Investment Solutions

# Monthly Market Commentary

October 2011

## Review

The Bank of England's Monetary Policy Committee maintained the Base Rate at 0.5%* in October and increased quantitative easing measures to £275billion.

The FTSE All Share Index rose strongly over the month rebounding from the sharp falls experienced in August and September as global sovereign debt concerns deepened as European leaders struggled to avert a Greek default. The FTSE All Stocks Gilt Index had another good month, from a performance perspective, as investors continued to seek safe haven assets.

Global Markets had a strong month in October rebounding from the lows experienced in September, although the uncertainty surrounding global sovereign debt continues to hit investor confidence hard.

| | Index Level 31 Oct 11 | % Change | | |
|---|---|---|---|---|
| | | Oct | YtD | 1 Year |
| FTSE All Share £ | 2861 | 7.9% | -3.19% | 0.6% |
| FTSE 100 £ | 5544 | 8.2% | -3.2% | 1.0% |
| MSCI World $ | 1217 | 10.4% | -2.7% | 2.3% |
| S&P 500 $ | 1253 | 10.9% | 1.3% | 8.1% |
| | Index Level 31 Oct 11 | Index Level 30 Sept 11 | Index Level 31 Dec 10 | Index Level 31 Oct 10 |
| UK 10 Year Gilt Yield % | 2.44 | 2.43 | 3.40 | 3.08 |
| GBP USD | 1.61 | 1.56 | 1.56 | 1.60 |
| GBP EURO | 1.16 | 1.16 | 1.17 | 1.15 |
| OIL - WTI $ | 93.2 | 79.2 | 91.4 | 81.4 |
| Gold $ | 1715 | 1624 | 1421 | 1359 |
| Wheat $ ** | 628 | 609 | 794 | 717 |

**Source: Financial Express

The European Central Bank (ECB) cut the euro zone interest rate to 1.25%. The significant sovereign debt of many member states particularly, Greece was a huge concern for markets and contributed significantly to the market volatility. European leaders agreed to give Greece another bail-out and vary the terms of the EFSF allowing for more funding to be given to struggling economies however; politics seemed to interfere with the execution of this plan. The Emerging Markets were not immune from the market volatility, but rose in line with developed markets.

*Source: Bank of England

## Outlook

The global economy is experiencing a particularly weak 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 exceeded our hypothesis and we believe this will continue whilst markets remain uncertain. 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. However, central bankers see the risk of a slowdown as being greater than higher inflation.

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 with several of the larger emerging economies revising down their expected rates of growth.

We have had a general lull in the advancement of global growth recently with disappointing global macro news-flow, not least poor 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. In the long-term, it is our view that markets and the global economy will move forward and grow, albeit below trend.

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## Asset Allocation

| View | Positive Points | Negative Points |
|---|---|---|
| **UK Equity**<br>Neutral | • UK macro environment looks reasonably stable.<br>• Companies have strong balance sheets and reduced cost base.<br>• Corporate earnings and margins are proving resilient. | • 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.<br>• Global sovereign debt issues weigh on markets.<br>• Stability of the coalition.<br>• Earnings expectations are starting to slow.<br>• Inflation could prove to be elevated on a long term basis. |
| **Global Equity**<br>Neutral | • The Global recovery broadly intact with reasonably strong corporate earnings figures, albeit reduced.<br>• Current climate benefits well capitalised businesses with more stable earnings. | • Concerns remain on the extent of Global government and consumer debt.<br>• Optimistic earnings over the next few years may already be priced in.<br>• Inflation - particularly from agriculture. |
| **Emerging Market Equity**<br>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.<br>• Emerging Markets have experienced recent outflows of investment and a sensible retrenchment in market levels. | • Inflation concerns as the base effect works itself out. Particularly wage inflation in India/China.<br>• EM equity is slightly expensive relative to history but more attractive than developed market equity.<br>• Government policy responses to international capital flows are a concern e.g. Brazil.<br>• Volatility in the short-term.<br>• Chinese fiscal tightening. |
| **UK Fixed Interest Gilts**<br>Neutral/Negative | • Defensive characteristics remain partially intact.<br>• Government continues to promote fiscal discipline.<br>• Continues to be the safe haven investment of choice. | • Inflation continues to be above government targets and QE remains in place.<br>• Global sovereign debt problems will heighten volatility.<br>• Real yields are unattractive. |
| **UK Index Linked Gilts**<br>Neutral/Negative | • Inflation continues to remain above target.<br>• Limited supply from the DMO although demand remains strong at both the short and long ends. | • Real yields remain unattractive.<br>• Issuance is expected to increase through 2011.<br>• CPI Issuance in 2012 may have a liquidity impact. |
| **UK Corporate Bonds**<br>Positive | • Spreads are widening – increasing the risk return characteristics compared to cash and gilts, for Investment Grade Bonds.<br>• Prefer industrial to financial credits due to uncertainty over effect of sovereign debt issues on banks. | • Interest rate risk remains a concern.<br>• Economic weakness in Europe may lead to spreads widening further. |
| **UK Property**<br>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.<br>• 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.<br>• Government spending cuts are likely to exacerbate the perceived problem in secondary and tertiary property.<br>• London office space is likely to go through a soft patch in rents as banks reduce costs. |
| **UK Cash**<br>Negative | • Short-term safe haven. | • The investment value of this asset class is being eroded by current interest rates being below inflation. |
| **Absolute Return**<br>Positive | • Following the strong run in equity and bond markets over the last year, a more defensive and diversified approach may be prudent.<br>• Expect volatility to be elevated. | • Non trending markets can cause problems for directional strategies thus resulting in short term underperformance. |

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