



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.

Pain in Spain

It was another tough week for global financial markets, which were rattled on Friday by a combination of weaker than expected US jobs data, European debt default fears and rumours of large derivative-related losses at French bank Société Générale. On the latter point, according to **The Times**, there was little evidence to support the speculation which was later rebuffed by the bank, but it reflected the particular nervousness of the markets at present. However, the news from the US was real enough. The Labor Department confirmed that 431,000 new jobs had been created in May, the fastest increase since 2000, but this was significantly tempered by news that 411,000 of those jobs represented the Government hiring temporary workers to carry out the 2010 census, leaving the net gain an unexpectedly modest 20,000. The unemployment rate edged down from 9.9% to 9.7%, underlining the slow pace of recovery. Quoted in the **Financial Times**, Paul Ashworth at Capital Economics said: "This is another timely reminder that, although the economic outlook is improving, the recovery is still pretty fragile."

The risk of contagion from the fiscal crisis in Greece to other areas of the eurozone and beyond continued to play most on investors' minds. Earlier in the week, markets became more concerned about the state of Spain's fiscal position, in part owing to the government's recent credit rating downgrade by Fitch from AAA to AA+. Adding to this were concerns about the ability of the government to tighten policy further to improve the public finances, given that the new austerity measures were only passed with a parliamentary majority of one, and ongoing worries about deflation and the potential for a worsening public debt to GDP ratio if the government is forced to implement costly measures to recapitalise the banking sector.

The final piece of news on Friday came from the new Hungarian centre-right government, sworn in less than a week ago. A spokesman for the prime minister said the economy was in a "very grave situation" due to the last government manipulating the data, but added that the government was "ready to avoid the path that Greece took...and will not hesitate to act." According to **The Times**, his comments followed a warning from the European Commission on Thursday that Hungary must cut its budget deficit faster. The Hungarian forint fell 5.3% against the euro over the week, but in turn the euro fell to a four-year low against the dollar.

By the end of the week the FTSE100 index had slipped -1.2%, whilst the S&P500 in the US was down -0.7%. Having negotiated the hurdles of debt fears in Spain and slowing growth in China, the FTSE Eurofirst 300 index finally succumbed to the Hungarian news and posted its first negative session of the week on Friday to leave the index broadly unchanged – down -0.01%. Asian markets were closed before any of Friday's events had a chance to undermine them and consequently many closed higher on the week. Tokyo's Nikkei 225 Average was up 1.4% as the yen slipped following the resignation of the Prime Minister Yukio Hatoyama.

Euro woes

The plight of the euro was taken up by **The Sunday Telegraph**, as it reported the results of its survey of 25 leading City economists. Confirming the old adage that if you put 10 economists in a room you'll get 11 different opinions, the responses to questions on economic growth, the budget deficit, inflation versus deflation and the future of the euro varied widely. Nearly half of those surveyed predicted that the euro would not survive in its current form this Parliamentary term, although opinion was further divided on how that might play out. Some felt Germany was the most likely country to leave, whilst others suggested the eurozone would lose three or four weaker members – Greece, Portugal and possibly Ireland. Views on interest rates were split equally between those forecasting a rise before the end of this year and those who believe the Bank of England will not raise rates until 2012. The one consensus was that Britain's economy is still finely balanced.

BP in the spotlight

The trials and tribulations of BP were a focus for much of the week. As **The Sunday Times** reported, the company's share price has collapsed 35% in the six weeks since the disastrous oil spill in the Gulf of Mexico began. Amidst much speculation over BP's future, the impact of the crisis on investors was analysed at length. Tony Hayward, the chief executive, did not rule out a cut in the dividend at a special conference for investors – a move that would hit UK investors hard given the scale of the company. BP paid £6.6bn in dividends last year – equal to £1 in every £6 paid to UK pension funds. However, most analysts agree BP can maintain its current payout, pointing out that it has \$15bn in cash and debt at its disposal and

generated \$30bn of cash flow in the last quarter. Iain Armstrong at Brewin Dolphin said: “BP has enough financial strength to deal with the clean up costs. We don’t believe the dividend is in danger.”

Although viewed by many brokers as a risky buy, private investors sought to take advantage of cheap-looking BP shares – T D Waterhouse said trading had doubled in the last week, with 80% of transactions being buys. BP is currently yielding 8.6% against an average of 3.7% for the FTSE 100 index and is trading on a price/earnings ratio of around seven compared to about 12 for the index. Hugh Sergeant of River & Mercantile made the point that it was rare for the share price of very large companies to fall out of bed in response to a one-off event and, as such, this could be a “once in a lifetime opportunity” for investors. “I suspect that longer-term investors are buying BP shares”, he said.

The Daily Telegraph also took a different tack and focused on the impact of the falling share price for investors in tracker funds. BP is the second largest constituent of the FTSE 100 behind HSBC and makes up 6.98% of the index, which means that any movement in its share price will have a big effect on the value of a FTSE tracker fund. When 46% of the index market value is made up by the ten largest stocks, the paper made the point that such a high concentration means such funds may not be as low risk as many investors perceive.

ImPrudent decision

Competing with BP for last week’s headlines was the Prudential. After last week’s collapse of its \$35.5bn (£24.5bn) deal for AIA, AIG’s Asian business, the Prudential’s annual general meeting on Monday promises to be a tempestuous affair, as the company faces a showdown with its shareholders. As **The Daily Telegraph** reported, the Pru confirmed it had terminated its agreement with AIG in a statement issued on Wednesday, after the US state-controlled company refused to cut the price of the deal to a revised \$30.4bn cash plus shares offer. Investors in the Pru had refused to back the deal at its original price and, perhaps unsurprisingly, are now holding chief executive Tidjane Thiam and other leading directors to account over the £450m in costs racked up despite the takeover’s failure. Robin Geffen of Neptune Asset Management commented: “This was ultimately a triumph of common sense and the investment management community standing up to fulfil their responsibilities to their investors.”

Despite calls for his resignation, Mr Thiam reportedly has the support of the Pru’s board and, indeed, as **The Sunday Times** revealed, is considering a resurrected bid for AIA before the end of the year. Combined with news that two of the Pru’s top 20 shareholders have demanded that the company break itself up and that three other large shareholders have voted against the pay packages offered to its executives, Monday’s meeting promises to be eventful.

Focus on fundamentals

Amongst those investors voting against the Prudential’s plans was Richard Peirson of AXA Framlington, who manages funds on behalf of St. James’s Place. Commenting a couple of weeks ago on the recent market volatility, Richard said: “The markets seem to be concentrating on a collection of problems rather than some of the positive news flow and stronger fundamentals for many companies – debt crisis, ash clouds, oil spills, BA strikes, Australian miners’ tax and tensions in Korea are seemingly at the forefront of investors’ minds. The challenge for fund managers right now is to decipher what macro news is just ‘noise’ which will blow over in time. With the current state of nervousness it doesn’t take much to move the markets, which I sense are being influenced by the actions of hedge funds and market timers, rather than long-term investors. The fact remains that the stocks I’m buying now are producing better than expected profits and the fundamentals are still there – they are good investments regardless of the short-term volatility. I have recently purchased Superdry, the manufacturers of the Superdry clothing brand, which floated at £5 per share and is now trading at £5.80 – just one example that shows the potential is out there. There remains a danger that we can talk ourselves into a double dip recession if investors continue to ignore the positive news flow.”

Safer havens

Recognising the likely continuation of volatility in financial markets, the **FT Weekend** put forward some suggestions for lower-risk holdings to counter the effects. Amongst those ideas were absolute return funds, of the sort recently launched by St. James’s Place, which aim to provide a smoother ride in different market conditions through a combined strategy of long and short share positions. The article went on to advocate the value of old-fashioned defensive stocks, which are less tied to the economy and offer higher yields relative to other sectors. Telecoms, utilities, pharmaceutical and tobacco companies are high on this list. Ted Scott of F&C Investment said: “Equities have suffered a big fall in the last month and some of these stocks are well-priced.” Neil Woodford of Invesco Perpetual, who manages funds on behalf of St. James’s Place, has been a long-term proponent of this more defensive strategy.