

OurView



Michael Lally

"...Europe had arrived at a point at which every country except Germany was afraid of the present, and Germany was afraid of the future".

First Viscount Edward Grey, House of Lords, 1924

The exodus of investors from European stock markets this year is uncomfortably reminiscent of the Battle of Dunkirk (or Dunkerque to give it the French name) 70 years ago. In both cases participants were cutting their losses and looking for a successful exit strategy at a time when the future looked distinctly uncertain.

There is also another more compelling parallel, ie. the battle started on the 25 May and finished on the 3 June. European equity markets this year hit rock bottom on the 25 May, having fallen by a quarter since January and then rallied to temporarily peak on - you guessed it - the 3 June. The war itself would of course take another four years before victory was finally achieved but the enforced hardship was by no means over, as this was to be followed by an extended period of austerity with low interest rates.

Not dissimilar, one could argue, to the current scenario? There is however one important difference. Unlike the 1940's (when only armaments manufacturers prospered) corporate Europe now - with the exception of banks - is in reasonably robust health with strong balance sheets and profit margins. Partly this reflects enforced efficiencies over the last few years, but more recently the beneficial effects of low interest rates and a weak currency. Whilst the likes of Greece, Portugal and Spain have borne the brunt of austerity measures, in Germany, in particular the manufacturing sector has prospered. Perhaps that accounts for their 'enthusiasm' for the recent rescue plan. After all, if the walking wounded are thrown to the wolves, the euro would most likely rise significantly.

A couple of months ago I intimated that, whilst we remained bearish on the currency, we were monitoring the equity markets closely for a suitably attractive opportunity to initiate an increase from our current negligible exposure. Contrary to perceived opinion stock markets do not follow general economic trends and waiting for any such correlation is akin to England's progress in the South Africa World Cup - ie. largely pointless.

Blue chips have been hit hardest, partly because they are the most liquid and therefore have had a higher percentage of overseas investors. However, Europe also includes; for example, some of the top international names in the fashion, healthcare and luxury brands markets, something which won't be overlooked by the growing middle classes in the fast growing emerging economies such as China, India and in Latin America. A weak currency is also a catalyst for consolidation (eg. overseas predators) and whilst there will certainly be plenty of casualties in Europe; the stronger international companies are well positioned to leverage off their healthier balance sheets.

As in the UK, the full impact of lower consumer spending (higher savings) over the next few years is still uncertain, but in some sectors markets are already pricing in a worst case scenario. Whilst the focus remains on emerging markets then this disparity may continue for some time, but at some stage there will have to be a reality check and as in previous bear markets, the initial bounce will be fairly quick and dramatic. Hence, as Buzz Aldrin might have said, 'we are looking for a safe opportunity for re-entry'!

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News



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Markets

Indices	Value as at 30/06/10	% Change on Month	% Change 2010 year to date	% Change on 12 Months
FTSE 100 Share	4916.87	-5.23%	-9.16%	15.71%
FTSE All Share	2543.47	-4.85%	-7.87%	17.10%
Dow Jones	9774.02	-3.58%	-6.27%	15.71%
DJ Euro Stoxx 50 €	2573.32	-1.42%	-13.25%	7.15%
Nikkei 225	9382.64	-3.95%	-11.04%	-5.78%
FTSE A British Government All Stocks	157.44	1.50%	3.49%	2.25%

Happy days

A miserable month for English football fans and equity investors alike, but Osborne's emergency budget has thankfully boosted Gilts and Sterling, just in time for us all to go on our summer holidays. Gilts could still effectively enjoy further rises for technical reasons, but the UK stockmarket is certainly now looking attractively valued. However, progress will only occur once investors relax about the Eurozone crisis and confidence starts to improve again. The issues within the Eurozone are extremely unlikely to be resolved anytime soon and indeed it may take the politicians at least five years to agree the way forward. The fact is that Germany and Greece are like 'chalk and cheese' that cannot be shared on the same platter - something will need to give eventually. In the meantime, the emergence of a global economic recovery will continue to a greater or lesser extent in different parts of the world. A double-dip cannot be completely discounted, but it certainly looks well priced into markets. If the US, China and others prove resilient and conditions continue to improve gradually, markets should be able to make progress again, but this gradual process may take until the autumn.

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It is worth noting that the recent budget is the most radical since WWII in terms of cutbacks, with reductions for most Government departments of 25% by 2014-15. The Chancellor also raised the rate of value added tax from next January to 20% and imposed a £2 billion levy

on banks, but neither retail nor bank shares reacted overtly to this news.

Barack's unrelenting rhetoric has finally led to BP suspending its dividend to shareholders while the leak continues. Interestingly, local media in Florida is viewing BP's clean-up efforts as being far greater than those of the Federal Government. The setting up of a \$20 billion fund to pay for damage claims is clearly immense and the company also said it planned to sell about \$10 billion in assets over the next 12 months to raise cash. It did not disclose what it would be selling, but since then potential investors have been queuing up, not just for these assets but reportedly for the whole company. Taking a longer term view and a plugged well, the shares should recover in time. Anglophiles everywhere are perishing the thought of a foreign takeover.

My Ozzie mates have reported 'that there's a new Welsh Sheila in charge down under', which believe it or not, is good news for mining stocks such as **BHP Billiton**, **Rio Tinto** and **Xstrata**. The new Prime Minister has already reached a compromise on the mining tax which cost her predecessor his job. The rate at which mining companies will be taxed on profits in Australia will now be 30%, rather than the 40% originally planned. While it will still be based on their profits it will only kick in after they have achieved an annual return of 12%, rather than the 6% originally suggested. The cost of extraction will also be deductible from profits by as much as 25%.

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News



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British Airways has struck a deal to plug the £3.7 billion hole in its two pension schemes, which will restrict it from making any dividend payments to its new parent company. Meanwhile, the fight with the union continues as the 'Brutish Airways' campaign refuses to go away. Elsewhere, **BT Group** union members are threatening to strike over pension issues. **BAA** said that the effects of the volcanic ash cloud, strikes by British Airways cabin crew and the bad winter weather had hit its full-year revenues by more than £40 million - ouch!

Asset sales and debt repayment strategies remain in fashion as **Tate & Lyle** has announced a deal to sell its sugar business to **American Sugar Refining** for £211 million in cash. The group said the proceeds of the deal, which was widely expected, would be used to reduce its net debt levels and the company would be 'more focused and less volatile' as a result of the sale. Tate & Lyle's sugar business consists of refineries in the UK and Portugal, as well as the Golden Syrup factory in London. **Wolesley** is reportedly looking at similar strategy for **Brandon Hire**, which it only acquired in 2006.

Jupiter, the fund management company added £116 million to its market value on its first day of trading on the London Stock Exchange as the shares closed up 15%. The group, which was last listed in 1995, began trading at its IPO price of 165p, but closed at 190.5p in what was reported to be the largest first day rise on the main London index since December 2007.

In a case of 'better the devil you know', **Schroders** reported that it had acquired a 49% stake in **RWC Partners**; a month after two of its top performing fund managers announced they would join the boutique hedge fund manager! Fund managers Nick Purves and Ian Lance - who ran the £1.5 billion Schroder Income fund - will join RWC in August to run a similar fund and have been made partners. RWC's chief executive, Peter Harrison, said the two managers were not told about the acquisition talks until they had come on board, but were then given the option of torpedoing the deal!!

Lloyds TSB has announced 650 UK job cuts. Insurance and back office-based staff in Nottingham and Chester

look set to be hit hardest. It will also close its network of **Halifax** branded agencies, largely based in solicitors and estate agencies, as they are 'no longer integral to its business model'. This will hit more workers who are not employed directly by Lloyds. Unions said 1,850 jobs would be affected. The group is also coming under pressure to sell its **Scottish Widows** business, which could fetch £7 billion and help them with the new capital adequacy requirements being drawn up by the Basel Committee - nothing to do with Mr Brush apparently, boom, boom!

Barclays is set to hire dozens of bankers in Russia as it seeks to become the leading foreign investment bank in two to three years. Bob Foresman, the bank's country manager said, 'We will need to have over 100 people just in the broker-dealership.' The former local chairman for **Dresdner Kleinwort Wasserstein** added that he is overseeing 'a very aggressive strategy' in Russia. *Vodka's all round then.*

House prices rose just 0.1% in June, a much slower pace than previous months, figures from **Nationwide** showed. These numbers echo other house price surveys, such as **Halifax's**, which have shown the housing market recovery stalling. The slowdown is in part due to the increasing amount of property coming to the market which is not being matched by demand. The building society had reported growth of 0.5% the previous month and 1% before that. Halfway through the year, prices have grown a total of 3%.

In a round-up of various other stories, **Resolution** has clinched its £2.75 billion deal to buy most of **Axa's** UK life assurance operations. **Ocado**, the online grocery delivery service, aims to raise £400 million at flotation, although the company has yet to make a profit. **Diageo**, the world's biggest drinks company, has raised £174 million through a sale and leaseback of some of its land and facilities in Napa Valley, California. Finally, **Network Rail** bosses are coming under fire for taking £2 million bonuses and with some 600,000 public sector jobs forecast to be lost by 2016 - the question must surely be who to fire first?!

Enjoy the summer while it lasts and of course the rest of World Cup...

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the View

A Thesis Asset Management view of the market



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