



## MONTHLY INVESTMENT REVIEW

September 2011

### ECONOMIC AND MARKET BACKGROUND

Europe's inability to provide a united front and find a solution to the debt problems of a number of countries, especially Greece, has ensured that financial markets have remained in a volatile state, albeit one which has not seen the lows of the first week of August breached. Adding to the European problems, the last month has seen the credit rating of the US downgraded and signs of slowing economic growth spread throughout the World. Against such a background it is surprising that we haven't seen a more significant decline in equities and rise in bonds. In fact what has happened has been a modest but clear rise in equities and signs of topping out in bonds. Even gold, which has been seen as the ultimate defensive asset, has started to display signs of stopping its rise.

What seems to be providing some comfort to the markets is a combinations of factors. Most importantly of these is a belief, based on unambiguous comments from policy makers throughout the World, that they will, variously, do what is necessary to prevent a disorderly default in Greece, preserve the euro, provide as much monetary stimulus as is necessary and even undertake additional government spending. Over the last year there has been a significant change in emphasis from a number of leading economic policy institutions throughout the World such as the IMF, US Treasury and in part the Bank of England. At the beginning of the year all were recommending a policy of debt reduction by way of reduced government spending. Now, in the face of slowing economic growth, they recognise (as Keynes would have advocated) the need to increase government spending to kick-start economic growth and worry about debt reductions later.

Other factors are the valuation of many equity and bond markets where the yield on the former is significantly higher than is available on the latter despite most companies throughout the World being in very strong financial positions. It is possible to identify a number of leading UK companies paying a dividend of approximately 5.5% to 6% which is likely to grow in real terms over future years as well as having the potential for capital growth.

The primary trend in most equity and commodity markets is down although support levels have held and markets have risen well from these levels. The intermediate trend is neutral as most markets are trading off their recent lows but have not been able to break above the intermediate term indicators. Fixed income markets show a better trend with the primary and secondary trends still being clearly up. The only negative has been signs of not being able to make new highs despite the deteriorating macro economic and political background.

### ASSET ALLOCATION

We have maintained our strategy of allowing cash reserves to build up in all accounts except for those looking for regular income. Should conditions deteriorate further then we will raise cash in clients with adventurous and balanced growth portfolios. For clients with balanced income and cautious portfolios there is a dilemma given the very low interest rates available from most forms of fixed interest investment which contrast strongly with the many blue-chip UK equities which yield 5.5% to 6% as discussed in the previous section.

With corporations in much stronger financial conditions than governments we believe that these dividend yields are sustainable and represent an attractive return compared to other asset classes. While yields could obviously go higher, and we are retaining some cash reserves for that contingency, locking in 6% returns is a good option.

For our adventurous clients we will be introducing an allocation to Managed Futures. This is an asset class which has historically demonstrated an ability to prosper in an environment of uncertainty and an inverse correlation to the equity markets. The Sharp ratios (risk adjusted returns) of the fund we are using are very good and were it not for the fact that the underlying instruments being used are futures which by their nature are volatile we would make an allocation more widely.

Within the funds we reduced cash levels on buy signals generated from the recovering market, we continue to have moderately high levels which will be increased on any further break of key support levels.

## EQUITY STRATEGY

Although the equity markets have recovered from their August lows there has been surprisingly little sector rotation which has been a warning sign about the robustness of the rally. Defensive sectors such as tobacco, utilities and pharmaceuticals have all made relative strength new highs and so we have been adding to these areas. In contrast financials and industrials have continued to make relative and absolute new lows so we have been reducing our positions in these areas.

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