



Market Outlook – 14 May 2012

The past month has seen continued nervousness in equity markets and a flood of money into “safe haven” sovereign bonds of Germany, the US and the UK, where ten-year bond yields have hit new lows. The evolving crisis in the Eurozone is again the main influence on markets. The election of the socialist Francois Hollande in France and the chaotic outcome of the Greek elections were expected and probably discounted by equity markets. The fall of the Dutch Government over the proposed cutbacks and renewed concerns about Spain came as more of a surprise – the Spanish Government had to bail out Bankia, one of Spain’s largest banks, whose problems look like only the tip of the iceberg. It seems increasingly possible that Greece will have to leave the Eurozone, and the main losers would be the ECB and the IMF, but we remain concerned about collateral damage. Money would drain from exposed countries, particularly Portugal and Spain, and could destabilise the whole continent. This would be bound to affect the UK and could cause a short term shock to our markets.

Although Wall Street had a bad week on these European worries, and March employment data disappointed, the US recovery is probably still ‘on course’ and we expect US equity markets to firm up, which should help ours.

The UK stock market anyway looks cheap, offering a yield twice as high as on the ten-year gilt and a trailing PE ratio of 9.5. It has been a difficult month for Britain following the Budget shambles. Inflation ticked up slightly to 3.5%, mainly on higher fuel prices. The initial estimate of Q1 GDP came out at -0.2% despite survey evidence and employment data suggesting a slight rise. Retail sales were down over 3%, but the unremittingly wet and dismal weather was an explanatory factor. Finally, the Queen’s speech contained little sign of measures to stimulate the economy. The one good piece of news was the fall in the oil price (from \$125 a barrel to \$111 so far). Even without a shock from Europe, however this year seems unlikely now to show much growth.

For the moment, we continue to regard carefully selected equities and corporate bonds as the best investments. We remain underweight banks and financial services. Despite their recent poor performance, we hold good weightings in oil & gas and mining stocks, as investments in the still-growing world economy. Sectors such as beverages, chemicals, industrial engineering, telecoms, gas & water & multi-utilities and media remain in firm uptrends. The demise of Clinton Cards underlines the stresses in the UK retail sector, though even here there are winners like Next and Debenhams. Overall, we expect the FTSE-100 index to trade between 5,400 and 5,900 over the months ahead. Tactically we have increased weightings in corporate bond funds and are looking to add American exposure.

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