AUGUST 2010

SHARING OUR KNOWLEDGE WITH YOU
AND KEEPING YOU UP TO DATE

simple INVESTMENTS

THE SCOTT REPORT

Nimble Punters Thriving amidst Utopian type Volatility

"The first rule is not to lose. The second rule is not to forget the first rule".
Warren Buffett.

Current Overview

The market has bounced in the region of 8.5% as I write since early July when investor apprehension was high relating to the possibility of the economy slipping back into recession. Concerns in this regard remain and there is much division in the City regarding short term market direction. Macro economic data suggests the US recovery is fragile at best with current unemployment and housing updates providing some alarm. Global growth levels in general are at risk. At the company specific level, UK and US first half earnings reports have been solid in the main and have supported the recent push higher in the index. The up move again seems to both demonstrate and vindicate the validity of buying the market when nervousness abounds by going against the herd. Some robust profits of recent have been achieved as a result of putting some money to work 6 to 7 weeks ago.

We would appear to be operating in a market dynamic where there is bottom-up (stockpicking value) investment attraction to a number of companies. However, this is to an extent being overshadowed by a weakening top-down, generalist macro landscape. It seems probable that until the macro picture improves, significant upside in stock prices will be limited. That said with interest rates set to stay low, capital flows into high yielding stocks will continue in my opinion.

Many economists and strategists believe central banks are going to have to be willing to expand stimulus further to assist in the support of potentially weakening conditions. The US Fed is already implementing additional measures by reinvesting the proceeds of maturing mortgage backed securities. It might be that the BOE will need to increase QE, so watch this space for 'QE2'.

Trading volumes are exceptionally thin and although markets are volatile, conviction lacks. I wonder if a market test of some significance looms for the early autumn. Certainly the October spending review is a big date in the trader's diary. I expect to see a big increase in dealing volumes and company newsflow at this time. Unpredictability persists and it was interesting to note that one of the market legends of this generation, Stanley Druckenmiller has just announced his retirement having struggled frustratingly to make any real returns over the past 3 years.

I believe market volatility will remain for the foreseeable future and there has been some recent debate regarding the applicability of the 'buy and hold' approach. Investors who bought the market back in 1999/2000 time would most probably still be down on their starting sum. People talk of the lost decade in the markets and the possibility of a Japan style protracted period of market doldrums. I happen to believe that the next 10 years will show equities to be the best performing asset class for investors. Shorter term, staying both selective and active I suggest is the way to play things.

A bubble in bonds? A current debate.

It is natural that during times of uncertainty investors often seek out what they believe to be the safe havens including fixed interest stocks. These might include Gilts and corporate bonds which in my mind are now overowned. My suspicion is that now is not really the time to buying here, infact I have recently been encashing and taking profits in this area. There has been a powerful appreciation in the pricing of these assets over the past 18 months or so providing an opportunity for taking excellent gains (not to mention the income return that will have been received during the investment period). As and when the interest rate cycle does turn and inflation perhaps becomes a real problem, I see this asset class as a likely underperformer going forward. I see equities as a better place to be in this scenario. I must stress however that on an asset allocation basis, there always remains the argument to have funds spread around and a fixed interest component (to a sizeable portfolio) should most probably still be in place.

The return of M&A activity

An interesting development of recent has been an increase in the level of corporate activity which could be interpreted as a bullish. RSA is weighing up buying Aviva's general insurance business and BHP Billiton is eyeing Potash Corp for a takeover. The insurance sector looks ripe for further activity in a market where there are possibly too many players. We know Resolution will undoubtedly remain active in this regard. Consolidation in the mining space also seems likely for the same reasons.

This report was written by Philip Scott - Head of Advisory Stockbroking at Simple Investments on 24th August 2010 when the FTSE 100 was trading at 5200 (contact: philip@simple-investments.co.uk). The writer does not hold a position in any equities mentioned above, although his clients may.