

INVESTMENT NOTE

May 2010

Sell in May and Go Away?

Not this year!

The Greek debt crisis is unfolding with predictable contagion to the Stock and Bond markets of the other three horsemen which we highlighted in our February Investment Note *"Spain, Greece, Italy and Portugal – The Four Horsemen of the Apocalypse?"*. The uncertainty has now spread to global stock markets and the familiar headline currently doing the rounds is "Sell in May and go away", the full version of which adds "stay away till St. Leger Day". However, we do not hold with this view in the current environment and we believe this will be a relatively short term correction in a market looking for a catalyst to take some profits. Equities have come a long way in 12 months and it is worth remembering that some market commentators were calling the top, based on valuations, back in September 2009.



The exposure of Greece as a weak link in Euro land was an accident waiting to happen but the European Central Bank (ECB) and European politicians have been predictably slow in getting to grips with the situation. This has frustrated financial markets, which demanded a credible response to go beyond verbose statements and imaginary financial lines in the sand. The situation is too fragile to stand up to a market determined to force the issue one way or the other.

Indecision since February, when the European Council first started mulling a rescue package, has allowed an already serious situation to escalate and actually make a Greek Government Debt default more likely. Greek yields started rising dramatically in response to internal squabbling, whilst politicians attempted the impossible task of coming up with a solution to keep everyone happy. The enhanced rescue package, now it has finally emerged, is EUR 110 billion in loans out to 2014. This is not the end of the story and major changes required to the running of the economy, well documented in the media, are not a foregone conclusion in the face of increasingly violent public demonstrations. The Greek Prime Minister, George Papandreou, will need to demonstrate decisive leadership to avoid on-going political and social conflict.

With this as a catalyst, stock markets have fallen swiftly in the last few sessions and we believe the sell-off in equities presents us with a buying opportunity, as predicted in our Investment Note *"Outlook for 2010 – A Year of Specific Opportunities"*. We see this as a short-term opportunity to achieve our long-term goal.

Macroeconomic indicators confirm, as we had anticipated, an underlying recovery in the US, UK (notwithstanding the imminent General Election result) and even Europe and we believe the risks of a global double dip recession are fading. Within Equities, we maintain our bias for non-UK and European investments and, as we have highlighted repeatedly, believe that we are right to stick with our exposure to Corporate Bonds in preference to Gilts within the UK and even overseas in relation to sovereign debt.

We believe that the short-term pull back in Equity valuations provides catalysts for rotation out of our more marginal tactical asset allocations and to bring our core exposures further in line with our strategic allocation models, thereby consolidating some good solid out-performance for our Cautious and Balanced asset investors. A clear example of this is increasing our core UK Equity allocation at a time when the FTSE 100 is hovering around the 5,300 level, a nine percent discount to its recent highs and, as opportunity allows, reducing our exposure to the Japanese markets, at a time when the Nikkei up is up over fifteen percent since its low this year (despite the post-holiday falls recorded today).

We remain committed to our China, Asian (ex Japan) and Latin American positions which offer exposure to economies that have remained relatively less affected by the recession that swept the Western economies and significantly are demonstrating levels of economic growth far in excess of those in Europe.

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A major theme within our portfolios is to continue to hold US exposure. We expect the recovery in the world's largest economy to maintain its momentum, albeit at a more sustained pace than we have witnessed in the last two quarters. The recently released Institute for Supply Management's Index of Non-manufacturing Businesses (which surprisingly make up over ninety percent of the US economy) remained at a four-year high for a second month and indicated further expansion in activity. Add to this, an unexpected rise in hired workers last month; a massive plunge in job-cuts and the highest growth in consumer purchases in five months and this reinforces our conviction of underlying recovery. Indeed, with corporate earnings (and more telling revenues) beating all but the most optimistic forecasts in the first quarter and GDP growth up to 3.2% in the same period (driven particularly by the pick-up in consumer confidence and thus spending) further emphasises the point.

In summary, we anticipate the underlying economic fundamentals to reassert themselves as soon as attention re-focuses from General Elections, oil spills and the reality of the "European miracle". Any short-term weakness offers us opportunity to consolidate gains and re-balance our tactical allocations before we enter the summer months. To "Sell in May and Go Away" could, therefore, be equally as wrong in 2010 as it was in 2009.

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