



This weekly Briefing Note aims to pick out some of the key financial and economic issues touched on in the press over recent days and from time to time includes the views of some of our independent fund managers.

Dizziness through debt

Events surrounding the European sovereign debt crisis and the run up to the 2010 UK general election dominated the markets last week. As this bulletin will go on to explain, much of the impact for investors is still unclear, with the next few days likely to present significant swings in the bond, equity and currency markets as rumour and hard facts continue to blur. Looking back at the week that was, the tumultuous conditions experienced across global stock markets last week were indeed fierce. Equity markets suffered some of the sharpest declines since 2008 with the blame being placed firmly on the shoulders of the European debt markets, in particular the concern over the instability in Europe as continuing fears over contagion from Greece weighed heavily on investors' minds. Sharp falls in the Asian stock markets set the downbeat mood early in the week, with the Nikkei 225 index ending the week down -6.3 per cent. In the US, the S&P 500 index closed the week down -6.4 per cent but had one of its most dizzying falls on Thursday registering some of the steepest declines since December 2008. The S&P 500 index wiped out much of its 2010 gains in a matter of moments despite calming later in the trading day.

Credit markets also suffered a challenging week in the wake of uncertainty over the EU sovereign debt crisis and the lack of a clear outcome in the UK general election. Stress emerged in interbank lending markets and the cost of insuring against default by euro zone banks rose sharply. Tough conditions in global bond markets drove a flight to safety, with yields in the US and German Government debt falling sharply to record lows.

Currencies ultimately felt the shock waves too with the Euro slumping to a 15-month low against the Dollar and an 8 year low versus the Yen, as investors expressed a deep fear that the contagion from the Greek fiscal crisis may not be contained.

Increased trading volumes triggered by investor fear over the sovereign debt crisis and fears of an inconclusive election result led to considerably more volatile conditions in the UK, with the FTSE 100 closing down -7.8 per cent on the week, its sharpest weekly decline since March.

Falling risk appetite and volatility in currencies, particularly the Euro, continue to be the primary concerns for global equity markets and the weekend papers were dominated by the need for concerted action both in the UK and in Europe. Paul Read of Invesco Perpetual, manager of the St. James's Place Corporate Bond and Investment Grade Corporate Bond funds last week pointed to the need for a major aid package. Writing on Friday last week Mr Read commented "We believed that a disorderly handling of the situation could lead to general risk aversion. However, it is very difficult to draw any firm conclusions at this stage. The issue is now a political one and the dilemmas are clear. The EU and IMF have committed to, and look set to pass, an aid package but some form of eventual restructuring is not out of the question. Contagion is the key risk, both to other peripheral markets and European banks. However, all markets may be adversely affected by Greek issues and a period of risk aversion and flight-to-quality may follow if the situation is not handled effectively. In particular it is possible that European banks may come under pressure. We do have exposure to subordinated debt issued by major European banks. On balance we believe that weakness in major investment grade corporate spreads, high yield or in Tier 1 European bank debt is likely to be a buying opportunity but we first need greater clarity from policymakers in order to retain the confidence of markets."

Authorities to the rescue

In line with Paul's expectations, this morning saw the European Union (EU) and the International Monetary Fund (IMF) launch an audacious package of measures in the early hours before financial markets opened, including €720bn of government-backed loan guarantees and a commitment to buy European sovereign bonds. This new rescue package is the latest step by authorities to combat the rising financial market tensions triggered by global fears over the situation in European public finances.

FT.com published further detail that the emergency funding facility agreed between the EU and the IMF is worth as much as €720bn (\$930bn, £625bn) in loan guarantees and credits to stabilise the Eurozone.

The stabilisation scheme agreed by EU finance ministers and top officials in Brussels consists of government-backed loan guarantees and bilateral loans worth up to €440bn (\$568bn) provided by euro zone members, a further €60bn supported by all EU members through expansion of an existing balance of payments facility and up to €20bn provided by the IMF.

Initial reaction to news of the package in Asia trading on Monday morning was favourable, with the Euro gaining almost 2 per cent against the US dollar and 3 per cent against the Yen. In Japan, the Nikkei average rose 1.3 per cent and Hong Kong's Hang Seng advanced 1.2 per cent to 20,154.07. European markets are also expected to react favourably and at the time of writing the FTSE 100 has opened up over 3 per cent.

Whilst we cannot predict how markets will react over the remainder of the week and going forwards, it is clear that global authorities are making a statement that they will do whatever it takes to get the sovereign debt crisis under control. It also highlights the ongoing need for investors to adopt a diversified approach to their investment avoiding the temptation to panic during volatile market conditions.

Uneventful Election?

Here in the UK, whilst very aware of the conditions in global markets, the focus remained on the general election, mounting concern over the likelihood of a hung parliament result – one where the absence of a clear majority of electoral seats prevents a party from proceeding with future bills and legislative changes without the support of other parties.

Despite a rollercoaster campaign which galvanised the electorate and engaged with younger voters, the final vote confirmed the widely anticipated result of the first hung parliament that many of the electorate will have experienced.

So what does this mean? The actual impact is difficult to quantify until an agreement can be made as to the future Government. For the time being, Gordon Brown remains in power as the incumbent Prime Minister but given the results there is significant pressure from within the Labour Party and elsewhere for Mr Brown to stand down.

What's the big deal?

The weekend press focused on the discussions between party leaders on how they might agree on running the country going forward. Nick Clegg has met with Conservative leader, David Cameron on two occasions so far to discuss and further talks are planned for today. One view, that Mr Clegg had painted himself into a corner by publicly announcing in the run up to the election that he could not work with Gordon Brown, has been shelved following a meeting between the two party leaders which took place over the weekend. In summary, the country is waiting with baited breath for the outcome of talks between Clegg and the leaders of the other two parties. The biggest stumbling block thus far would appear to be the issue around electoral reform where the Lib Dems want nothing less than a proportional representation system with a reduced number of MPs and a written constitution. This issue could be the golden ticket for a successful coalition if Mr Cameron can reach a compromise.

Today's hot topic is the ongoing talks between David Cameron and Nick Clegg following a private meeting over the weekend where the two met at Admiralty House in Whitehall for over an hour. **The Sunday Telegraph** reported that the meeting was said to be 'constructive and amicable' and more importantly the view from senior Tories that there was 'leeway' in party proposals on tax, schools and green issues as well as the critical electoral reform issue. This may be the best news for David Cameron in terms of progressing forwards towards the introduction of a 'LIB-CON coalition' government.

One other outcome is that of a ‘Minority Administration’ which **The Times** described as a Party without an overall Commons majority that forms a government nonetheless, offering deals on individual pieces of legislation or defying opponents to vote it out.

Whilst this outcome is thought to be more likely than calling for a further general election in the short term, the danger is that this could take the bite out of Tory policy with David Cameron likely to cut back his most controversial plans and trim cuts which his party had argued were right and necessary. The risk is that at some point he would lose a key vote which would lead to a motion of no confidence and another election would be called.

Market outlook & opportunities

Whilst the talks will continue and the speculation is rife over what will happen next – the markets continue to operate regardless. The financial package introduced to address problems in Europe has given global equities a fillip, but **The Daily Telegraph** reported over the weekend how the Pound has been taking a hammering and the outcome of the election had delivered the result that the City and the financial markets had most feared. The hope was for a clear-cut Tory victory, delivering a strong government with a mandate to tackle Britain’s debt crisis. However, uncertainty is what investors and traders fear the most and a hung parliament delivers it in spades which contributed to share price falls and a weaker Pound. Interestingly, the headline belies the true nature of market conditions as despite sterling falling to a 10 month low against the dollar in early trade it recovered Friday, closing down only 0.3per cent.

There is a difference between ‘investors’ and ‘traders’ which is fundamental. Whilst we all undoubtedly share concern over stability in the markets – traders most definitely operate at the sharp end where a single day’s movement in equity or bond prices can be critical. An investor, however, should be focusing on the medium to longer term using short term volatility as a way of accessing value not generally available.

John Innes of RWC Partners, manager of the St. James’s Place UK Growth funds has many years experience managing equities during periods of financial uncertainty. Whilst appreciating the gravity of the situation he recently commented on his perspective following the election result. “The political and macro turmoil is also happening at the same time as the economic and corporate data remain very robust. Valuations in the UK equity market have fallen back down again so that there is once more a yield crossover between equities and gilts, price to earnings ratios are low on a historical basis and companies, including the banks, are in much better shape financially.....equity markets should find some support as earnings continue to see positive revisions. Cheaper sterling helps the economy and corporate earnings generally and lays the UK quoted sector wide open to overseas corporate predators.”

John Chatfield-Roberts, CIO at Jupiter Asset Management, reiterated the fact that no clear winner in the election was one of the key stumbling blocks for getting the UK economy back on track and also in the short term, protecting the bond markets perceptions of Britain’s credit worthiness. Despite this he did see opportunities for equity investors. “...for long term equity investors, the currency moves and market falls we have seen bring opportunities; but to make the best of them, investors need to be positioned correctly. In our view, that means investing in companies that are not dependent on single markets and having actively managed portfolios that are broadly diversified by asset class, geography and currency.”

The need to diversify

The St. James’s Place approach to wealth management focuses on providing our clients with a diverse range of investment solutions with externally appointed fund managers who adopt differing strategies and approaches to investing. The aim of this approach is to provide access to the right skill sets and reduce risk through diversification of investment management style and asset class increasing the scope for more cautious investors.

During a particularly volatile week in global investment markets, it was interesting to note how some of our recently launched investment funds fared. Our International Corporate Bond fund returned a positive return of just over 1 per cent in the last month despite the nervousness in the

bond markets. Equally, our UK Absolute Return fund managed by Mark Lyttleton & Nick Osborne of Blackrock Investment Management has protected investors from the full brunt of recent falls in the equity markets, posting a minor loss in the short term of -0.8 per cent relative to the FTSE All Share which has fallen by -7.6 per cent (Source: Analytics). Both of these new funds are proving popular with investors and whilst past performance is no indication of future performance particularly in the short term, it is reassuring that they have withstood last week's testing market conditions.

Our diverse range of investment solutions is aimed at managing and reducing risk in uncertain times and generating attractive and sustainable real returns for investors over the medium to longer term. If you are interested in finding out more about our approach or the new investment funds we have recently launched, please do not hesitate to contact your St. James's Place Partner.

We are enduring uncertain times in the political and economic arena, but it remains important not to lose sight of the fact that against this backdrop a more encouraging picture is presented by the many individual company results that are beating analysts' expectations. Although it may take some time for the smoke to clear, there is a growing opinion that the global economy has turned the corner yet we need to remain vigilant in the face of increasing personal taxation and dramatic cuts in public spending. Close monitoring of our personal financial affairs is likely to be an important factor for the majority highlighting the importance of financial advice you can trust.