

“Equities will be supported by valuations, monetary policy and earnings upgrades”

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SUMMARY

- Despite a recovery in July, June was another poor month for equities as risk appetite waned and investors concentrated on the negatives of sovereign debt worries in Europe and weak unemployment and consumer confidence figures in the US, Japan and Europe. This is in spite of good global growth, at 4% plus this year and for the next few years, and the maintenance of heavy monetary stimulus. The basic fear is that measures to be taken to reduce government borrowing in the so called Developed World will result in lower growth with the possibility of a double dip recession.
- The Euro remains weak, (although at these levels this will benefit European exports and reduce imbalances with the rest of the world). Gold remains a relatively safe haven. Equally, the dollar, and sovereign bonds of the stronger countries, such as the US and Germany continue strong. After its strong rise, oil has weakened on the back of reduced demand.
- Despite negative sentiment and weak share prices, the US economy continues to expand at around 3.0% per annum, and emerging markets continue to drive global expansion. As arguably the second largest economy in the world, Chinese growth, albeit moderating, remains a positive influence on the global economy, especially in relation to commodity demand. Europe continues to disappoint, with continuing questions about the long term sustainability of the Euro and the underlying health and liquidity of its banking sector.
- UK Sterling has strengthened to over \$1.50 after the recent UK Budget which has been well received. The yield on the UK 10 year Treasury Stock remains strong at 3.5%, well down on levels seen a few months ago and lower than the yield on blue chip shares. Despite worries about the budget deficit (11% of GDP, UK sovereign debt is longer term and more domestically financed than in many other countries.
- The Euro continues weak but could be now over sold.
- Short term interest rates still look likely to remain near zero in the US and Europe for at least the next quarter or so although inflationary pressures may force a modest rise later in the year. Rates should stay low for the foreseeable future.
- Bond risk in Asia remains less than in other parts of the world.
- There remains a great deal of uncertainty regarding extent and timing of continuing fiscal tightening which is hindering stronger equity gains. Very much a stock picker's market, especially in the US, as quality shares have been marked down to attractive levels after the correction in May.

- Property remains a good long term investment play with quality properties being available at bargain prices. Question marks remain concerning the UK market where budgetary constraints may lead to lower occupancies by government departments. Good yields still available. The next property super cycle could occur once bank lending and economic growth return to trend.

I. MARKETS

- After a poor May and a flat April, June continued the downward correction after the fast run up in equity values from April 2009. The S&P 500 lost a further 5.4% and the FTSE 100 lost a similar 5.3%. The Shanghai Composite lost 7.5% as the Chinese authorities continued to reign in credit expansion. China has been the worst performing equity market apart from Greece this year, as a result of moderating growth and the cooling of the housing market. Europe was more stable, benefitting from the weaker Euro. The German Xetra Dax index was stable for the month. The MSCI AC World Index lost 2.5% and is now 10% lower than at the beginning of the year. Sentiment towards equities remains risk averse and negative.
- US, UK and German 10 year sovereign bonds had a good month also. The bond market remains unnaturally suppressed at the short end, where the Government monetary stimulus remains. Safe haven currencies and investments are investment choices with many until key market questions are resolved.
- Pan-Asian bonds remained relatively strong. Greek, Spanish, Portuguese and Italian bonds remain very weak. The Spanish government surprised markets at the ease with which it managed to refinance its first debt tranches.
- Gold continued to recover to \$1 244 from \$1 213 per ounce, based on increased risk aversion. Long – term, gold remains in a bull trend.
- The dollar weakened marginally on a weighted basis. Sterling improved further and is higher, on a weighted basis than at the beginning of the year. The Euro weakened further by 2.5% as it sought to resolve the problems of its weaker members.

2. INVESTMENT MANAGERS' REPORTS

2.1 VAM Equity Funds (Driehaus Capital Management-“Driehaus”)

- Markets have experienced two very poor months, but this should not deter those who have a strategic asset allocation to equities as this set back is a normal feature of the investment cycle.
- Market currently over duly concentrating on negatives, which skews judgement.
- Global double dip recession would be highly unusual- the only one being 1982, with circumstances very different from today's.

- Europe still a concern- it represents 17% of the S&P company profits, so it is of some impact, but a poor economic showing from Europe should not create a recession in the US.
- Investors should stay in alpha generating assets like Driehaus equity funds in this sort of market.
- In Emerging Markets, likes Brazil, Indonesia and Turkey as well as domestically orientated stocks in China, notably pharmaceuticals, consumer cyclical and financials. In the Far East, well represented in Korea, China and India. In these areas underweight base materials and energy as economic growth stabilises in China.
- Confident that Driehaus can still deliver outperformance based on its stock selection process.
- Risk appetite remains high, impacting on valuations.
- Keep investment objectives in mind and leave emotion out of the equation.
- Active managers have an advantage over passive (eg ETF's) in this complex environment.

2.2.VAM Multi Asset Strategy Fund (Valu-Trac Investment Management Limited - "Valu-Trac")

- No allocation to equities in June, due to expectation of resumption of bear market.
- All equity moving averages for equities now falling.
- Recovery in earnings continues but is not yet enough to turn the tide for equities.
- Significant concern regarding levels of international debt and unsustainable monetary policies spell market instability.
- Scope for further market falls with no help from excess monetary liquidity.
- Gold and bonds likely to outperform against equities, at least in short term.
- Commodities other than gold not attractive in the short term. Long term background is encouraging.
- Likes Yen most of all currencies with US Dollar second. Euro looking oversold.

2.3.VAM Property Fund (Fleming Family and Partners - "FF&P")

- Yields on property and relative longer term value will provide good returns over the cycle. Will benefit from demographics as "baby boomers" seek value investments upon retirement (property, bonds and cash).
- Fund relatively defensively positioned. Cash component raised and hedges are employed (e.g. shorts on the S&P 500 index).
- Property investment seen as a safer haven for investors during times of market uncertainty.

- US will probably announce new stimulus measures to improve recovery picture ahead of the November elections.
- Redemption of the more illiquid property investments accelerating through secondary market. Investments redeemed or to be redeemed close to existing valuations. The proceeds to be used to invest in bargain property opportunities which presently exist.
- Fund now international, with around 50% in the UK, the rest in Europe, Far East and the US. Looking at Indonesia, Thailand, Brazil and Australia.
- Not all unlisted property companies have reflected the increase in market value.
- Overall, wary of present market and believe there could still be a further equity market sell-off later in the year.

2.4 VAM Asia Fixed Income Fund (Enhanced Investment products Limited – “EIP”)

- Fixed income market was characterised by an improvement in sentiment across most sectors, the benchmark iTraxxSovX Asia Pacific showing large gains during the month, before surrendering part after renewed jitters concerning European sovereign debt resurfaced.
- Fund components broadly unchanged. Biggest holdings in financials.
- Average maturities marginally reduced to 6.51 years.
- Likes Hong Kong, South Korea, Malaysia, Singapore and Australia as issuers. Japanese holdings were liquidated and a small position was taken in China.
- Maturities all remain under 10 years with largest being 2019.
- Cash holdings remain high with a view to providing better entry points in the market. Becoming more confident to use this cash.
- Stance remains defensive and these bonds should outperform in turbulent times.
- Political risk lower, with positives coming from China Taiwan gradual rapprochement and reduced risk from North Korea.
- Forward yields of around 5% should be achievable.

3. CURRENCIES

- Pound stronger but still below its latest 10 year average against the dollar. This suggests some future improvement once economic problems are resolved. Some element of safe haven status appearing. Euro remains under pressure but may well be undervalued.

- Dollar's strength less pronounced.
- Top currency is the Yen. Dollar still looking attractive, however.

4. JUNE PERFORMANCE

The continued fall in equity prices in June, may still be seen as a correction after the long run up in prices since the second quarter of 2008, and continue to be influenced not just by risks primarily associated with the sovereign debt issues in Europe, but also by the likely negative impact of fiscal tightening on global growth. Present valuations may be seen as an opportunity for those who missed out on the rally to enter the market at lower prices. Investors should, however, remain cautious and continue to assess their investments in the light of their investment objectives and risk profile. For risk averse investors, the VAM Asia Fixed Income Fund offers relative security in turbulent markets and returns well in excess of cash, whereas the managers of the VAM Multi-Asset Strategy Fund have proven that they are ready and able to switch rapidly out of asset classes where value is seen to be unsupportive and into traditional safe havens of gold and cash. For those who wish to be invested in equities for the longer term, the VAM Driehaus Funds offer superior returns over their benchmarks. The VAM Property Fund also has value attractions in these volatile markets, offering more stability and solid long term valuations.

“Maybe the double dippers are right; there could indeed be another slowdown, or even outright contraction. But the benign longer term prognosis looks good enough to believe otherwise”

Jeremy Warner, Daily Telegraph, 1 July 2010

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