



MONTHLY INVESTMENT REVIEW

January 2012

ECONOMIC AND MARKET BACKGROUND

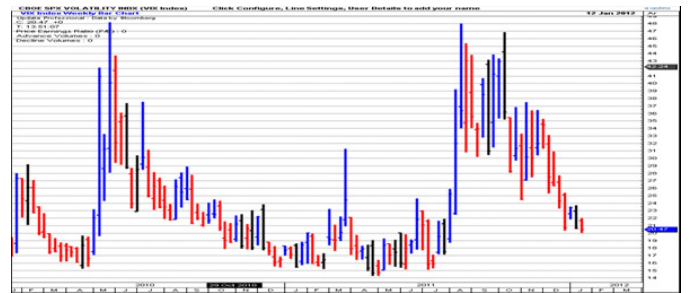
With the New Year came the usual slew of economic forecasts which almost universally predict a contraction in Global economic growth and an outright recession in Europe. Recent economic numbers from the US have been generally stronger than forecast with the key barometer of the current cycle, employment growth, showing real signs of a positive tone. Allied to this, early reports from US companies such as aluminium producer ALCOA indicate that business conditions are showing signs of improving sufficiently to give rise to positive outlook statements for the next 12 months. The most recent economic survey from the Federal Reserve Board concluded that the pace of economic expansion improved in December albeit at a level slower than they would like to see.

Within Europe Mario Draghi, new President of the ECB, undertook a quite dramatic move to secure the banking system by offering unlimited loans to any bank that needed funds for a period of three years. This is monetary stimulus by any name and had a very positive impact on the banks and government bonds. It is not in itself a solution but it is the first real sign of action to address current problems. At the margin, it is a sign of a positive economic development.

In a similar vein recent news out of China has indicated, albeit tentatively, that the moves to slow economic activity have come to an end and efforts are now being made to stimulate the economy. If both these two initiatives are sustained then the momentum will shift back in favour of a recovery in global economic activity, yet again confounding the forecasters.

If we look at various developments in the equity markets some support can be found for the notion that the real economy is improving and things aren't as bad as the pessimists would have us believe.

The chart below shows the VIX which represents the price of volatility in options for the US equity market. As you can see the price has been dropping since August which means that investors are no longer as willing to pay as much to protect the value of their portfolio as they were before. This stands in stark contrast to the popular view that everyone is afraid to invest and caution is the key to successful investing this year. Maybe what this is saying is that those who are scared have already sold leaving the long term investors holding stocks they are happy with.



Source: Updata

Another positive sign has been the fact that both the US and UK markets have risen above their 200 day moving averages. By any definition this means that the trend in the equity markets has moved from negative to positive.

Finally, we have started to see sector rotation pick up quite significantly. This began late last year but so far in 2012 the defensive sectors such as food and pharmaceuticals have started to under-perform the market while the cyclical and commodity sectors have performed much better. This could be a temporary valuation driven event or it could represent a sign that the economic prospects are much better than had been anticipated.

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