

DEC
Dec 2009

the **View**

A **Thesis Asset Management** view of the market



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Michael Lally

'Bankers' genes were Wall St. genes... If the banks were conservative now (1955) it was because bankers still awoke in the middle of the night, trembling and sweaty with thoughts of the Crash. But in time a new generation would take over: ambitious, over competitive young men to whom 1929 would be merely a date on a page; such men would sever the roots of memory as with an axe, not realising that those tendrils were also the rudder cables.'

Michael Thomas

The above quote is, I believe, as fresh today as when it was written 22 years ago. A salutary reminder, if needed, that whilst history changes the propensity of man to invent ever more ingenious ways to lose money never does. No doubt politicians will, temporarily, take away some of the bad boys' toys but, amidst the subsequent tantrums, and uncomfortable realisation of their potential contribution to economic recovery, then once again all will be forgiven (if not forgotten).

Many comparisons were made earlier this year with the Great Depression of the 1930's. In terms of debt then we in the UK can certainly show our American cousins how to really go to town. UK Government debt could peak at around 80% of Gross Domestic Product (GDP) which compares with just 6.4% in the US in 1934! Fortunately, this time round the Bank of England has so far resisted the temptation - at the first sign of the green shoots of recovery - to tighten policy too soon. Let us all hope that they fully appreciate the fragility of the current recovery and the importance of rebuilding tax revenues (particularly corporate) - the Americans didn't and whilst the stockmarket did rally strongly for a time, the economy then fell back into recession again in 1937.

Over the next few months expect the words austerity, tightening of purse-strings, fiscal prudence and expenditure deferment to regularly pass across politicians' lips. Do not expect any mea culpa for the rising rate of unemployment (blame that one on the bankers). Or three cheers for the private sector (Premiership footballers and WAGs excepted), as evidenced by a higher savings ratio, cut back in spending and reduction in personal debt.

And now for some good news. Most corporate balance sheets are in good shape, as companies (outside the financial sector) have resisted the temptation to

overspend, hence profits have grown faster than GDP. More importantly stockmarkets, as mentioned earlier this year, have facilitated a record amount of capital raising, both in terms of equity and bond issuance. There have also been a growing number of hostile bids (as opposed to the usual friendly mergers common in economic slowdowns).

This can of course partly be attributed to the influence of the key emerging economies - hence our continued overweight (but not recklessly so) exposure to these areas. We have also recently initiated weightings in emerging market debt (ie. both local and international) given the more favourable debt to GDP ratios and greater propensity for increased domestic consumption.

And finally, as the festive season approaches, I couldn't sign off the year without reference to the important Christmas Price Index, courtesy of those clever fellows at PNC Financial Services Group in Pittsburgh. Thought up originally by the bank's chief economist, the index actually is an uncannily accurate representation of the health of the US service sector.

The cost of buying all 12 items in the Christmas song increased by 1% to \$87,402.81.

- Biggest contributor was the five golden rings, up 43% thanks to the strength of the price of gold
- The largest individual riser was, however, the French hens, up 50% to \$45 for three. This compared with a meagre 2% rise in the cost of 2 turtle doves
- But not all good news on the poultry front, partridge prices fell by a half (but offset by a 25% rise in the cost of the pear tree), 6 geese-a-laying cost 37% less whilst the price of 7 swans-a-swimming was only 6% higher
- Thanks either to line dancing mania or America's Got Talent, the cost of 9 ladies dancing leapt 15%
- The high unemployment rate impacted on the costs of 10 lords-a-leaping, 11 pipers piping and 12 drummers drumming - all unchanged on last year
- But an increase in the federal minimum wage pushed the cost of 8 maids-a-milking (ie. the only unskilled labourers) up by 11%.

One surprising statistic is that the cost of buying all the items mentioned in the song from on line retailers was considerably higher than offline. Apparently something to do with shipping costs for all those birds!

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Giles Marriage

Markets

Indices	Value as at 30/11/09	% Change on Month	% Change 2009 year to date	% Change on 12 Months
FTSE 100 Share	5190.68	2.90%	17.06%	21.05%
FTSE All Share	2648.43	2.47%	19.88%	24.11%
Dow Jones	10344.80	6.51%	17.87%	17.17%
DJ Euro Stoxx 50 €	2797.25	1.96%	14.10%	15.10%
Nikkei 225	9345.55	-6.87%	5.49%	9.79%
FTSE A British Government All Stocks	156.32	-0.10%	-2.80%	2.19%

'Dubai Sheikhs'

There was a young man from Dubai who liked to build skyscrapers high he got in a pickle borrowing many a nickel dreaming of pie in the sky.

Dubai's ruler Sheikh Mohammed said of the crisis, "It is the fruit-bearing tree that becomes the target of (stone) throwers. What about someone who has seven fruit trees? It's normal for us to be facing this campaign and this exaggerated media noise." Whilst I didn't quite grasp his point, the market's reaction did seem a bit bananas!

Whilst \$80 billion of debt is clearly not small beer, it pales into insignificance when we consider the outstanding Public Debt of the United States, which currently stands at \$12,097,517,752,067. The estimated population of the USA is 307,405,875; therefore each citizen's share is effectively \$39,354. However, my estimated comparison puts Dubai's at some \$6,666 per citizen. I daren't work out the figures for good old Blighty; after all it's close to Christmas and not a time to feel sorry for ourselves!

Whilst the media unfairly trumpeted that insuring Dubai's sovereign debt could cost almost as much as insuring Iceland's, based on the above stats, Sheikh Mohammed seemed to have made a fair point. Although, with

minimal oil revenues, the Emirates' reliance on finance and a tottering property sector make it more exposed to economic perils than its less ostentatious Gulf peers, Dubai is certainly here to stay. It is now arguably the 'Hong Kong' of the Middle East, acting as an international gateway to the Arab world, which for all its recent woes does not seem to have been built entirely on sand...

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UK banks wobbled on the back of Middle East woes, **HSBC** the biggest bank in the region, has \$16 billion of loans outstanding there, although this only represents 2% of their total book. **Standard Chartered**, with \$12 billion of debt, appeared to be slightly more at risk, as this represented 10% of its loans. **RBS** and **Barclays** also came under pressure, given their regional exposures.

Water companies' warnings of dividend cuts, job losses and lower capital spending appear to have paid off, after the regulator scaled back its requests for cuts to customer bills. OFWAT ruled that the companies should on average lower bills by £3 over the next five years, retreating from initial demands last July that prices should be £14 lower.

National Grid's first half results are up on last year (+16%), primarily due to lower interest charges as some 20% of the Group's debt is variable. Current

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performance remains in line with management expectations. Credit ratings are stable and their net debt is down to £693 million.

Premier Oil's interims were guided downwards marginally on 2009 production, although the medium term target remains intact for 2011/2012. Good performance from Indonesian and Pakistani gas fields has been offset by maintenance downtime at UK fields.

Reed Elsevier's trading update showed that the trends in the first half of the year have broadly continued in the second half. The major professional markets, accounting for the majority of their business, are proving more resilient than most, but are not immune from late cycle pressures given the subscription nature of much of this revenue. Advertising and promotion markets remain particularly exposed to the global recession.

Electra Investment Trust, which specialises in private equity investments, delivered better figures on the back of improving markets. Net Asset Value grew by +13.8% in the second half, driven mainly by the listed stocks portfolio, rather than aggressive mark-ups on the unlisted positions, with the latter only increasing by 4%. The fund appears to be in good shape and with net cash on the balance sheet, the trust's well placed to take advantage of opportunities.

Kingfisher took a buzz saw to analysts' forecasts by delivering excellent third-quarter profits. Europe's biggest home improvement retailer, which operates the B&Q chain of DIY stores, saw a steady improvement in sales in the UK over the past year as people do up their homes instead of selling them in the property slump. It has also cut costs across its international operations, helping to lift profits substantially.

Compass group expects to return to like-for-like sales growth in 2011 and is targeting a further 200 basis points of margin improvement over the medium term. Chief Executive, Richard Cousins, said he expects organic sales, which strip out currency and acquisitions, to return to growth in 2011 after a flat 2010, and by 2012 organic sales will have returned to the trend of around +6% growth seen prior to the downturn.

Majestic Wine posted a 9% rise in first-half pre-tax profit, as sales to the public offset weaker demand from business customers. The retailer said its move to reduce the minimum purchase in store to six bottles from 12 has led to 'encouraging' results since it was introduced in September, adding that while the average spend per transaction is down -1.5% at £133, there has been an increase in transaction volumes.

Elsewhere, American cable company **Comcast** agreed to buy a majority stake in **NBC Universal** from **General Electric**. Meanwhile, **Bank of America** decided it was time to fly the governmental nest, stating that it would repay its \$45 billion bailout cash and issue \$20.5 billion in new stock. Haven't we heard this somewhere else closer to home?

Happy Christmas and "may the force be with you" in 2010.



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