Investment Solutions

Monthly Market Commentary

September 2011

Review

The Bank of England's Monetary Policy Committee maintained the Base Rate at 0.5%* in September and made no adjustments to quantitative easing measures. Although speculation has been mounting that the Bank of England may cut interest rates to 0.25%.

	Index Level 30 Sept 11	Sept	% Change YtD	1 Year
FTSE All Share £	2654	-5.0%	-10.9%	-4.4%
FTSE 100 £	5128	-4.7%	-10.6%	-4.4%
MSCI World $	1104	-8.6%	-11.8%	-3.8%
S&P 500 $	1131	-7.0%	-8.7%	1.1%
	Index Level 30 Sept 11	Index Level 31 Aug 11	Index Level 31 Dec 10	Index Level 31 Aug 10
UK 10 Year Gilt Yield %	2.43	2.60	3.40	2.95
GBP USD	1.56	1.63	1.56	1.57
GBP EURO	1.16	1.13	1.17	1.15
OIL - WTI $	79.2	88.8	91.4	80.0
Gold $	1624	1826	1421	1308
Wheat $	609	745	794	674

The FTSE All Share Index fell significantly over the month as global sovereign debt concerns deepened as European leaders struggled to avert a Greek default. In fact the FTSE All Share Index had the worst quarter's performance since 2002**. The FTSE All Stocks Gilt Index had a particularly good month rounding off an astonishing quarter, from a performance perspective, as investors sought safe haven assets.

Global Markets had a particularly volatile month in August which continued into September as the uncertainty surrounding global sovereign debt hit investor confidence hard. The US suffered as politics got cracking and the warm up to the elections in 2012 started in earnest, the hunt for a moderate Republican candidate continues. Stresses were exposed in the Banking System as future expectations for a slowdown increased.

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 and September. European leaders agreed to give Greece another bail-out and vary the terms of the ESFS allowing for more funding to be given to struggling economies. The Emerging Markets were not immune from the market volatility, as a result of declines in the materials and industrials sectors as well as tightening in Chinese monetary policy the MSCI Emerging Markets Index fell over 10% during the month.

*Source: Bank of England
**Source: Financial Express

Outlook

The global economy is experiencing a 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. Inflation remains of particular concern to us and many central bankers, as the cost of consumer staples, such as food and fuel, continues 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. 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 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. 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 Neutral/Positive	• UK macro environment looks reasonably stable. • Companies have strong balance sheets and reduced cost base. • 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. • Global sovereign debt issues weigh on markets. • Stability of the coalition. • Earnings expectations are starting to slow. • Inflation could prove to be elevated on a long term basis.
Global Equity Neutral	• The Global recovery broadly intact 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 sensible retrenchment in market levels.	• Inflation concerns as the base effect works itself out. Particularly wage inflation in India/China. • 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. • Real yields are unattractive.
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 Positive	• Spreads are widening, increasing the 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. • Economic weakness in Europe may lead to spreads widening further.
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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