



MONTHLY INVESTMENT REVIEW

December 2011

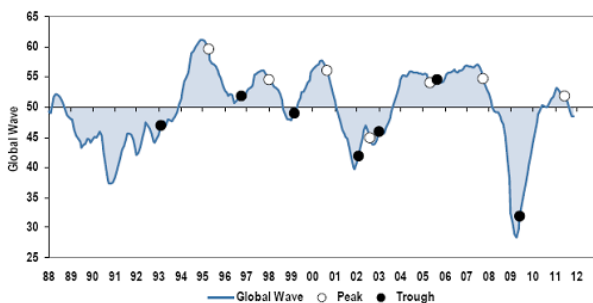
ECONOMIC AND MARKET BACKGROUND

Yet another European summit to address the problems of the Euro area and despite the fan-fare accompanying the new treaty it is difficult to see what has happened to address the current problems. The new treaty, if ratified by all the members which is far from certain, looks as though it may very well prevent a repetition of current problems but does nothing to address the debt levels or lack of growth within Europe. Until these fundamental problems are addressed it is difficult to see the crisis coming to an end any time soon.

The new president of the ECB has continued in the tradition of his predecessor which favours communication in an obscure, contradictory and some would say confusing manner. Having previously indicated that the ECB would look favourably (taken to mean that the ECB would begin to buy bonds of troubled European governments in a similar manner to the Bank of England) on any move to establish a fiscal union, statements last week contradicted this policy.

Problems in Europe have added to those emerging from the Far East to paint a picture of increasing economic uncertainty. One of our favourite charts combines a range of economic indicators into one index in an attempt to illustrate the ebb and flow of economic activity. This chart is reproduced below. What this shows is that economic activity peaked during the summer and has been slowing ever since. The main drags on the index can all be traced back to what is happening in Europe in that the deterioration is being fuelled by declines in industrial and consumer confidence, widening credit spreads and deteriorating earnings expectations.

Chart 1: The Global Wave



Source: BofA Merrill Lynch Global Quantitative Strategy, MSCI, IBES, Bloomberg, OECD, IMF

While not the sole determinant of future equity performance this indicator does suggest that it is going to be difficult for equity markets to move significantly higher until we see an improvement in the macro economic environment. Policy changes, such as fiscal or monetary stimulus, could bring about an improved environment but the prevailing political environment in Europe makes that unlikely there. The US has been very accommodative for some time and is the reason why their growth has been far stronger than elsewhere in the world. The swing factor could be the far east where China dominates. With signs of slowing activity in China it could very well be that moves are made there to stimulate domestic activity. If that were to happen then we could see a reversal of this indicator.

Within the markets generally the stalemate between poor macro data and political posturing set against good corporate performance and cheap valuations continues. The break seen in early August has not seen any follow through but neither has there been a successful test of the recovery highs of around 5600 on the FTSE. The stalemate will be broken at some time in the future but exactly when and what will prompt it is unclear. We have recently reduced our equity exposure due to the deteriorating macro economic picture but have not become very defensive as the technical background of the equity market and cheap relative valuations provide some encouragement. We find high yielding equities to be particularly attractive given yields of 5% +, potential for real dividend growth and capital gains once confidence is restored. Set against the returns available for cash or 10 year gilts there is little competition.

FOR MORE INFORMATION PLEASE CONTACT US ON:

0870 1500 900 visit imassetmanagement.com

or email clientservices@imassetmanagement.com