BERRY

ASSET MANAGEMENT

Investment Update

Autumn 2010

Avoiding the frost

The holidays are over

No sitting on the fence

China syndrome

The holidays are over

Having experienced several summers on the trot when equity markets have seen some significant weakness, it has been refreshing to return from holiday in the knowledge that hard-fought gains have not been eroded away. Global stockmarkets have just enjoyed one of the best quarters on record, recovering most of the lost ground seen earlier in the year. Bond markets have also staged a further recovery. Historically, the summer market season has seen some heavy clouds cross its path, most noticeably in the past few years, and this summer has been no different. Yet it is encouraging to see that markets have coped remarkably well with a barrage of ever-changing and often conflicting economic news. The lack of interest in cash and from cash may have something to do with this fundamental market support, but whatever the reason, it has been most welcome.

Mark Robinson
Director
Head of Investment

Before Autumn really sets in, let's stay with the holiday theme for a moment: the often repetitive whining of "are we nearly there yet?" from the back seat of a typical family holiday car journey can be compared to the economic question of whether we are any closer to seeing a sustained rebound in activity. In recent months, many column inches of the global press have been devoted to the question of whether the current deceleration in economic activity is anything to be really concerned about, potentially leading to a so-called double-dip recession, or whether it is a typical pattern on any road to recovery. Markets are still very much divided as to the correct answer – truthfully, nobody really knows. On the one hand a raft of data emanating from the US suggests all is not well but on the other hand forward looking company statements, results and business sentiment point to a corporate backdrop that is not only coping quite well now, but is expected to continue to do quite well in the future, despite a tough consumer backdrop.

Mark Robinson

No sitting on the fence

So where are we in this great debate? On balance, we are in the camp that the current weakness in economic revival will be short-lived, and that whilst activity will remain quite weak there will be sufficient momentum for us not to retreat into a deflationary spiral. This economic rebound may have been weaker than other post-recession periods due to several one-off stimulative measures, such as the initial rebuilding of stock inventories, the massive monetary and fiscal stimuli and the associated revival in the availability of finance.

It is therefore quite realistic to expect the wider economy to take a breather, but we should not forget that the current accommodative policy measures are very supportive to both businesses and consumers. Ultimately, we believe that inflationary pressures, brought about by the current stimulus, will build rather than dissipate, particularly when one adds in things like a hike in VAT and food inflation, which is a real threat due to huge rises this year in agricultural commodity prices. The effective printing of more money through additional quantitative easing will also, in our view, ultimately evolve into inflationary rather than deflationary pressures. For these reasons we have introduced some time ago into portfolios a significant commitment to index linked government securities and, where appropriate, exchange-traded physical gold investments.

China syndrome

China's influence on the global economy is not only complex but gathering momentum by the day.

Having broad exposure to developing Asian and other emerging markets remains an important component of our asset allocation framework since in our minds it is these areas which will continue to drive global economic growth. Conversely, we have had little or no exposure to another major trading bloc, continental Europe, for some time, a stance which has generally proved to be correct, particularly given the problems in the peripheral eurozone countries. However, the eurozone has been repairing its financial framework and some countries do offer more appeal than a year or so ago based on economic fundamentals and valuation. Germany's finances, for example, appear to be in much better shape than many other developed economies, and its stockmarket, along with other core eurozone countries, appears attractive on valuation grounds. We are monitoring the situation, but for the moment are inclined not to invest until the contagion from weaker eurozone members reduces.

So where next for share prices?

Against a backdrop of sluggish growth and persistent conjecture about double-dip recession, it will probably be difficult for stockmarkets to remain on a steady trajectory and deliver as strong a period of performance in the final months of 2010 as they have done in the third quarter.

More likely is a rangebound phase for markets, but punctuated by bouts of both nervousness and optimism as the relentless stream of daily and weekly data focuses minds on the shorter rather than longer term. Constantly reviewing longer term implications, rather than being swayed too much by individual short term events or news, is an investment discipline that can be hard to keep in focus, particularly now that information is on our desktops in an instant. But keeping slightly longer term trends in our sights is what we must continue to do, otherwise we run the risk of being whip-sawed by the week-by-week changes in market mood and daily market noise.

On balance, we continue to view bouts of market weakness as providing buying opportunities as they have done on several occasions this year.

The hunt for income

Not only is dividend income from equities attractive relative to bond and cash yields, it also gives real scope for an increase in income where the alternatives do not. For example, a whole host of UK market heavyweights, such as Vodafone, HSBC and GlaxoSmithKline should be capable of increasing their dividends by anything between 5% and 15% next year, whilst the resumption in payments by former market-leader, BP, which suspended its dividend in the wake of the Deepwater Horizon disaster, could further enrich the dividend scene.

Whilst investing in solid, income-generating companies might have become quite a fashionable trade given the lack of opportunities elsewhere, we believe that it is one built on solid foundations – shares might be more risky than bonds or cash, but progressive dividend policies should be seen as a reflection of financial strength and profitability within any business and one of the most fundamental and important characteristics around which a share price is both created and built over the longer term. Furthermore, in a financial world that still remains quite troubled, then securing at least some positive return in the form of a healthy dividend income seems highly appropriate.

"A whole host of UK market heavyweights should be capable of increasing their dividends next year"

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