

Analyst Investment Management Plc

Market Insight January 2012

2011 Gone but not forgotten

Highlights

The financial train crash that was 2011 may have been left behind by using a new calendar but the debris remains. An early rally in the New Year has come tinged with a hint of optimism and more than a sigh of relief. However following the announcement from the S&P ratings agency at the end of last week that it was lowering its ratings on France, Austria, Italy and Spain, should this rally have been brought to a grinding halt? Just a few weeks ago this news would probably have caused panic and another 5% intraday drop in equities that was becoming the norm last year, but this time the hysteria was largely missing except from the wider media outside of the markets. The uncertainty and ensuing volatility remain lurking in the shadows and many scenarios of how the Eurozone crisis will play out from 'muddling through' to a 'total collapse' in the Euro continue to be thrown back and forth, however the markets seem less inclined for the moment at least, to pre-empt any event or decision's which are still largely in the hands of the politicians.

Investment Strategy

Equities

Expect further volatility
Buy on dips

Currencies

Preference for USD over Euro & GBP

Bonds

Corporates having recovered will continue to be volatile
Treasuries to benefit from any renewed uncertainty

Commodities

Oil trading buy
Gold trading buy

MACRO REVIEW

At what pace will the Global economy grow this year? This will probably be the question for most investors aside from any arising from Eurozone although the Eurozone crisis is never far away. Following the breakdown of debt talks last week suggestions are that Greece is more than likely to default by the end of March, as it looks unlikely to salvage any deal to meet their debt obligations and make a €14.5bn bond payment which will be due on March 20th.

That said a measure of how far we have come is that should Greece default (becoming the first European country to do so in sixty years) and aside from any initial chaos for Greece, this would probably be seen as positive for the Eurozone in helping it to reform and move forward. Focus would turn to the Euro peripheries without doubt yet that seems inevitable, and uncomfortable as this scenario may be in the interim it may well force the issue that the Euro politicians still seem reluctant to address.

US

Economic data has remained encouraging lately with signs of both improving labour and housing markets helping to push the threat of a double dip recession to the back of people's minds. The fly in the ointment of high unemployment remains though and is not helping to boost confidence for any

	GDP	Jobless	Infl.	Rates
US	1.50%	8.50%	3.40%	0.25%
EU	1.40%	10.30%	2.80%	1.00%
UK	0.60%	8.30%	4.80%	0.50%
Spain	0.80%	21.52%	2.40%	1.00%
France	1.55%	9.70%	2.50%	1.00%
German	2.50%	6.60%	2.10%	1.00%
Italy	0.20%	8.60%	3.30%	1.00%
China	9.10%	4.10%	4.10%	6.56%
Russia	4.80%	6.40%	7.00%	8.00%
Brazil	2.10%	5.20%	6.50%	11.00%
India	6.90%	9.40%	9.34%	7.50%

investor just yet. But for this reason the Federal Reserve is unlikely to raise rates until at least mid 2013 and this may well go on into 2014 which will mean investors will need to look for better returns if they want to avoid negative returns on cash.

Europe

The scenarios for Europe are now well documented, a Eurozone with Greece or without Greece, is Portugal or Spain or Italy next? What are their bonds yielding at auction? Are they above 7%, which would indicate difficulties? The outlook remains bleak but France losing its AAA rating, an event which President Sarkozy said would finish him did not make most of the front pages in the financial press, the issues have not gone but the markets are dealing with them cautiously as opposed to reacting blindly by hitting the sell button first and thinking later.

UK

Inflation slows

Inline with forecasts UK inflation slowed to a six month low of 4.2% and

supporting both the Bank of England's forecast and other observers that inflation will drop sharply over the next six months, which is positive for consumer spending, but should still allow for further monetary spending or additional quantitative easing. The inflation figure is still above the BOE's target of 2%, as it has been for two years but they are still forecasting a target inflation rate of 1.7% by the end of 2012.

China

China's latest GDP figure released today at 8.9% for the fourth quarter although the slowest in 10 previous quarters still beat forecasts of 8.7% and indicates further monetary easing. China still has a difficult path to tread in 2012 as it tries to avoid a hard landing domestically and its biggest external market the Eurozone struggles with recession whilst trying to hold itself together. Undercurrents of friction between China and the US over trade and currency's may also create unwelcome obstacles. Concerns of a domestic property correction remain and China will need to stimulate internal growth to adjust for the shortfall externally, however early signs are that focus has shifted from inflation fighting to growth. With forecasts of 8- 8.5% growth for 2012 the days of 10 or 11% growth are behind them, for now at least.

Brazil

As the Brazilian government cuts growth forecasts for this year to 3.5%, not to be unexpected given the global climate, according to the London based Centre for Economics and Research group Brazil has overtaken the UK as the world's sixth largest economy. Brazil's economy has picked up in the last quarter after three months of declines, alongside indications of investment inflows

resulting from overseas debt issues such as one issue by the Brazilian Treasury that will bring in \$825mln. All supportive of an optimistic new year but as with other economies there will be hurdles to climb.

Bovespa Index Dec 2011 to YTD



Russia

The election results probably came as no surprise to anybody outside of Russia, however the unprecedented scenes of thousands protesting on the streets in Moscow must have surprised all but a very few. As we highlighted in our last Insight report it's not just on the streets where disillusionment is festering, the board rooms of Russian businesses are becoming increasingly disgruntled. The uncertainty of the Kremlin's economic policy has led to a drop in business optimism from 15% in the first quarter of 2011 to minus 4% in the fourth quarter according to a report by Grant Thornton. Although partly attributable to the global feeling of gloom the results largely reflect the fact that Russia has done little if anything to stimulate domestic demand in the eyes of most business leaders. According to the report the combination of this, the increasing volatile political situation in Russia and the outlook in Europe gives Russian business's the most pessimistic of all the BRIC countries and show little sign of improving.

EQUITY MARKET

Accumulate

- Continued volatility
- Trading Buy on dips

Investment Strategy

- Overweight BRICS (Brazil, Russia, India, China)
- Long DAX (German Leading Equity Index)
- Long US

Equities

A buoyant start to the year for equities should not disguise the difficulty facing the markets this year. Volatility will more than likely be a recurring theme in most market reports over the coming months, as well as a measure of confidence, whether from the investor, the consumer or a broader confidence in economic growth. Probably the most important area of confidence is in the politicians dealing with the Euro crisis, which will continue to be a drag on equity markets globally. We still prefer US equities over Europe, as earnings continue to outperform expectations and further positive economic data supports the argument for being long US equities. That said any shock event or sharper than forecast slowdown in Europe would hit US equities as Europe still accounts for an estimated 20% of corporate earnings.

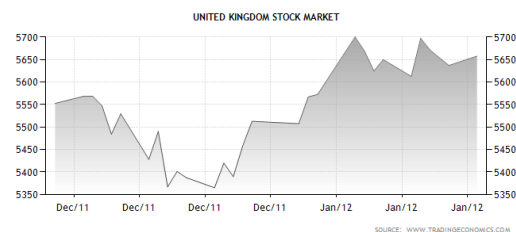
Euro Stoxx 50 Dec 2011 to YTD



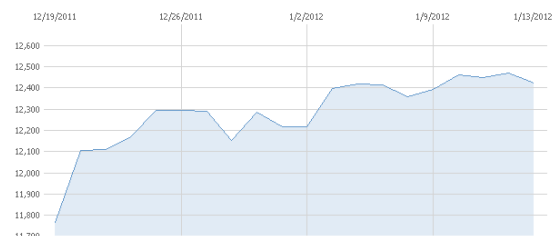
DAX Dec 2011 to YTD



FTSE Dec 2011 to YTD



Dow Jones Dec 2011 YTD



FIXED INCOME

Investment Strategy

- **Maintain European and High yield credit positions**
- **Hold high yield emerging market bonds**

Treasuries

A combination of good news from China, the US and an investor confidence report from Germany saw treasuries retrace gains from last week, and as discussed above we will see government bonds being driven by any diverse news but expect yields to move higher through the year, although a deterioration in Europe would support a rally in treasuries. In London LIBOR dropped for the 8th day its longest run since May 2011, indicating increased lending between banks.

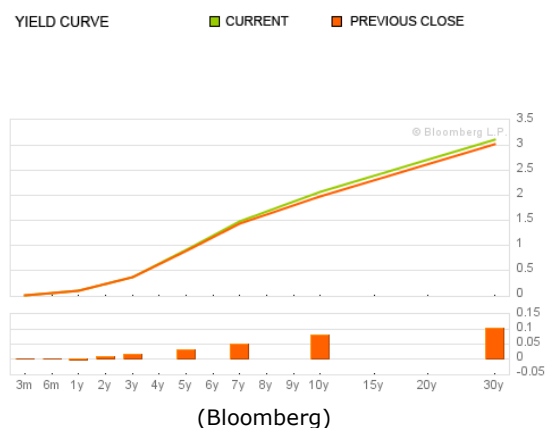
Corporates & Emerging market bonds

After the announcement of the S&P downgrade in Europe issues were marked down and a small amount of selling came into the market but the announcement was largely discounted. As with equities High yield corporates have had a positive start to the year and we remain optimistic over the year, and believe that as and when confidence makes a welcome return volatility will fall. We do not anticipate any major refinancing risks this year and believe there is an increasing appetite for further issues.

JP Morgan Emerging Market Bond Index



US Treasuries



CURRENCIES/COMMODITIES

Currencies

- **Prefer USD over Euro**
- **Prefer GBP over Euro**
- **Prefer USD over GBP**

Euro

Prefer USD and GBP

Despite being relatively weak over recent months the Euro has defied logic by holding the levels it has until recently, but now has finally succumbed to the torrent of bad news that has been battering it. Currently at 1.27 vs the US Dollar and 1.21 vs GBP I believe these will hover at these levels barring any shock event or news. However should any news be Euro Positive there may well be an exaggerated move to the upside as it is rumoured the hedge funds are very short the Euro for now.

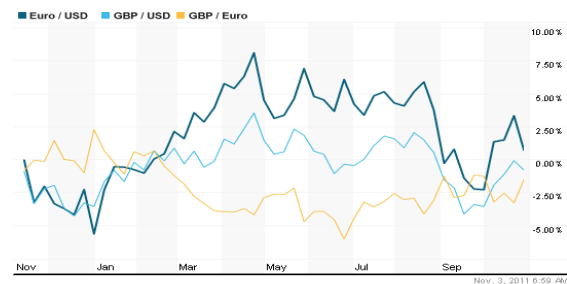
GBP

Prefer GBP over Euro but USD more favourable

After France was downgraded by S&P along with several other Euro members, there have been murmurs of disquiet in currency markets regarding the UK's current position with a possible downgrade, I think the difference here is the S&P was largely holding the lack of political leadership responsible above all else so the UK and GBP may well keep the high ground over the Euro for now.

Commodities

- **Oil range bound (current price \$99.35)**
- **Gold loses it's shine for now**



Oil

Rangebound

Oil is being held within a range, although this range has expanded to the upside on the geopolitical issues over Iran's threat to block the Straits of Hormuz, but equally could be susceptible to a downside push if the Eurozone looks fragile again. These potential events apart the oil price over the coming months will be led by growth outlook positive or negative for the world economy but would expect to stay in the current range.

Gold

Gold has remained in the doldrums but with the unresolved Euro issue still hovering and continuing problems in the Middle East and Iran's ongoing war of words support for Gold will remain.