Investment Solutions

Monthly Market Commentary

August 2011

Review

The Bank of England's Monetary Policy Committee maintained an interest rate of 0.5% in August and made no adjustments to quantitative easing measures. The FTSE All Share Index fell over the month as global sovereign debt concerns played on the minds of investors.

	Index Level 31 Aug 11	% Change August	YtD	1 Year
FTSE All Share £	2801	-6.9%	-6.2%	7.3%
FTSE 100 £	5395	-6.6%	-6.1%	6.7%
MSCI World $	1211	-7.0%	-3.5%	15.1%
S&P 500 $	1219	-5.4%	-1.8%	18.5%
	Index Level 31 Aug 11	Index Level 31 July 11	Index Level 31 Dec 10	Index Level 31 Aug 10
UK 10 Year Gilt Yield %	2.60	2.86	3.40	2.83
GBP USD	1.63	1.64	1.56	1.53
GBP EURO	1.13	1.14	1.17	1.21
OIL - WTI $	88.8	95.7	91.4	71.9
Gold $	1826	1628	1421	1247
Wheat $	745	673	794	653

Global Markets had a particularly volatile month in August as the uncertainty surrounding global sovereign debt hit investor confidence hard. Germany saw its biggest one day decline in nine years and, in the United States, the combined indices of the S&P500 index, Dow Jones and NASDAQ had their worst August since 2001. The US started the month particularly badly as politicians wrangled over raising the debt ceiling. This soon spread to Europe when it became clear that Greece required further loan assistance. Safe havens did well, as witnessed by the strong rally in government core bonds. The rally in bonds was also prompted by weak European and US economic data which led to speculation that the Federal Reserve may resort to further economic stimulus measures. However, markets were disappointed when further monetary stimulus was not delivered by Federal Chairman Ben Bernanke, at the Jackson Hole Conference.

The European Central Bank (ECB) left the euro zone interest rate at 1.5%. The significant sovereign debt of many member states, particularly Greece, was a huge concern for markets and contributed significantly to the market volatility witnessed in August. European leaders agreed to give Greece a second bail-out. The country will receive another €109 billion in loans from the euro zone and the IMF.

Outlook

The global economy is experiencing a soft patch in economic growth at the moment with elevated volatility and key areas of concern such as inflation and global sovereign debt. Our expectations for market volatility in 2011 have been amply filled and we expect this to continue whilst markets remain uncertain. Inflation remains of particular concern to us and many central bankers, as the cost of consumer staples such as food and fuel, continue to rise. Central banks have indicated that they expect to remain with the current loose monetary policy for some time to come; this carries the risk of a policy error with inflation exceeding targets for a prolonged period of time and puts the credibility of some central banks at risk.

We are watching the unravelling of the sovereign debt situation in Europe, particularly Greece, Portugal and Italy with increasing alarm. The possibility of the global economic recovery being derailed is a realistic threat from the current uncertainty, especially if the emerging economies revise down their expected rate of growth.

We have had a hiatus in the progress of global growth recently with disappointing global macro news-flow, not least low GDP and employment growth. In the short-term we believe the periodic setbacks and occasional weaker patches will continue as market sentiment fluctuates and policy makers struggle to innovate solutions.

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Asset Allocation

View	Positive Points	Negative Points
UK Equity Neutral/Positive	• UK macro environment looks reasonably stable. • Earnings numbers are starting to slow. • Companies have strong balance sheets and reduced cost base.	• Concerns remain on the extent of government and consumer debt as well as the impact of remedial measures as we appear to be in an economic soft patch. • Global sovereign debt issues weigh on markets. • Stability of the coalition. • Inflation.
Global Equity Neutral	• The Global recovery looks stable, with reasonably strong corporate earnings figures, albeit reduced. • Current climate benefits well capitalised businesses with more stable earnings.	• Concerns remain on the extent of Global government and consumer debt. • Optimistic earnings over the next few years may already be priced in. • Inflation - particularly from agriculture.
Emerging Market Equity Neutral	• Emerging Markets have been somewhat insulated from debt issues as governments have less debt and private savings ratios are far higher than developed economies. • Emerging Markets have experienced recent outflows of investment and a retrenchment in market levels.	• Inflation concerns as the base effect works itself out. Particularly wage inflation in India. • EM equity is slightly expensive relative to history but more attractive than developed market equity. • Government policy responses to international capital flows are a concern e.g. Brazil. • Volatility in the short-term. • Chinese fiscal tightening.
UK Fixed Interest Gilts Negative	• Defensive characteristics remain partially intact. • Government continues to promote fiscal discipline. • Continues to be the safe haven investment of choice.	• Inflation continues to be above government targets and QE remains in place. • Global sovereign debt problems will heighten volatility.
UK Index Linked Gilts Neutral/Negative	• Inflation continues to remain above target. • Limited supply from the DMO although demand remains strong at both the short and long ends.	• Real yields remain unattractive. • Issuance is expected to increase through 2011. • CPI Issuance in 2012 may have a liquidity impact.
UK Corporate Bonds Neutral/Positive	• Reasonable risk return characteristics compared to cash and gilts, for Investment Grade Bonds. • Prefer industrial to financial credits due to uncertainty over effect of sovereign debt issues on banks.	• Interest rate risk remains a concern.
UK Property Neutral	• Reasonable yields, improving rates and increased activity following large flows into the sector make this an attractive asset class only if investing in Prime Property. • There is a degree of inflation protection.	• Non-prime Commercial Property markets are likely to continue to lag as demand in this area is weak. • Government spending cuts are likely to exacerbate the perceived problem in secondary and tertiary property. • London office space is likely to go through a soft patch in rents as banks reduce costs.
UK Cash Negative	• Short-term safe haven.	• The investment value of this asset class is being eroded by current interest rates being below inflation.
Absolute Return Positive	• Following the strong run in equity and bond markets over the last year, a more defensive and diversified approach may be prudent. • Expect volatility to be elevated.	• Non trending markets can cause problems for directional strategies thus resulting in short term underperformance.

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