

# Trader Talk

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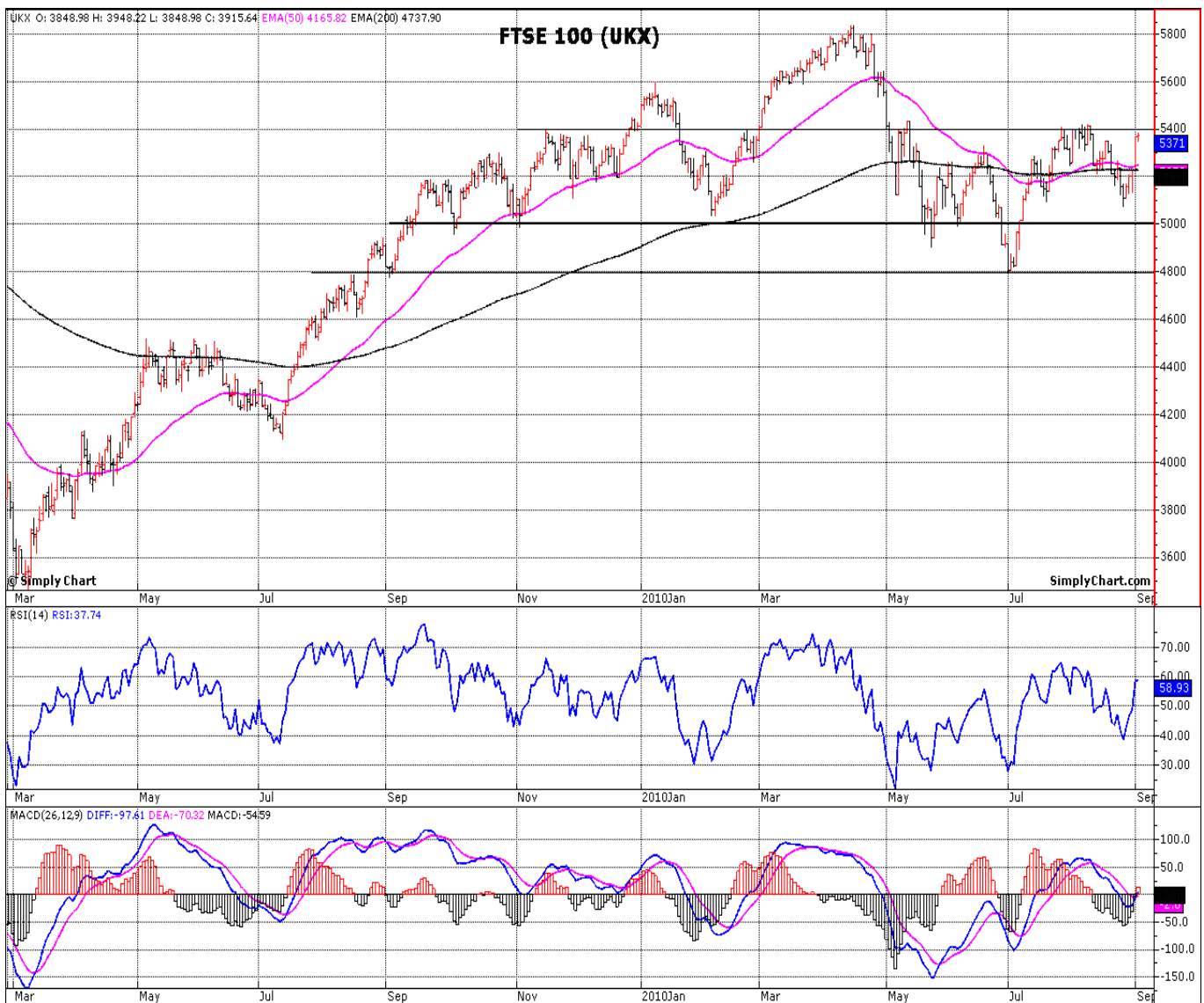


Chart source – Simply Charts 03.09.2010

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Equities had a muted start to the week following a public holiday in the UK, but a bout of encouraging global economic data provided a rare glimmer of optimism amid the relentless tide of negative sentiment regarding a possible double-dip recession.

At last week's annual gathering of central bankers in Jackson Hole, Ben Bernanke, chairman of the Federal Reserve said "pre-conditions for a pickup in growth in 2011 appear to remain in place", but emphasized that the central bank was prepared to intervene should the economy experience a sharp deterioration.

Investors in Asia also drew solace from the new measures unveiled by the Bank of Japan. The BoJ announced an extra ¥10,000 billion in six month financing and the government outlined a ¥920 billion package of stimulus measures.\*

Encouraging manufacturing reports from around the world helped revive the bulls. In the Asia-Pacific region China's official purchasing managers index (PMI) showed an eighteenth successive month of manufacturing growth in August, South Korean exports surged and Australia's second quarter GDP grew ahead of forecasts.

The US institute for Supply Management's Index of manufacturing activity unexpectedly rose to a three month high of 56.3 last month from 55.5 in July, comfortably ahead of the 53.0 expected by analysts.\*

The US Conference Board's consumer confidence index also exceeded expectations, rising to 53.5 in August from 51 in July and US home prices edged up 0.3% in June following recent falls.\*

Technical analysis highlights the sharp moves experienced this week, with a new low at 5070 suggesting the uptrend since early July remains in place. A fresh high above 5420 is needed to confirm this, but the index is likely to encounter significant resistance around 5400 which has contained the FTSE for the past four months.

The MACD histogram is stepping higher and the moving averages are intersecting to the upside, indicating that a new trend could be underway.

In summary, the data this week has been encouraging and supports the argument that the economy is working its way through a transition phase rather than plunging towards a double-dip recession.

\*Source – Simple Investments Internal

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Choppy trading is likely to continue over coming weeks as investors react to each economic data release, but in general I believe that equities are historically cheap and offer attractive buying levels, with the gap between investment grade corporate bond yields and the earnings yield on the S&P 500 at its highest level in 30 years.

Support services have been among the worst performing sectors over the past month as revenue fears from the government's austerity measures weigh heavily on the sector. Babcock International (Epic: BAB) is the UK's leading engineering support services group, with an order book in excess of £12 billion. \*

The group is on the periphery of the FTSE 100 with a market capitalization of £1.865 billion and its main sectors including defence, energy, telecommunications, transport and education.

Many service companies have been under pressure recently as government cut-backs have resulted in lower revenues, but Babcock recently announced it has met expectations and it still sees "an increase in outsourcing opportunities in our chosen markets".

The group's recent acquisition of VT Group for around £1.4 billion is expected to bring significant strategic and operational benefits. The combined business will be one of the biggest military training providers in the UK, which according to insiders is expected to benefit from an increase in outsourcing after the strategic defence review is completed in the autumn.

The directors have also offered their vote of confidence by buying shares on the recent weakness in August, with three directors buying almost £200,000 worth recently.

At current prices the shares are trading on 9.5x forward earnings and with almost 20% growth forecast it offers an attractive REG ratio of 0.5. The shares are also supported by a 3.7% dividend, which looks safe with almost three times earnings cover.\*

\*Source – Simple Investments Internal

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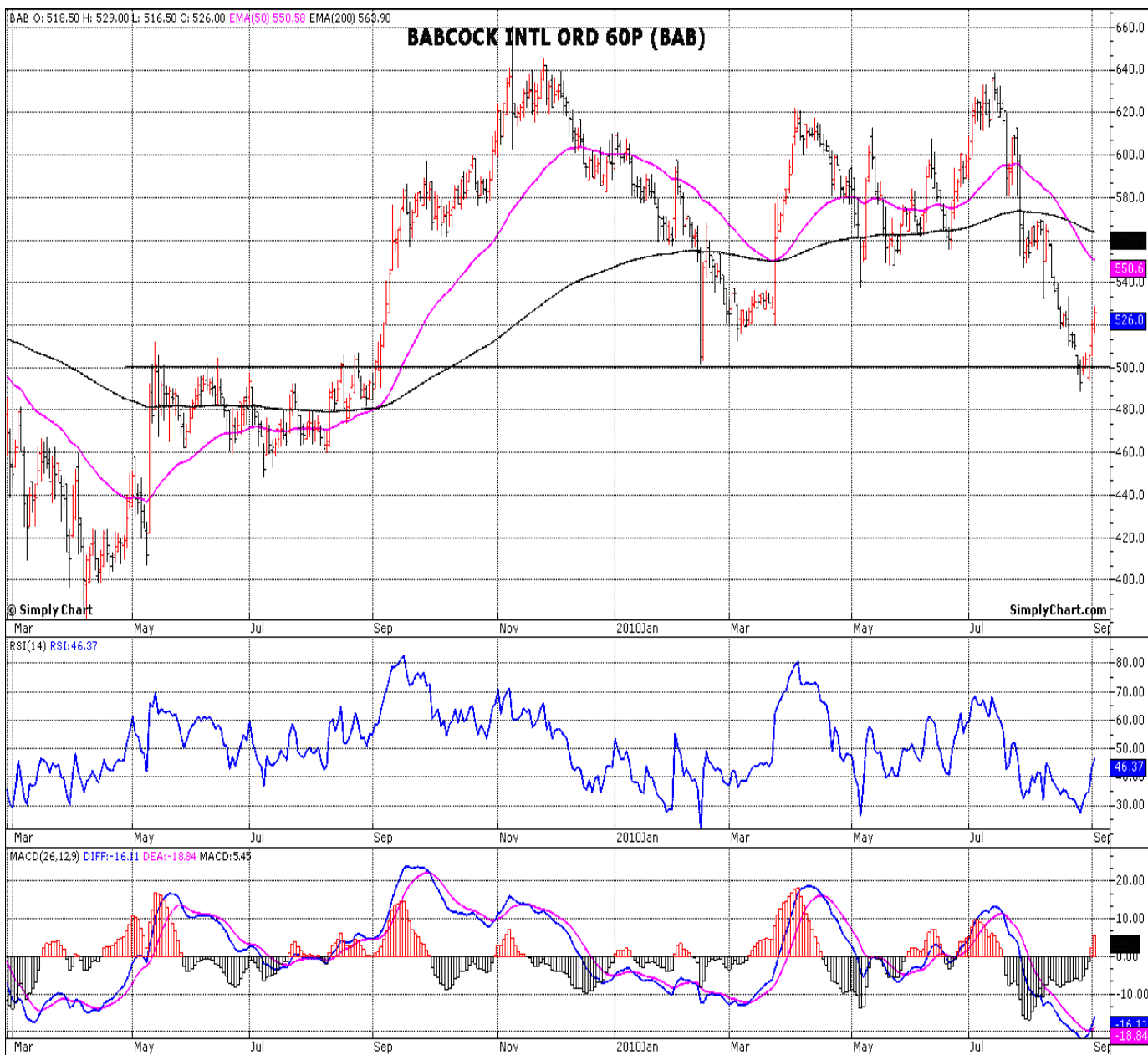


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The above chart of Babcock highlights the recent weakness in the share price, losing around 20% of its value in the last two months.

Having found support at this year's low and previous resistance of 500p the shares have started moving higher. The MACD histogram has stepped into positive territory with the moving averages bottoming out and intersecting to the upside, indicating a new uptrend could be underway. The RSI has also risen out of oversold territory suggesting a pickup in buying momentum over recent days.

In light of the earlier analysis of the FTSE 100 and the strong fundamental and technical analysis discussed for Babcock, I am inclined to suggest the shares will move higher in the short term.

At the time of writing the share price is 526p and near term targets are seen at 549.5p, 565.75p and 581p, with a stop loss marginally below the psychologically important support level at 493.5p.

This report was written by Mark Allen – Head of derivatives at Simple Investments Stockbrokers. The writer does not hold a position in Babcock International, but client accounts may. The material in this report has come from Simply Charts and Babcock International's corporate website.

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