same rate as the projected public sector job losses. Unemployment may therefore not be as bad as people think.	Investment dinner 1/2/11
Bill Dinning, Head of Strategy, Aegon Asset Management	The Purchasing Managers Indicies (PMI) are showing very positive growth in the UK at around 3% pa. He believes growth is therefore strong and will beat most expectations.  He expects inflation to remain high and this could force the Bank of England to raise rates.	Investment dinner 3/2/11



**General (continued)**

Who	What	Source
	<p>Focusing on the prospects of a double-dip recession, if the weather continues to behave itself this quarter, then the bad weather effects should reverse, adding half a percentage point to current forecasts. This should ensure the UK avoids the dreaded double-dip, though this is by far no means a certainty.</p> <p>In any case, the poor GDP result should put an end to fears of rate rises in the next six months. As the economy is growing sub 2% per annum, in the Bank of England's mind, the output gap, and therefore deflationary pressure, is increasing. We could even see a return of quantitative easing being the next favoured policy move.</p>	
<p>Mervyn King, Governor of Bank of England</p>	<p>He signaled a sharp slowdown in the economy, dampening expectations of an early interest rate rise in the battle to curb inflation.</p> <p>Inflation was likely to fall back to its 2% target next year, given the deterioration in the state of the economy. He stressed the temporary nature of recent double-digit rises in the cost of food and energy, coupled with the government's VAT increase.</p> <p>"What we need is an economic policy which sees a rebalancing in the economy, and that's what we are doing through our deficit reduction plan.</p> <p>"As a result of that plan, interest rates should be able to stay lower for longer."</p>	<p>Guardian Article, 16/02/2011</p>



**General (continued)**

<b>Who</b>	<b>What</b>	<b>Source</b>
James Foster, Fund Manager, Artemis Strategic	<p>He is worried about inflation. QE has fed commodity prices and this is pushing up inflation. He is concerned it is getting ingrained in the psyche, as expectations of inflation are increasing and therefore inflation will increase in future.</p> <p>He thinks CPI will go close to 5% this year, but would be closer to 4% if not for the VAT rise. Interest rates need to go up to push up Sterling and counter commodity inflation.</p> <p>QE in Europe is likely. This would cause the Euro to fall, pushing up inflation. They would also raise rates to counter it.</p>	Meeting 9/2/11
William Littlewood, Fund Manager, Artemis Strategic Assets	<p>The sovereign debt crises will rumble on. Governments can't cut spending too much as they get voted out of they do. Their only solution is inflation and QE will lead to an inflation problem one day, even if inflation could fall back a little next year.</p> <p>He believes the Chinese GDP and inflation figures are not correct and bad loans will emerge. There will have to be a slow down or recession in China at some point – they can't abolish boom and bust. State capital investment is 50% of GDP which is a record and which he believes points to an inevitable bust at some point. There are not only lots of empty buildings in China but even an empty city!</p> <p>China wants to become more environmentally friendly and goods will have to become more expensive if they change the way they are manufactured to be less polluting.</p>	Meeting 9/2/11

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## General (continued)

Who	What	Source
The Sunday Times - Money Supplement, Various	<p><b>Simon Kiby (National Institute of Economic &amp; Social Research):</b> "...there is not going to be a rate rise before May"...if interest rate expectations continue to rise we could even see the MPC opt for a half point rise rather than a quarter point rise. We would expect two further rises by the end of the year."</p> <p><b>Madhar Jha (global economist at HSBC's investment bank):</b> "We have not seen any evidence of wages rising sharply and, ultimately, there is still a lot of spare capacity in the system, so we do not think there will be any rate rise until next year."</p> <p><b>Jim Leavis (Head of institutional &amp; retail fixed interest at M&amp;G):</b> "A rise in rates would be GDP suicide - it would only lead to a double dip. The only impact of a rise in rates will be to make us poorer and that's a real risk in a world where the government's austerity measures haven't even started yet."</p>	The Sunday Times, 27/02/2011
Tom Elliott, Global Strategist, JPMorgan	<p>Between 2008 and 2010 the Chinese government prompted increased lending from banks in order to support the Chinese economy during the global economic crisis. One of the results of the credit growth has been increased inflation, including higher commodity prices and higher Chinese wages.</p> <p>Chinese companies are unable to pass the increased costs on to UK and US consumers who are already suffering from price inflation that is not being matched by wage inflation.</p> <p>Not all of this lending by Chinese banks was prudent as the scale of the bad debts becomes clear banks are starting to raise interest rates and hold increased levels of assets.</p>	Meeting 14/02/2011

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## General (continued)

Who	What	Source
Consensus/Summary	<p>The debate continues on whether to raise interest rates before May or later in the year due to the impact of rising inflation. Inflation should remain above Bank of England target for most of 2011. After that, opinion is split about whether it will remain high or fall back to BOE target level of 2%</p> <p>There are some opinions on whether the UK economy could enter a double-dip recession after negative growth of -0.6% in Q4 2010.</p>	



### Equities

<b>Who</b>	<b>What</b>	<b>Source</b>
David Coombs, Fund Manager, Rathbones	Warns of the dangers of emerging markets and says "It is too soon to go back in – although falls of 10% to 15% for emerging markets might change my view"	The Sunday Times, Kathryn Cooper, 06/02/2011
Andrew Milligan, Head of Strategy, Standard Life Investments	<p>Many companies have high levels of cash. If they don't spend it, governments will find a way of taxing it away. They therefore will invest it in their business or workforce, or look for merger/acquisition opportunities.</p> <p>He is positive about equity but not for the long term. He doesn't think this is a new 10 year bull market, but it may last 2 years. After that, he can see potential large corrections.</p>	Investment dinner 1/2/11
Richard Buxton, Fund Manager, Schroder UK Alpha Plus	Whilst the consumer is bound to be subdued in the coming months, we expect the growth in corporate sector spending and hiring to ensure that the UK does continue to grow this year, albeit in uneven fashion. Coupled with the continuation of very low interest rates, this underpins our expectation of further progress from the UK equity market during 2011. One could argue that less debt-fuelled private consumption and public spending with more private investment and exports could be exactly the gradual economic rebalancing that the UK economy needs.	Schroder's Email, 14/02/2011
Derek Stuart, Fund Manager, Artemis UK Special Situations	He is avoiding mining stocks which are based almost solely on commodity prices. He doesn't think these can be accurately valued and therefore doesn't want to invest in miners right now.	Meeting 9/2/11
Adrian Gosden, Fund Manager, Artemis Income	<p>Believes income stocks will come back into fashion. Dividends have not been appreciated in the recovery but they will be eventually. The dividend yield of the stocks that they own are covered 2.5x.</p> <p>He believes that there will be plenty of merger/acquisition activity as companies are holding high cash levels. He believes this is generally good for the share price of both the buying company and the takeover target, and so income funds could profit.</p>	Meeting 9/2/11



### Equities (continued)

<b>Who</b>	<b>What</b>	<b>Source</b>
Tim Steer, Fund Manager, Artemis UK Growth	The forecast PE ratio for the UK market is around 10x for the next year. This makes the UK more attractive than emerging markets which are trading on too wide a premium to be justified by the potential growth.	Meeting 9/2/11
Colin McLean, Managing Director, SVM Asset Management	A study looking at the last 25 years of US forecasting, shows that each year the estimates for earnings growth have typically ranged from 10% to 12%. However, the actual outcome was just 6%. Only twice, during the earnings recovery following recession, has forecasts underestimated earnings growth.	Citywire 3/2/11
Haig Bathgate, Chief Investment Officer, Turcan Connell	We remain underweight in some of the high octane areas like miners where we believe there are bubble characteristics. It is worth noting the proportion of the UK market which is now accounted for by three related sectors, namely integrated oil & gas, precious metals & minerals and speciality mining & metals.  These equate to nearly 40% of the FTSE – if commodities are in a bubble, the UK market will get hit very hard as a result.	Citywire article 16/02/2011
Simon Brazier, Threadneedle, Head of Equities	The UK market is attractively valued, with price to earnings, price to cash flow and price to book value ratios that are all well below their long-term averages. The prospective dividend yield of 3.2% is healthy and is likely to grow further as confidence continues to recover. We are forecasting earnings growth of almost 17% this year in the UK and, clearly, valuations afford scope for the market to rise in line with this figure at the very least.  While threats to this bullish view cannot be ignored – especially following six months of very strong returns - we believe that the market can deal with these risks and deliver a healthy gain over the remainder of 2011.	Threadneedle Viewpoint, email 28/02/2011

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## Equities (continued)

Who	What	Source
Jeremy Grantham, GMO, Chief Investment Strategist	<p>Grantham expects stock to continue on their upward path, at least until October (2011).</p> <p>“Be prepared for a strong market and continued outperformance of everything risky. But be aware that you are living on borrowed time as a bull; on our data, the market is worth about 910 on the S&amp;P 500, substantially less than current levels, and most risky components are even more overpriced.”</p> <p>“Emerging equities seem to be in the early stages of the “Emerging, Emerging Bubble” that, 3½ years ago, I suggested would occur. How far a bubble expands is always anyone’s guess, but from now on, we must be more careful.”</p> <p>“Commodity price rises in the next few months could be so large that governmental policies in emerging countries might just stop the global equity bull market.”</p>	Citywire 28/01/2011
<b>Consensus/Summary</b>	<b>Most opinions have remained positive regarding the continuing bull market into 2011. Opinions still believe that the UK remains attractively valued, even at these levels at around 6000. There is a growing feeling emerging markets and commodity based stocks could be entering into “bubble territory”.</b>	



### Property

Who	What	Source
Andrew Milligan, Head of Strategy, Standard Life Investments	Is positive on property taking a long term view due to its good yield and the inflation protection element. Capital has been flowing back into property.	Investment dinner 1/2/11
Philip Nell, Fund Manager, Aviva Property	We are probably on the threshold of a short period of below-average total returns for the UK commercial property market until we see more signs of rents growing once again. We expect below average total returns through the final quarter of 2010 and into 2011, with strong returns expected for 2012 and 2013 as the rental recovery broadens out across the market. On a medium-term view, we continue to expect UK commercial property to deliver attractive returns.	Email, Property Update, 14/02/2011
Fiona Rowley, Fund Manager, M&G Property Portfolio	Most prime properties now look fairly valued, with reasonable valuations relative to gilts and cash.  Rental growth is broadly flat and is likely to remain so for some time. Lower quality secondary properties may see further capital losses.	Email update 16/2/11
Gerry Ferguson, SWIP Property Fund Manager	Whilst availability of good quality stock remains low, the yield compression that has been driving the market appears to have halted. Properties offering asset management opportunities are becoming more attractive as investors look further up the risk curve in order to generate acceptable returns. Risk of tenant default and falling rental values/voids still having an impact on poor secondary values. Rental growth at an all property level remained marginally negative in 2010 but the general weakness was offset by continuing positive growth in the Central London sub-markets. Performance over the short term will be generated by increasing and lengthening income through active asset management rather than by further yield compression or strong rental growth.	Email update 23/02/2011
<b>Consensus/summary</b>	<b>The consensus is for low growth within commercial property but with rents now stable. There is little chance of falls in prices but further growth is not expected for at least the next 12 months.</b>	



### Fixed Interest

<b>Who</b>	<b>What</b>	<b>Source</b>
James Foster, Fund Manager, Artemis Strategic	<p>He is glad he is managing a strategic fund as is worried about investment grade. He is short gilt and bunds within his fund. He would not hold emerging market debt.</p> <p>He holds a high weighting in financials as these will not be affected by rising gilt yields.</p>	Meeting 9/2/11
Kevin Telfer, Fixed Income Product Specialist, Aegon Asset Management	<p>Expects gilt yields to rise but not dramatically, perhaps the 10 year gilt may go to perhaps 4.75% but he would expect more like 4.25%.</p> <p>A 5% total return is do-able from investment grade bonds in 2011 with the right holdings, including a high financial weighting. Expects a lot of funds to do less than 4%.</p> <p>Believes that high yield can deliver high single digit returns this year. History shows they are less interest rate sensitive and in normal conditions there would have to be 6 rate rises before they were affected.</p> <p>He agrees inflation is an issue but that traditional index linked bonds are not the answer as they are still sensitive to interest rate rises.</p> <p>The Bank of England has implied that rate rises are in line with market expectations, which is perhaps 0.25% in May and a further 0.25% to 0.5% later in the year. If rate rises are in line with expectations the impact on bonds will be minimal.</p>	Meeting 18/2/11
Richard Woolnough, Fund Manager, M&G	<p>Richard believes the current economic environment remains supportive for credit. In their view, corporate bonds are still priced for a much higher level of defaults than they have experienced historically. The team therefore believes that many corporate bonds continue to offer value. He does not expect that there will be a double-dip recession in the UK and Europe. However, he believes spreads are attractive because they are pricing in another downturn.</p>	Email 21/02/2011

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## Fixed Interest (continued)

Who	What	Source
Nina Montagu-Smith	<p>“There are signs that corporate bonds, particularly high yield or “junk” bonds may be heading for a bubble, with some fund managers starting to pull out of the sector.</p> <p>According to the Credit Suisse High Yield Index, the average yield for low-grade bonds has hit an all time low of 6.86%, having fallen from 20.5% in November 2008. In May, before the financial crisis, the yield was 7.6%. It hit a high of 15% in 2000.”</p>	The Sunday Times, 27/02/2011
<b>Consensus/summary</b>	<p><b>There is continued concern that rising inflation and a potential early rise in interest rate will see a fall in bond prices. The consensus for government and high quality investment grade bonds are currently negative with higher yielding corporate bonds potentially delivering high single digit returns this year.</b></p> <p><b>Corporate bonds are still expected to outperform government bonds.</b></p>	



## Research Summary – February 2011

### Fund Manager Contact Summary

\* Includes other key contacts and speakers such as analysts, economists, and others.

Event	Speaker(s)	Type of Contact
Investment dinner	Andrew Milligan, Head of Strategy, Standard Life Investments	Face to face
Investment dinner	Bill Dinning, Head of Strategy, Aegon Asset Management	Face to face
Investment dinner	Stephen Jones, Co-Head of Fixed Income, Aegon	Face to face
Artemis Roadshow	Derek Stuart, co-Manager, Artemis Special Situation	Face to face
Artemis Roadshow	Ruth Keattch, co-Manager, Artemis Special Situation	Face to face
Artemis Roadshow	James Foster, Fund Manager, Artemis Strategic Bond	Face to face
Artemis Roadshow	Adrian Gosden, Fund Manager, Artemis Income	Face to face
Artemis Roadshow	Jacob De Tusch-Lec, Fund Manager, Artemis Global Equity Income	Face to face
Artemis Roadshow	Tim Steer, Fund Manager, Artemis UK Growth	Face to face
Artemis Roadshow	William Littlewood, Fund Manager, Artemis Strategic Assets	Face to face
Meeting	Kevin Telfer, Fixed Income Product Specialist, Aegon Asset Management	Face to face
JPM Fund Manager Roadshow	Tom Elliot, Vice President, JPM	Face to face
JPM Fund Manager Roadshow	Nick Gartside, Chief Investment Officer, JPM	Face to face
JPM Fund Manager Roadshow	Peter Kirkman, Global Equities, Fund Manager	Face to face

This month we met 14 fund managers and other key individuals.

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## Monthly Figures – February 2011

Index	Value
FTSE 100 – last day of last month	5870
FTSE 100 – last day of this month	5994
% change (ignores dividends)	+2.1%
FTSE Allshare – last day of last month	3088
FTSE Allshare – last day of this month	3106
% change (ignores dividends)	+0.58%
Oil price (Brent Crude) \$	\$115.49
% change	+13.9%
US\$ to £ - last day of last month	1.61
US\$ to £ - last day of this month	1.62
% change	+0.62%
Euro to £- last day of last month	1.17
Euro to £- last day of this month	1.17
% change	
RPI	5.1%
Change from last month	+0.3
CPI	4.0%
Change from last month	+0.3
BoE Base Rate	0.5%

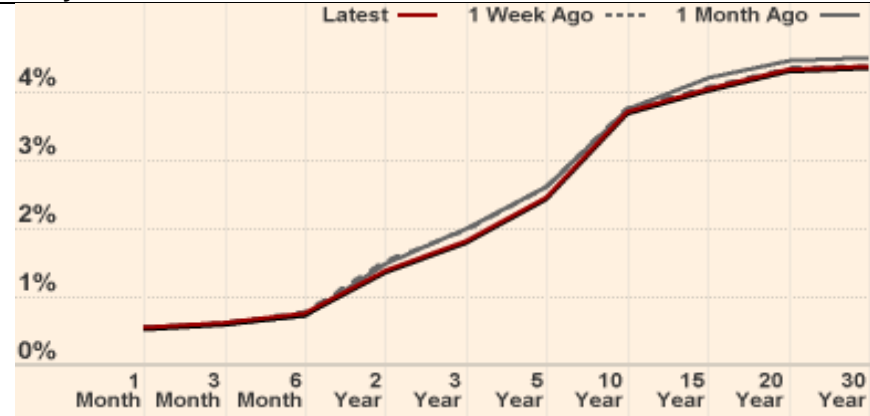
Index	Value
UK 10 Year Gilt Yield	3.69%
FTSE Allshare P/E Ratio	16.5x
FTSE Allshare Yield	2.8%
Spread v Gilt	0.89%
IBOXX Sterling Corp Bond Yield	5.85%
Spread v Gilt	2.16%
IPD UK All Property Yield	6.4% (January 2011)
Spread v Gilt	2.71%

Monthly Portfolio Figures	% Change
Fixed Interest	+0.79%
Strategic Fixed Interest	+0.84%
UK All Companies	+1.17%
UK Large Companies	+1.65%
UK Dynamic	+1.14%
Global Established	+0.90%
Global Dynamic	+1.36%
Global Speculative	-2.82%
Alternative Equity	+0.35%
Property	+0.28%

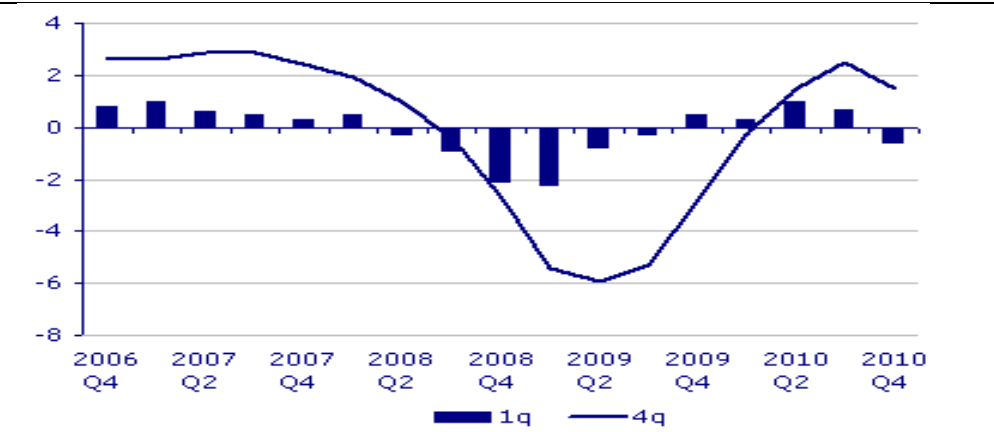
Sources: Financial Express Analytics, Indexco.com, National Statistics, Bloomberg, FT.Com, Google Finance, Yahoo Finance

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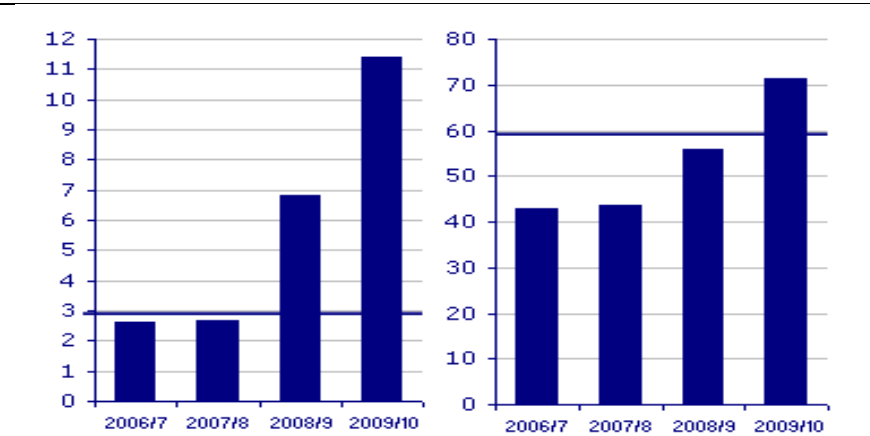
**Gilt yield Curve**



**GDP Growth**



**Government Debt & Deficit**



**Corporate Bond/Gilt Yield Spread**

