investment update

RECOVERY -
at a price

THE UK -
a global portal

BRIC -
the world’s 21st century driver

POSTCARD -
from Hong Kong

BERRY

RECOVERY BUT AT A PRICE

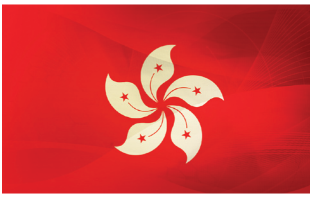
Global stockmarkets have made a powerful recovery in the past year, brought about by a steady rebuilding of confidence as investors' trust in economic recovery has strengthened. Only those investors who were fully committed to equities at the low point in March last year will have made substantial returns, but those same investors will also have seen some of the nastier falls during the crisis. We have traded some market upside for a more prudent approach to increasing exposure to equities and other asset classes as the recovery has unfolded, but the gains made over the past year have still been very encouraging.

As we know, the recovery has come at a big price: authorities are now faced with tackling huge debt mountains and run the risk of policy mistake on interest rates; political uncertainty in the UK is causing currency weakness; and rescue packages for countries such as Greece highlight some deep-seated structural issues in the eurozone. The difficulties ahead are not insurmountable, and there is every good reason to suggest that markets will continue to drive ahead in the near term, albeit at a less frenetic pace, particularly whilst monetary conditions are so accommodative and corporate recovery continues. But correct positioning is essential for the next phase of recovery.

Mark Robinson

MARCH 2010

GO WEST YOUNG MAN OR EAST

But it is overseas economies where we feel most excited longer term - given the UK and eurozone's problems, we have increased the exposure to US, Asia and emerging markets since last summer, a move that has worked well, and is a decision that is unlikely to be reversed in the short term. On the contrary, whilst emerging economies did not come through the crisis completely unscathed, it is now becoming clear that they suffered much less damage than most major developed economies, are still fully powered up and are not constrained by debt straitjackets.

Back in 2001, Goldman Sachs coined the acronym 'BRIC' to encapsulate the fast-growing economies of Brazil, Russia, India and China. A couple of years later Goldman produced an important and now widely-quoted analysis of how they saw the growth of these emerging economies altering the economic landscape by 2050. The numbers were quite scary: they suggested that China's economy could be as large as the US by 2041, India's larger than Japan by 2032 and that in combination the four BRIC economies might be larger than the whole of the G6 by 2039. Late last year Goldman updated their research to take account of the global financial crisis, with some findings equally as thought-provoking as those contained in their original research: China's economy is now expected to overtake the US a staggering fourteen years earlier than originally forecast, and the four BRICs could become as big as the G7 by 2032, some seven years earlier. These figures will undoubtedly be revised again and again judging by the superior growth rates in the emerging economies.

And it is not just the BRICs that lie at the heart of this overtaking manoeuvre – smaller economies such as Korea, Mexico, Indonesia, Vietnam and Turkey are all forces to be reckoned with and will undoubtedly play their own role in the shaping the future economic landscape.

The economic and financial crisis has generally been kinder to the world's emerging economies than it has to the developed ones, and the moment when China, for example, will be the largest global economy has been brought forward yet again. Today, we deliberately have the highest allocation to overseas stockmarkets and economies than we have had for many years, and if the present trend in the ascendency of the BRICs and other emerging economies is anything to go by, then it is quite possible that our clients' portfolios will have morphed still further in another five years or so to reflect this seismic shift in global demand and economic activity. Heightened currency and political risk tend to come with the territory of investment in emerging economies, but then again we are not without these problems in the UK at present. We tend to think of countries such as China taking market share from the West. This is partly true, but the real powerhouse of growth will undoubtedly come internally from the domestic demand for items such as cars, white goods, mobile phones and, ultimately, luxury goods.

POSTCARD FROM HONG KONG

In the next section, Jamie Berry expands upon the growth story that is China. He recently visited Hong Kong to meet local fund managers and clients, and here he presents his thoughts.

While the West has been busy saving its banks and other important financial institutions, China has been quite busy too. As the Chinese reach the end of their eleventh 5 year plan, it is a salutary tale for the West to consider some of the things that they have been up to in the last few years.

By the end of this year, 186 new airports will have been constructed, at a cost of about $18bn. By the end of their next 5 year plan in 2015, this will have increased to about 260. They've also just laid a whopping 19,000 miles of new railway line, much of it for an inter city high speed link between about 40 cities. The trains will travel at 220 mph – that's a bit faster than Japan's Bullet or France's TGV, and embarrassingly quicker than anything in the UK or the USA. The extraordinary scale of what is going on, and the speed in which it takes place, simply cannot be underestimated.

In all of this, Hong Kong seems under pressure to remain relevant against a backdrop of a booming mainland economy and Shanghai snapping at its heels. As I was told on more than occasion: "this is increasingly just another Chinese city". If this is truly the case, then it seems likely that, given time, Shanghai will eclipse Hong Kong as China's true financial capital. What is also apparent is the number of mainland Chinese in Britain's former pride and glory, now twelve years into its new ownership. You used to be able to spot them as the ones in cheap blue suits and plastic shoes. Not any more: they're the immaculately dressed businessmen in expensive restaurants ordering 100 year old cognac. (It ran out in mainland China in 2009).

So where does this leave investors? Headlines daily talk of asset price bubbles, and there can be little doubt that the property market in cities like Shanghai and Hong Kong is overblown, although it has to be said that it has not been fuelled by debt in the manner of the Western property markets. In stockmarket terms, it is fair to say that we are at the cab driver stage: taxi drivers are tuned into financial news-stations and are active market participants. It's rare when this is anything other than a bad sign. Cynics and contrarians might also suggest that the advent of a new China Investment Trust is the last straw, although if anyone can pick good long term value shares, Anthony Bolton can. The problem that he – and his shareholders – may face is that the link between China's undoubtedly astonishing economic miracle and the stockmarket itself is, at best, tenuous. The links in all markets between economic reality and market levels can be a little shaky, but nowhere more so than in Asia.

That said, this is a not a region to bet against. Canny long term investors with the appetite for risk must remain committed. And anyway, sometimes roller coasters can be fun.

29 MARCH 2010

THE FTSE 100

One area of interest is the international opportunity within our domestic stockmarket, where there are companies with solid balance sheets, healthy dividends and a stream of overseas earnings that can provide the appropriate diversification away from our flagging domestic economy and currency.

Over 75% of the FTSE 100's revenues now come from overseas, helped by international diversification by major companies such as Vodafone and BP, but also through relative newcomers to this Index - Aggreko, Fresnillo, Inmarsat, Intertek, Kazakhmys, Petrofac and Vedanta may be unfamiliar names to many, but they are amongst the leading 100 'UK' companies and are representative of the truly global marketplace that we now have at our fingertips. They are also accessible via blue chip equity funds, many with handsome dividend yields.

A global stockmarket?

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