Analyst Investment Management Plc

Market Insight November 2011

Papandreou's Trick or Treat

Highlights

Even before EU leaders had gathered in Brussels the deal for the Eurozone bailout was largely tipped to disappoint, so the package that was eventually struck was not only welcomed but initially seen as extremely positive and endorsed by equity markets around the globe by capping the best monthly rally in years. However no one had anticipated the Greek Prime Ministers 'spanner in the works' by calling for a referendum on the debt deal, a move that has pushed the Eurozone into uncharted waters and the situation is changing dramatically on an hourly basis. Before any referendum the Greek P.M. faces a vote of confidence this Friday, and as I write he has a majority of just one, and in my view we are unlikely to see a referendum. However the damage has been done with EU leaders announcing they will withhold further aid ahead of any elections, and any vote now is being treated as an 'in or out vote' on Euro membership. There are too many questions to list here but a major one is whether a Greek exit from the Eurozone will set a precedent for Spain and Italy? The fact of the matter is we will see a very different outcome from the one we thought we had just a few days ago.

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 renewed uncertainty following the news from Greece

Commodities
Oil Range bound
Gold trading buy

MACRO REVIEW

As the Greek prime minister single-handedly destabilises the Eurozone and brings the threat of the break up of the Euro to the brink, Asian economic data potentially casts further long shadows of doom, but is it all gloomy. After a summer of watching the markets from behind the sofa there seemed a genuine change of sentiment, the world had not changed, the issues remained, however not all news was being greeted with an Armageddon scenario. Corporate earnings remained buoyant, takeover activity began to bolster markets; at the beginning of last month even Goldman Sachs predictions slowing global growth and recessions in Germany and France could not scupper the strongest monthly rally in equity markets since 2008/9. We have not seen the last twist in this Greek tragedy and it will almost certainly not be plain sailing, but the small signs of light at the end of the tunnel have not diminished entirely.

Stop Press ECB surprises with rate cut by .25%

	GDP	Jobless	Infl.	Rates
US	1.60%	9.10%	3.90%	0.25%
EU	1.70%	10.20%	3.00%	1.25%
UK	0.70%	8.10%	5.20%	0.50%
Spain	0.70%	21.52%	3.00%	1.25%
France	1.60%	9.60%	2.20%	1.25%
German	2.70%	6.60%	2.40%	1.25%
Italy	0.80%	8.30%	3.40%	1.25%
China	9.10%	4.10%	6.20%	6.56%
Russia	3.40%	6.00%	8.25%	8.25%
Brazil	3.10%	6.00%	7.31%	11.50%
India	7.70%	9.40%	8.99%	7.50%

US

Despite the Federal Reserve cutting its growth forecast last night, it would appear that recent encouraging data supports the view that the US is unlikely to fall into recession. Two thirds of companies reporting earnings beat expectations, and the economies growth in the third quarter improved significantly over that of the second quarter. However in light of events in Europe the fragile path to recovery is still in the balance and the G20 leaders meeting in Cannes today will need to take decisive action to encourage global growth. The Fed is likely to keep any news on a third tranche of QE in its back pocket but any further problems in Europe would almost definitely see the Fed pull the trigger sooner rather than later.

Europe

There really is only one story in Europe and that is Greece's position and whether it will now remain part of it. The implications for the global economy of contagion from a Greece default remain a concern. The EU big guns, Germany and France have made it abundantly clear that there is nothing more on the table and Greece needs to take it or leave it, but I suspect that patience has run out and whether the Greeks like it or not they have left it and Europe will find a way forward without them. How this plays out will dictate any outcome for the Eurozone. Amongst the encouraging signs from the bailout package agreed last week was the feeling that Europe may finally be on the path to increasing unity and the holy grail of a joint fiscal policy with the same goals, unfortunately now we are discussing the Euros very survival again and for the moment nothing is clear or predictable but time will tell.

UK

PM sharpest fall since June

A better than expected GDP figure for this quarter is largely being seen as a one off by economists, a theory being supported by a very poor purchasing managers index figure which fell to 47.4 from 50.8 in September and manufacturing growing at just .2%. With unemployment at a 17 year high consumer confidence has slumped following recent optimism, raising questions about the government's austerity measures and whether now is the time to change policy and do more to boost the economy.

China

Easing monetary policy?

China's purchasing managers report showed its lowest figure in 3years falling well below forecasts, as non manufacturing industries slowed and property prices cooled further, although consumer demand remained buoyant fuelling speculation that the Government will ease monetary policy to help boost the economy. Despite concerns of a slow down there is increasing speculation that low valuations and the potential for corporate and economic reforms will help Chinese companies outperform their current EPS growth estimates for 2012, seen by some local strategist as at the low end.

Brazil

Despite cuts in growth forecasts Brazilian exports hit monthly records in August of $26.2bln taking the year to date total to $166.7bln, a 32.2% increase on the same period in 2010, and preliminary data for September looks shows the trend looks set to continue. That said industrial production sank 2% in September and could signal further rate cuts. This has not changed monetary policy which is still seen to focus on growth whilst arguing that cuts in rates will not jeopardise the governments inflation target of 4.5% for next year despite the fact that inflation has remained above the 6.5% upper limit of the governments own target since April.

Russia

Question marks over official growth estimates

Questions have been raised following the publication of an independent report on the Russian economy, describing the official growth estimates as nothing more than wishful thinking. The report cites over optimistic domestic demand and an unrealistic oil price prediction in light of a global economic slowdown, and suggests that 3% growth as opposed to the 4% predicted by the ministry was more realistic, and yet may still be too optimistic if the oil price falls steeply on a potential second wave of recession. Russia is also more sensitive to developments in Europe than other 'emerging economies'. The official signs of over optimism and the reliance of fiscal policy on higher oil prices have again been publicly criticized by former finance minister Alexei Kudrin who refuses to go quietly following his sacking last month adding weight to the claims within the independent report.

EQUITY MARKET

Accumulate

- **Continued volatility**
- **Buy on dips**

Investment Strategy

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

Euro Stoxx 50 year to date

DAX year to date

FTSE year to date

Dow Jones year to date

Equities

An excellent month for equities for the first time in several months, with the MSCI world equity index rallying 11% in October, which meant that for the first time in a year equities were offering better value than bonds, commodities and the US Dollar. This however was brought to an abrupt halt following shocking news form the most talked about man in Greece which we have discussed in detail above. Following the news from Greece equity indices in Europe were down as much as 6%, with European banks in some cases being battered by as much as 20% at their lows.

Earnings again had impressed and from a corporate perspective stocks look to offer value but events over the last days and how these are dealt with will determine any direction for markets over the short term, but for the medium term we remain optimistic for equities.

FIXED INCOME

Investment Strategy

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

Treasuries

In a simple reaction to the Greek news and following last weeks sell off, the exiting investors for Treasuries, German bunds and UK Gilts were flooding back in to the safe haven of government debt once again. The renewed concern over Europe's inability to solve its debt issues helped extend the 30 year Treasury's biggest rally since March 2009.

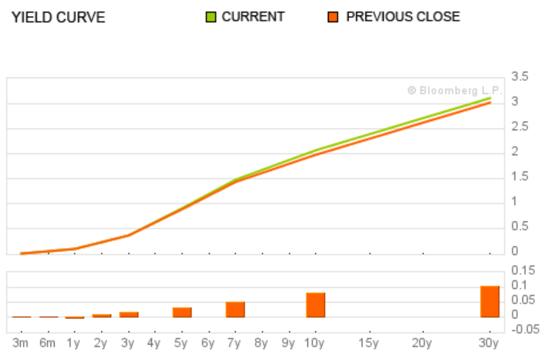
Corporates & Emerging market bonds

Corporates rallied alongside equities, with the EMBI index up 4.4% for October, although had still not recovered all of September's losses. Banks lagged in Europe as the detail of the Eurozone bailout was scrutinised and the 'risk off' trading strategy that had seen high yield and EM bonds hit was side lined. According to a report by JP Morgan emerging market defaults for 2011 stand at less than 0.5% presenting another encouraging sign for long term investors despite the recent volatility.

INEOS one of our high yield holdings released a trading statement that was lower than consensus, showing a fall in operating Earnings to €371 mln vs a consensus of €400mln. Given previous statements from the company signalling a negative trend the market took the news in its stride with no negative impact. We remain positive on our holding as INEOS has a strong market position in several markets, with good product diversification and a focus on cost cutting.

JP Morgan Emerging Market Bond Index

US Treasuries



(Bloomberg)

CURRENCIES/COMMODITIES

Currencies

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

Euro

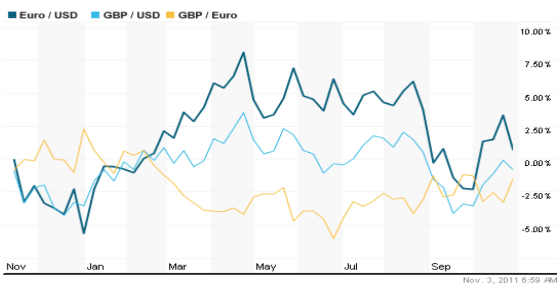
Prefer USD and GBP

Following the agreed bailout package the Euro rallied strongly only to be halted in its tracks and perform a u-turn after the Greek P.M.'s call for a referendum on the bailout deal. Any referendum is not likely to be held soon and will undermine any confidence in the Euro for the time being.

GBP

Prefer GBP over Euro but USD more favourable

Despite the strongest quarterly growth in four years for GDP, the latest chapter in the Euro crisis over Greece's calls for a referendum on the bail out will again raise concerns over the UK being pushed into recession. Another thorn in the side for Sterling will be further potential QE following the Bank of England pumping £75bln into the market in October.



Commodities

- **Oil range bound (current price $94)**
- **Gold remains solid**

Oil

Rangebound

Encouraging data from the US and a generally more positive change on sentiment on global growth earlier in the month offered support to Oil, but the news from Europe regarding Greece and disappointing PMI numbers from China have left Oil range bound and this looks to be remain the case over the coming weeks.

Gold

Although the rally in Gold has been looking tired and price movements recently have moved inline with equities, the global woes and the resulting 'risk off' trading activity will continue to support the Gold price with price targets of $2000-2100 looking at the top end of the range for the moment.

Gold Price year to date