



Research Summary – March 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
Jonathan Ruffer & Steve Russell, CF Ruffer Fund Managers.	We perhaps share Mervyn King's view that inflation will fall by the summer in terms of the arithmetic; but we think that directionally he is the wrong side of this trade. Inflation may well drop back a bit if China hits the buffers and takes base metals and other commodity prices with it, but we think the authorities will be non-plussed at how entrenched inflation and inflation mentality already is.	Citywire Article – 08/03/2011
Mervyn King, Governor, Bank of England	Believes inflation will ease in the middle of 2011, back to around the target levels.	Citywire 2/3/11
Ben Bernanke, Chairman, US Federal Reserve	The soaring oil price poses a threat to the US economic recovery if rises are sustained.	Investment Week 1/3/11
British Chamber of Commerce	Expects interest rates to rise in May, but are concerned that any rate rises could derail the recovery. They have downgraded their UK GDP growth forecast from 1.9% to 1.4%.	Investment Week 8/3/11



General (continued)

Who	What	Source
<p>Nick Gartside, Head of Fixed Income, JP Morgan</p>	<p>Believes there is a 15% chance of stagflation in the UK. He has believed for some time that inflation would surprise on the upside.</p> <p>"This is because, firstly, the inflation in the UK is externally generated so it is higher food and fuel prices. Secondly, broadly, sterling has been weak. Thirdly, inflation expectations are high now in the UK, and inflation is a self-fulfilling prophecy - if you think something will become more expensive, you go out and buy it now. The VAT rise has also impacted today's inflation number."</p> <p>"At the start of the year we thought there was a high probability of an anaemic recovery, so we put 70% on that strategy. We ascribed 15% to a double-dip recession scenario and 15% to a strong recovery and a closing of the output gap."</p> <p>However, with the turmoil in the Middle East and the macro impact of the Japan earthquake, Gartside now believes the probability of anaemic growth is 65%, a double dip 10%, and closing the output gap 10%, leaving a 15% chance of stagflation.</p>	<p>Investment Week 22/3/11</p>
<p>Consensus/Summary</p>	<p>Different opinions continue on whether to raise interest rates soon or later in the year due to the further impact of rising inflation. The opinion remains split about whether it will remain high or fall back to BOE target level of 2% in later this year or in Q1 of 2012.</p>	

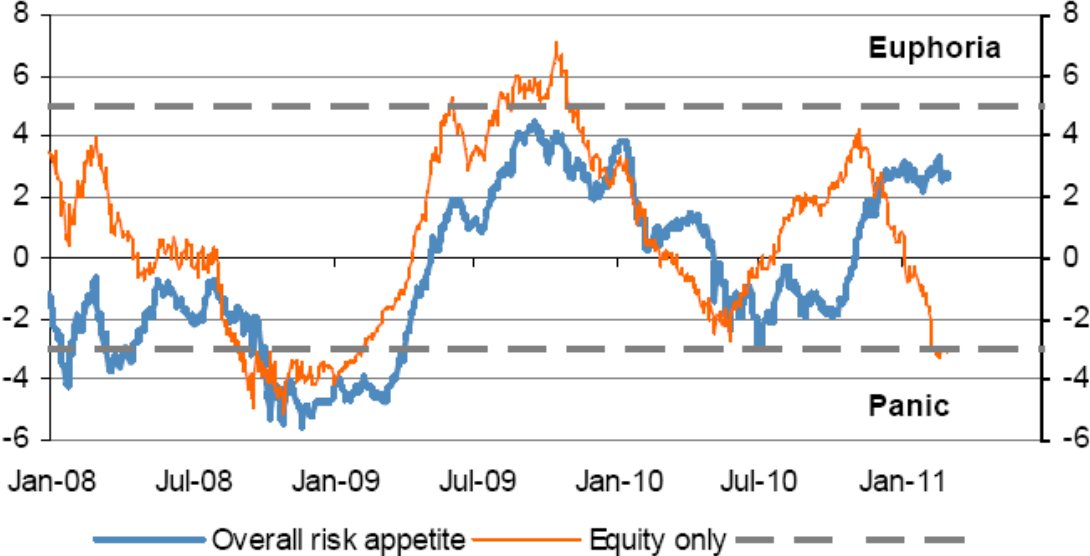


Equities

Who	What	Source
Ewan Thompson, Fund Manager, Neptune Emerging Markets Fund	<p>Since September 2010, investors have aggressively shifted their focus towards developed markets, particularly the US and Japan, at the expense of several major emerging markets, including Brazil and India. As the Federal Reserve continues to stimulate the US economy by pumping liquidity into its financial system, fast-growing emerging markets are now confronted with rising inflation, led by commodity and food prices.</p> <p>In order to respond to aggressively reflationary policy in the US, emerging economies are fighting fund inflows with capital controls and raising interest rates to cool growth. We see the present time as an attractive entry point for these same markets. The MSCI Emerging Markets Index now trades on a forward P/E multiple of 11.5x against a multiple of 13.2x for developed markets – so one can access the growth potential of emerging markets at a valuation discount to developed markets.</p>	Neptune Emerging Markets Update – Email 07/03/2011
Robin Geffen, CEO and Fund Manager, Neptune	<p>Believes dividends in the UK will grow by around 15% this year.</p> <p>He says: "Cash levels on many corporate balance sheets are high relative to history, and we expect payout rates to go up as corporate earnings rise."</p> <p>Believes inflation and interest rate rises will see investors deserting bonds and seeking equity returns.</p>	Investment Week 9 March 2011
Edward Legget, Fund Manager, Standard Life UK Equity Unconstrained	<p>Believes there is plenty of upside potential left in UK companies as corporate profits continue to come in above expectations. Legget argues that the FTSE100 index is likely to rise between 10% and 20% by the end of the year.</p> <p>'Corporates have lots of cash on their balance sheet and they are looking to invest, having not invested during the downturn.'</p>	Citywire 3/3/11

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Equities (continued)

Who	What	Source
Tom Elliott, Head of Strategy, JP Morgan Asset Management	<p data-bbox="575 534 864 564">Investor risk appetite</p>  <p data-bbox="575 1166 1711 1321">The above chart shows the Credit Suisse risk appetite measures, which estimate the amount of volatility per unit of excess return across a range of markets, both developed and emerging. A recovery in overall risk appetite has been sustained in 2011, suggesting a switch from bonds into equities, while the equity-only measure has moved towards “panic” territory. This suggests that investors have added to equities but have de-emphasised Asian and emerging markets.</p>	Email update 7/3/11



Equities (continued)

Who	What	Source
Tom Elliott, Head of Strategy, JP Morgan Asset Management	<p>By region, the strongest earnings momentum is in the US, followed by Japan. Emerging markets have seen the ratio of upgrades / downgrades fall further last month, to 1.02, the lowest level since April 2009. Within the emerging market world, all four BRICs (Brazil, Russia, India and China) are now experiencing negative momentum – it is hard to see a full scale recovery in EM relative performance until this trend has been reversed.</p> <p>It is noteworthy how rapidly economic momentum has been slowing in the BRICs. While investors have focused on the policy tightening measures in China, policy Brazil has seen a 49% appreciation of its real exchange rate since December 2008. This has probably left the currency overvalued, with the real now 27% and 57% above its five and ten-year averages.</p> <p>Meanwhile, Russia's real exchange rate is at its highest level in 17 years – higher than just before the 1998 crisis. Annual industrial production growth is close to zero in India and Brazil, while Chinese electricity output growth (a gauge of the industrial cycle) has fallen below 10% y/y. This does not look like overheating to us – it smacks more of stagflation.</p> <p>It has been striking how rapidly the emerging markets have fallen from grace during early 2011. However, our sense is that this is a needed correction (rather than the end of the cycle), where excess positions have been flushed out. The four BRICs combined comprise 48% of the MSCI emerging markets index. It therefore suggests that renewed outperformance of emerging markets could await their return to health.</p>	Email update 7/3/11
Francis Brooke, Fund Manager, Trojan Income fund	<p>Believes we are still in a secular bear market and there could still be some dangerous times to come. He is concerned about inflation and the impact on the economy.</p> <p>They are buying large, high quality internationally focused companies.</p>	17/3/11



Equities (continued)

Who	What	Source
Alastair Mundy, Fund Manager, Investec UK Special Situation and Cautious Managed funds	<p>“Companies have enjoyed record low interest rates around the globe in the last few years, coupled with low inflation and accommodative government and central bank policies.</p> <p>However, the situation has changed, with opportunities drying up, and he thinks a pullback for equity markets looks more likely than another run higher after two years of favourable conditions.</p> <p>“We think markets are much more likely to come back now than go up. Everyone has been in this bull market, but now we have fewer and fewer stocks we want to buy.</p> <p>“In general we think many stocks are trading at the top end of their range now,” he said. “Anyone buying a random basket of equities is asking a lot of those companies, and we cannot find sufficient cheap shares at present.”</p> <p>He has taken cash up to over 10% of his cautious managed fund, is buying gold and short dated gilts.</p>	Investment Week 28/3/11
Paul Chesson, Fund Manager, Invesco Perpetual Japan	<p>“Japanese equities remain significantly undervalued in our view. The Topix index is again trading at the value of its net assets (as at 25 March), which we believe is too low. In some specific areas corporate earnings will see some short-term weakness, but this has been more than discounted in our view by the fall of more than 7% in the Topix index since the earthquake to the close on 25 March (local currency).”</p>	Email update 25/3/11
Consensus/Summary	<p>Opinions have remained generally positive on equity and most still believe in a good bull market run throughout 2011. There are a few dissenting voices however. Most still believe that the UK remains attractively valued, even at these levels at around 6000. Many believe Japan is significantly undervalued now after the tsunami even though earnings will see a short tem weakness.</p>	

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Property

Who	What	Source
Schroder Property Team	We expect that capital growth will be fairly modest over the next few years and that the income return of 6.5-7% will be the mainstay of performance. The level of income should prove attractive to investors, provided gilt yields remain below 4-4.5% (10 year gilts currently yield 3.5%). If gilt yields jumped higher, property would look relatively expensive along with other risk asset classes such as equities.	Schroders Talking Point - Email, 02/03/2011
Fiona Rowley, Fund Manager, M&G Property	<p>“There has been a clear polarisation between prime and good secondary property on the one hand, and lower quality secondary and tertiary assets on the other, reflecting the underlying risk to rental income. It is likely that weaker assets may see further yield expansion (price falls) over the short term. On an absolute basis, we believe prime and near-prime property looks broadly fair value and, relative to gilts and cash, remains attractively priced.</p> <p>“Following significant falls in rents over the past two years, the occupier market is moving through the bottom of the property market cycle, with prime rental growth now broadly flat. Due to the current level of economic uncertainty, no significant rental growth is expected in the short term.”</p>	Email update 16/3/11
Philip Neil, Fund Manager, Aviva Property Trust	<p>“Increases in capital values look set to end for most sectors of the market and, whilst pricing of top-quality assets looks generally well supported, secondary property looks vulnerable to some valuation falls.”</p> <p>He is expecting below-average returns through much of this year, with strong returns forecast for 2012 and 2013 as the rental recovery broadens out across the market.</p> <p>“Despite this it is fair to say that there is an increasing view that 2011 may prove to be a better year than our current forecasts would suggest and that 2012 could be a more difficult year. On a medium-term view, we continue to expect robust returns from real estate.”</p>	Email update 17/3/11

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Property (continued)

Consensus/summary	Overall opinion is for low growth within commercial property but with rents now stable. There is some chance of falls in prices and further growth is not expected for at least the next 12 months or even into 2012.	
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Fixed Interest

Who	What	Source
John Pattullo, Fund Manager, Henderson Strategic Bond	He has been short gilts since late last year which is currently detracting from performance. However, he is maintaining this position, confident that this is the right call.	Citywire 17/3/11
Richard Hodges, Fund Manager, L&G Dynamic Bond	Is positive about high yield in the short term, believing default rates will drop to around 2% but that the market is still offering about 6% more than treasuries. However, he feels we could be about to enter a multiyear bear market for bonds. Rates are likely to rise and the BOE may sell back some of the gilts it has purchased as part of QE.	Investment Week 1/3/11
Christine Johnson, Fund Manager, Old Mutual Dynamic Bond	Many high yield bonds are now yielding similar to what investment grade has traditionally yielded. However, default rates are low and the spreads to government bonds remain attractive. The spread is actually as high now as it was in 2008, when economic concerns were huge. As a result, she still feels this sector is attractive.	Investment Week 7/3/11
Richard Woolnough, Fund Manager, M&G Optimal Income	Believes that corporate bonds continue to offer value as: <ul style="list-style-type: none"> • investors are being well paid for taking credit risk as credit spreads remain wide relative to their history • duration risk is attractive as yield curves are the steepest they have been for many years • he expects interest rates to remain low to support the fragile economic recovery – an environment which traditionally favours corporate bonds. 	Email update 14/3/11

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Fixed Interest (continued)

Who	What	Source
Ben Lord, Credit Analyst, M&G Asset Management	<p>“Two-thirds of a rate hike will directly pass through to RPI via mortgage income payments (MIPs).</p> <p>“The market is now pricing in three 25 basis point rate hikes this year. That means of 75 bps of hikes, MIPs will be pushed up enough to cause RPI to rise by about 0.5%. So the Bank of England hikes rates to lower inflation, and a direct offshoot of this is that RPI actually rises!</p> <p>“As this MIPs increase feeds through to RPI, I’d expect to see the front end of the linker curve outperform conventional gilts. It’s not unreasonable to expect breakeven expectations to fall at the longer end reflecting the belief that the dawn of a monetary policy tightening cycle will mean we’ll be moving towards a structurally lower inflation environment. Interesting, these unintended consequences...”</p>	Bond Vigilantes Blog 18/2/11
Consensus/summary	<p>Continuing concerns on 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.</p> <p>Corporate bonds are still expected to outperform government bonds.</p>	



Research Summary – March 2011

Fund Manager Contact Summary

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

Event	Speaker(s)	Type of Contact
Telephone meeting	Francis Brooke, Fund Manager, Trojan Income fund	Telephone
Telephone meeting	Simon Laing, Fund Manager, Newton American	Telephone
Meeting	Mathew Jealous, Fund Manager, Margetts Asset Management	Face to Face

This month we met 3 fund managers and other key individuals.

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Monthly Figures – March 2011

Index	Value
FTSE 100 – last day of last month	5994
FTSE 100 – last day of this month	5908
% change (ignores dividends)	-1.43%
FTSE Allshare – last day of last month	3106
FTSE Allshare – last day of this month	3067
% change (ignores dividends)	-1.25%
Oil price (Brent Crude) \$	\$116.20
% change	+0.6%
US\$ to £ - last day of last month	1.62
US\$ to £ - last day of this month	1.63
% change	+0.1%
Euro to £- last day of last month	1.17
Euro to £- last day of this month	1.14
% change	+2.6%
RPI	5.5%
Change from last month	+0.4%
CPI	4.0%
Change from last month	+0.4%
BoE Base Rate	0.5%

Index	Value
UK 10 Year Gilt Yield	3.69%
FTSE Allshare P/E Ratio	14.8x
FTSE Allshare Yield	2.9%
Spread v Gilt	0.79%
IBOXX Sterling Corp Bond Yield	4.44%
Spread v Gilt	0.75%
IPD UK All Property Yield	6.4%
Spread v Gilt	2.71%

Monthly Portfolio Figures	% Change
Fixed Interest	0.25%
Strategic Fixed Interest	0.27%
UK All Companies	-0.38%
UK Large Companies	-0.92%
UK Dynamic	-0.70%
Global Established	+0.66%
Global Dynamic	-0.20%
Global Speculative	+2.64%
Alternative Equity	+1.02%
Property	-0.40%

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

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