



## Research Summary – May 2010

### 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
Charles Wyplosz, Director of the International Centre for Money and Banking Studies / Stephanie Flanders, Economics Correspondent, BBC	<p>“What has been offered to Greece cannot be refused to other eurozone governments... this process means that ultimately there is no national debt anymore, at least for the next few years. In effect, in the market eyes, there will then be just one eurozone debt.</p> <p>“Could markets run on all eurozone public debts? Once again, no one would expect all eurozone governments to be forced to default but markets can and do panic and self-fulfilling crises can occur wherever there is vulnerability. Just imagine that, one by one, each eurozone country falls in the same trap as Greece. Eventually, Germany could be last one. Could it underwrite all the other public debts, on top of its already own respectable one? Current estimates set the overall eurozone public debt level at 90% of GDP in 2012. This is reassuringly lower than Greece's 135%, but it is about the same as Portugal's and it represents 330% of the German GDP.”</p> <p>“German debt is still considered a safe haven within the eurozone, even though it's Germany that could end up paying all the bills. Either investors cannot think this far ahead, or they think - probably rightly - that German voters would jump ship long before.”</p>	Bbc.co.uk 5/5/10



**General (continued)**

<p>Jim Leaviss, Head of Fixed Interest, M&amp;G</p>	<p>Credit availability remains poor, which suggests that quantitative easing (QE) has not worked; the vast amounts of money that were pumped into the economy have not redressed the imbalance between the demand for and supply of credit.</p> <p>There is spare capacity in the economy. This includes the under-utilisation of factories and high levels of unemployment. Wage inflation is the biggest driver of inflation, accounting for about 70% of the total. Wage inflation continues to fall. Jim believes that in the current low-growth environment, high unemployment and spare capacity will put downward pressure on inflation.</p>	<p>Email update 11/5/10</p>
<p>Bank of England Governor, Mervyn King</p>	<p>The Bank of England Governor has reported that he expects inflation to fall in the coming years, removing what little pressure there has been to increase interest rates. Bank of England Governor Mervyn King predicts that inflation would remain above the 2% target for the rest of 2010, but would then fall below this level and remain under 2% for much of the following two years, even if interest rates remain on hold.</p> <p>He also seemed to leave the door open for more quantitative easing at some stage this year. He said: 'I think you should certainly conclude the Committee has not ruled out any further asset purchases. We haven't decided to do it, but it's certainly an instrument in our armoury and it would be wrong to rule it out.'</p>	<p>This is Money article 12/05/2010</p>
<p>John Mauldin, President, Millennium Wave advisers</p>	<p>The entire eurozone is in for a double-dip recession. One country after another is going to have to convince foreigners to buy its debt. But if they make spending cuts, their GDP will fall, ironically increasing their debt-to-GDP ratio and making investors demand even higher rates, which becomes a very vicious spiral.</p>	<p>Email update 8/5/10</p>

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## General (continued)

Who	What	Source
Invesco Perpetual Asian Team	<p>Responding to speculation that Chinese real estate is in a bubble that will cause economic difficulties in the future, they say:</p> <p>“With 25% of new Chinese housing purchased with cash, it is difficult to argue, in our view, that this is a credit-fuelled boom. With the possible exceptions of tier one cities, such as Beijing and Shanghai, property affordability remains reasonable. In evaluating the affordability of participants in the Chinese property market, income levels as well as income growth are worthy of consideration. Research suggests that the vast majority of households do not spend a large percentage of their income on housing and even less on servicing their mortgage.”</p> <p>They do, however, believe prices could get out of control if the Chinese government do not act. They are bringing in new rules to limit property speculation and Invesco believe this will be successful.</p> <p>The long term prospects remain good in Invesco’s opinion.</p>	Email update 11/05/10
Tom Elliott, Chief Economist, JP Morgan	<p>Believes that economic growth could slow but does not believe it will turn back into a recession:</p> <p>“The business cycle may soon be peaking, with several leading indicators clearly turning down. The latest release of the OECD leading indicators showed that six-month annualised growth has peaked in several economies, with the US, eurozone, UK, and Japan all down from their peaks for at least four months (interestingly, in the case of China the leading indicators peaked back in June 2009). This suggests that real GDP growth will peak in the next 1-2 quarters (although it could signal a mid-cycle pause before activity reaccelerates).”</p>	Email update 17/5/10



**General (continued)**

<p>John Greenwood, Chief Economist, Invesco Ltd</p>	<p>Deleveraging of public sector will take longer than in the private sector, lasting up to 6-7 years. Government spending will need to be reduced but, contrary to many commentators' beliefs, "cuts will be palatable".</p> <p>The greatest risk to a fragile economy is the tight rope the government must walk. They must not act too quickly and endanger the recovery, but must lay out clear plans. If firm commitments are made the markets will be generous.</p> <p>Under the rules set out for the Euro it is not possible for a country to leave or to be kicked out. If it were possible and did happen there would be complete outflows from that country, causing a run on its banks and further exasperating the problem.</p>	<p>Election debate 18/05/2010</p>
<p>Phil Stephens, chief political commentator Invesco Ltd</p>	<p>Protection of specific areas of public spending (eg. ring fencing of the NHS) will force the government to make stringent cuts elsewhere to avoid Greece like issues.</p> <p>Though an increase in VAT to 20% is "not a done deal", the Treasury has told George Osborne that there is no other real option. The increase may be staged to encourage spending in the short term.</p> <p>If VAT is not increased there will need to be draconian measures elsewhere.</p>	<p>Election debate 18/05/2010</p>
<p>Michael Konstantinov, Fund Manager , Allianz RCM BRIC Stars</p>	<p>The Euro crisis should not have a big impact on the BRIC markets. In 2008 / 2009 they were marginally affected by the down turn and came out of recession much more quickly than developed economies. In addition only 23% of Chinese GDP is generated from export.</p>	<p>Face to face meeting 18/05/2010</p>



**General (continued)**

<p>David Shairp, Global Strategist, JP Morgan Global Multi Asset Group</p>	<p>“Markets are picking up the smell of deflation. German 10-year bond yields fell to 2.66%, lower than after the Lehman Shock, while US 10-year yields have fallen 85bp since early April to 3.13% towards the end of last week. Indeed, our deflation alert measure (which comprises three indicators that help track the inflation/deflation pendulum) has now swung back into mild deflation territory. We have long believed that deflation represents the bigger risk to the global economy than inflation over the course of 2010, despite the operation of quantitative easing(which has now been suspended in both the US and the UK).”</p>	<p>Email update 14/5/10</p>
<p>Fisher Investment Policy Committee</p>	<p>The sovereign liquidity crunch appears resolved. Spain auctioned off 10 year bonds recently and demand outstripped supply 2 to 1. They achieved a yield of 4.05%, comparable to a US Treasury auction the month before.</p> <p>So far in May, all 12 PIIGS bond auctions have been completed successfully.</p>	<p>Email update 21/5/10</p>
<p>OECD</p>	<p>The UK authorities, almost alone among the OECD, need to be wary of losing their credibility on inflation. The OECD advises the Bank of England to raise interest rates to 3.5% by the end of 2011, starting "no later than" the last three months of this year.</p>	<p>BBC.co.uk 28/5/10</p>
<p><b>Consensus/Summary</b></p>	<p><b>Some analysts are now becoming more concerned about inflation and interest rate rises look more likely and could be steeper than first thought. However, there are still some who are concerned about deflation and there is a strong argument that inflation rises are temporary,</b></p> <p><b>The Eurozone sovereign debt crisis refuses to go away, with concerns moving from liquidity to the realisation that economic growth will be muted across Europe. However, all 12 “PIIGS” bond auctions have been successful in the past month indicating bond markets remain supportive.</b></p>	



**Equities**

Who	What	Source
Derek Stewart, Fund Manager, Artemis UK Special Situations	“We thought there was value in equities even before this sell-off. That case is simply stronger now. Dollar earners, and we have plenty, look even more attractive now.”	Email update 7 May 2010
Adrian Frost, Fund Manager, Artemis UK Income	“Company balance sheets are strengthening. They look pretty healthy and supportive of maintaining and growing dividends. Good, sound stocks are probably the best place to be, <i>vis-à-vis</i> sovereign debt etc. Tangible cashflows and credible P&L accounts compare very favourably with dodgy politicians and debt-ridden economies. As for the UK election, some kind of coalition might actually be better if there’s going to be harsh medicine handed out — which there needs to be.”	Email update 7 May 2010
David Balance, Fund Manager, Ruffer Investment Management	<p>There is a bubble in China, particularly in property. There was massive property speculation as a result of the huge amount of liquidity pumped into markets by the Chinese authorities.</p> <p>He is instead allocating to Japan where expectations are so low that “even the slightest whiff of success would give a significant boost” to their equity and index linked bond holdings.</p>	Citywire 11/05/10
Andrew Shard, Head of US Equity, Invesco Perpetual	<p>“Some estimates for S&amp;P 500 earnings growth for 2011 are for 20% year-on-year earnings per share growth after 30%-40% earnings growth this year. This will take us to a record high. At best it has been discounted into market valuations and at worst it will prove optimistic given the economic outlook that we envisage.</p> <p>“Probably as a generalisation, the US equity market has been putting a greater-than-average multiple on peak margins and potentially peak earnings. That, to us, is discounting a V-shaped economic recovery which we do not expect to evolve.”</p>	Email update 21/5/10



**Equities (continued)**

Who	What	Source
David Shairp, Global Strategist, JP Morgan Global Multi Asset Group	<p>They are overweight stocks vs bond as valuations provide a compelling argument.</p> <p>Within equities they are overweight Japan, UK, and Emerging Markets.</p> <p>Many companies are now trading below book value. Over 50% of Japanese company book values are now above their markets values, signifying cheapness.</p> <p>Dividend yields in the UK are close to the 10 year gilt yield and there is good earnings momentum.</p>	Email update 24/5/10
Jim Wood Smith, Head of Research, Williams De Broe	<p>“The yield on the FTSE All Share Index is 3.60%. ... the gross redemption yield on the 10 year gilt is 3.55%. We have thus technically moved into positive yield gap territory. What is quite extraordinary about this is that according to Reuters the current consensus forecasts predict 10% dividend growth for this year and for next. History is suggesting therefore that to believe equities are going to provide a lower return over the coming decade, one has to be quite extraordinarily pessimistic.”</p>	Email update 24/5/10
Adrian Cattley, Analyst, Citigroup	<p>UK equities are yielding more than gilts and this was a clear buy signal in 2003 and 2008.</p>	Sunday Times, 25/5/10
Felix Wintle, Fund Manager, Neptune US Opportunities	<p>The US is the best positioned of all the OECD economies. Corporate earnings are beating expectations and they believe this will persist. Unemployment numbers are getting better. Consumption trends are improving. Interest rates are to remain low for quite some time in the US.</p>	
<b>Consensus/Summary</b>	<p><b>The majority opinion is that equities are even more undervalued now after the setback in the markets for the month of May. Analysts point to the low P/E ratios, high book to market ratios, and yields favourable vs gilts as evidence. Some analysts have pinpointed the US, Japan and Emerging Economies as the most compelling regions to invest in.</b></p>	



**Property**

<b>Who</b>	<b>What</b>	<b>Source</b>
Ian Potter, Operations Manager of the Association of Residential Letting Agents	The potential change in CGT rules from 18% to 40% could lead to a fire sale in buy to let residential property.	Introducertoday.co.uk 14/5/10
Gerry Ferguson, Fund Manager, SWIP Property	UK Commercial Property prices could fall next year.  "We have reached the point where we are trying to take a step back from parts of the market where it has got ahead of itself.  "If the yields on U.K. government bonds go up, then property yields should move up," he said. Yields on bonds and real estate move inversely to prices. The yield on 10-year U.K. government bonds was 3.84 percent yesterday, up from 3.66 percent a year before. "If you are not going to see rental growth and the gilt yield is 4.5 percent, why not buy gilts?"	Bloomberg 14/5/10
Fiona Rowley, Fund Manager, M&G Property Portfolio	Is also concerned about price rises: "Our forecast is based on the assumption that the momentum will slow down in the second quarter," Rowley said. "The more positive capital uplift we see this year, the more negative it will be next year. It would be robbing Peter to pay Paul."	Bloomberg 14/5/10
Phil Nell, Fund Manager, Aviva Property Trust	"There's been a bit of a pause for reflection and the market will fall a little bit over the next few months (but) it won't be material."  He expects prices to dip 3 percent in 2011.	Bloomberg 14/5/10
Michael Konstantinov, Fund Manager, Allianz RCM BRIC Stars	There is not a property bubble forming in China. Increases in prices have not been driven by credit. In addition, increases outside the main cities have been largely in line with increases in real wages.	Face to face meeting 18/05/2010
<b>Consensus/Summary</b>	<b>Fund managers are becoming more worried that UK Commercial Property prices could see a drop off next year and momentum in the asset could see a slow down. Residential property could see further dips as a result of changes in tax rules.</b>	



**Fixed Interest**

<b>Who</b>	<b>What</b>	<b>Source</b>
Richard Woolnough, Fund Manager, M&G Corporate Bond	Remains bullish on corporate bonds.  "We think the economic environment means that demand for bonds should remain robust. Bonds tend to do well during periods of low growth and subdued inflation and, although we won't see equity-like returns again this year, there is still value to be had from the asset class."	Financial Express, 1 May 2010
Mike Matthews, Fund Manager, Fixed Interest, Invesco Ltd	Interest rates are on hold for the foreseeable future with the US likely to increase before the UK.  Credit spreads on bonds are still attractive, corporate balance sheets are in good shape. There is still value to be found in fixed interest, mainly in higher yielding corporate bonds and short Gilts.  Mike is positive on bank debt which is not risk free but does offer good returns and holds far less risk than 12 months ago.	Election debate 18/05/2010
Adam Cordery, Head of European and UK Credit Strategies, Schroders	Believes the case for corporate bonds in 2010 is supported by their valuation relative to cash and government bonds. This spread is certainly not as wide as it was in March last year and it is, therefore, unlikely that we will see any replication of the robust capital returns that we witnessed last year. Nevertheless, the spread of corporate bonds over government bonds remains twice as high as it was in 2007 – the peak of the credit cycle – and the spread over cash remains even higher.	Email update 26/5/10



**Fixed Interest (continued)**

<b>Who</b>	<b>What</b>	<b>Source</b>
Dr. Michael Hasenstab, Senior Vice President, Global Fixed Interest Group, Franklin Templeton	Feels the sovereign debt issues are confined to Europe and we will not see a domino effect of defaults. He feels that the newsflow out of Europe is affecting bond prices irrationally. He cites the Norwegian government bonds (outside the Eurozone) where yields have risen, despite the fact that their sovereign oil wealth fund could cover Norway's debts 4 times over.	Email update 27/5/10
Richard Hodges, Fund Manager, L&G Dynamic Bond	The environment is still generally supportive for credit, but a selective approach is needed. The more robust part of the high yield market and the financial sector – where balance sheet strengthening will be a widespread feature – appeal on value grounds and also because of the income they provide in a world of ultra-low cash rates.	Email update 24/5/10
<b>Consensus/Summary</b>	<b>Most analysts believe there is still plenty of value in Corporate Bonds, but returns are unlikely to be as good as last year. Spreads have narrowed against government bonds this year, but they are still wider than they were back in 2007. High Yield Corporate Bonds are still generally seen as better value than investment grade.</b>	



## Research Summary – May 2010

### Fund Manager Contact Summary

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

Event	Speaker(s)	Type of Contact
Neptune Lunch	Felix Wintle, Neptune US Opportunities, Fund Manager	Face to Face.
Allianz BRIC Stars Dinner	Michael Konstantinov, Allianz BRIC Stars, Fund Manager	Face to Face
Octopus Absolute Road show	David Crawford, Octopus UK Absolute Return, Fund Manager	Face to Face.
Octopus Absolute Road show	Colin Lunnon, Octopus Multi Manager, Fund Manager	Face to Face
Octopus Absolute Road show	Thierry Serero, Octopus Absolute European, Fund Manager	Face to Face
Teleconference	Mike Matthews, Fund Manager, Fixed Interest, Invesco Perpetual	Telephone
Invesco Meeting	Paul Chesson, Fund Manager, Invesco Perpetual Japan	Face to Face

This month we met six fund managers and had telephone contact with one more.

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## Monthly Figures

Index	Value
FTSE 100 – last day of last month	5553
FTSE 100 – last day of this month	5188
% change (ignores dividends)	-6.6%
FTSE Allshare – last day of last month	2863
FTSE Allshare – last day of this month	2617
% change (ignores dividends)	-8.6%
Oil price (Brent Crude) \$	\$74.05
% change	-16.64%
US\$ to £ - last day of last month	1.52
US\$ to £ - last day of this month	1.44
% change	-5.3%
Euro to £- last day of last month	1.15
Euro to £- last day of this month	1.19
% change	+3.4%
RPI	5.3%
Change from last month	+0.9%
CPI	3.7%
Change from last month	+0.3%
BoE Base Rate	0.5%

Index	Value
UK 10 Year Gilt Yield	3.58%
FTSE Allshare P/E Ratio	11.3x
FTSE Allshare Yield	3.4%
Spread v Gilt	-0.18%
IBOXX Sterling Corp Bond Yield	5.89%
Spread v Gilt	+2.31%
IPD UK All Property Yield	6.7%
Spread v Gilt	+2.8%

Monthly Portfolio Figures	% Change
Fixed Interest	-0.80
Strategic Fixed Interest	-3.08
UK All Companies	-6.18
UK Large Companies	-5.65
UK Dynamic	-6.85
Global Established	-5.16
Global Dynamic	-5.12
Global Speculative	-5.13
Alternative Equity	-2.52
Property	0.46

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