



## MONTHLY INVESTMENT REVIEW

June 2011

### ECONOMIC AND MARKET BACKGROUND

While the theme last month was of inflationary concerns and the potential for monetary tightening this month the concern is the sustainability of the existing growth rate.

Throughout the World economic reports have painted a picture of slowing growth which in the case of China is encouragingly in line with policy objectives but elsewhere is worrisome. In the UK it is hard to see any real growth even before the budget cuts take effect. The OECD and a number of leading economists who had previously been supportive of rapid deficit reduction have changed their minds and are now calling for a more modest approach. In the US signs have emerged of a meaningful slowdown in growth with very little progress being made on reducing unemployment. The question is whether this global slow down is structural in nature and will lead to a recession or is just a temporary pause in the growth cycle. As always it is impossible to say with any certainty. Last year at this time we saw a similar slow down only to see growth accelerate at the end of the summer following the Federal Reserve introduction of QE II (or that was deemed to be the proximate cause anyway). This time, based on the apparent conflict within the US over debt the prospects of QE III appear less likely but we wouldn't bet against it. There has never been any question in the minds of US policy makers that preventing another recession so soon after the last one is of paramount importance. On the positive side this time is the stage of the cycle in China where a year long effort to slow growth to a sustainable level appears to be working and so this is likely to be less of a dampener in the near future.

Debt problems continue to dominate in Europe with Greece being at the forefront of these. There is much speculation about how this problem is resolved with many conflicting interests at play and little real leadership. Thus far a combination of initiatives has kept the economy going but despite the political assertion to the contrary, most market participants believe that Greece will default in some way or another (default, restructuring or re-profiling). The main impact should this happen will be on the banks and concerns that it sets a precedent for other countries.

Looking at a number of indicators the best conclusion is that at the moment it is safe to say that the economy is in a slowing phase but is likely to avoid a full blown recession. However, this cannot be ruled out as policy mistakes could easily push the slow down too far. What is clear is that interest rates are not likely to rise in the near future in the West. There are some calls for higher rates still to slow the rate of imported inflation but how that would work is far from clear; the pressures driving up commodity

prices are from the Far East where activity to slow growth is already in place. In the UK, as a report indicated last week, any rate increase would have a devastating impact on the housing market and in turn undermine the banks such as Lloyds thereby significantly worsening the government's financial position.

Within the equity and commodity markets the primary trend (which we base on monthly data) still remains up but it is becoming challenged and there is significant resistance at levels just above current levels. It will take some significant good news to break through these. The intermediate trend is more of a concern. At best this trend is flat but could easily break down over the slower summer months.

### ASSET ALLOCATION

Last month we began to add to our cash positions and have continued that process. We are now actively reducing our equity allocation given the intermediate trend identified above. This is being done within the funds so as not to crystallise any capital gains that have been built up over the last two years. We will be adding to bonds as they have recently generated a buy signal.

### EQUITY STRATEGY

Sector rotation continues to be important and keeps us from taking large sector bets. The volatile mining sector has entered a down trend and we have reduced our position there but it does seem to have found a level of support and should signs emerge of a change in policy in the Far East then this sector could recover strongly. Defensive sectors such as food and pharmaceuticals are strong but so are property companies and industrial engineering. It appears likely markets are going to be stuck in a sideways rotational phase until the economic picture becomes clearer. Based on analysis of similar times that is of economic slowdown a momentum strategy is one of the optimum approaches. Evidence is beginning to emerge that this time is no different.

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