



# MARKET BULLETIN



ST. JAMES'S PLACE  
WEALTH MANAGEMENT

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## Overview

- **Equities enjoy strong returns as investors turn to risk-on assets**
- **FTSE 100 approaches 6,000**

This past week saw investors react positively to signs that the global economy was, perhaps, being driven more by fundamentals than short-term fillips. Whilst concerns around the eurozone and the outcome of its latest rescue plan rumble on, it was other, more positive, news that suggested the environment is becoming a little more settled. Growing optimism about the US economy and a sell-off in US Treasury bonds and gold prompted a strong performance for equity markets. And whilst a number of threats remain – further increases in the oil price, the Middle East political situation and a potential eurozone recession – investor sentiment drove many of the major markets to finish the week at recent highs.

Following the broadly successful outcomes of the ‘stress tests’ on US banks, the financials sector contributed to the S&P 500 Index ending up 2.5%, to trade above the 1,400 level for the first time since June 2008. The FTSE Eurofirst 300 rose 2.6% on the week to end at an eight-month high, while the Nikkei 225 in Tokyo climbed back through the 10,000 barrier for the first time since July 2011.

In the UK, strong performance during the week from some of the most familiar names in the retail sector, including Sainsbury's, Next and Tesco (despite the latter issuing their first profits warning for 20 years), saw the headline FTSE 100 Index close at levels not reached since last summer.

## A presidential opportunity

- **Corporate America positioned to take advantage of global growth**

The prime minister's recent trip to the US has put the spotlight on the forthcoming US presidential election later this year. As Mitt Romney and Rick Santorum continue their quest to win the right to battle Barack Obama for the presidency, the importance of providing the foundations for a more stable and sustainable US economy remains. Data from the US suggests that the recovery enjoyed recently may be beginning to gain some traction. US first-time claims for jobless benefits fell to a four-year low as the private sector added more than 250,000 jobs in January. The overall employment rate has fallen close to the 8% mark President Obama targeted when he announced the first multi-million dollar stimulus package. Following the US Federal Reserve's confirmation that interest rates would stay at record lows for more than two years as part of Operation Twist, stock markets have surged.

“Certainly the economy seems to be improving,” says Howard Gleicher of Aristotle Capital Management, lead investment manager for the St. James's Place North American fund. “If you look at practically any indicator – employment, consumer confidence, bank lending – things have been improving, while inflation is running below expectations.” But is this improvement in the economy reflected in the position of corporate America? “Corporate profits have been relatively strong, though to date this has been more the result of cost-cutting than revenue growth.” Gleicher notes that “corporate profits are growing at near 6% and we expect them to produce high single- or double-digit gains over the next couple of years”.

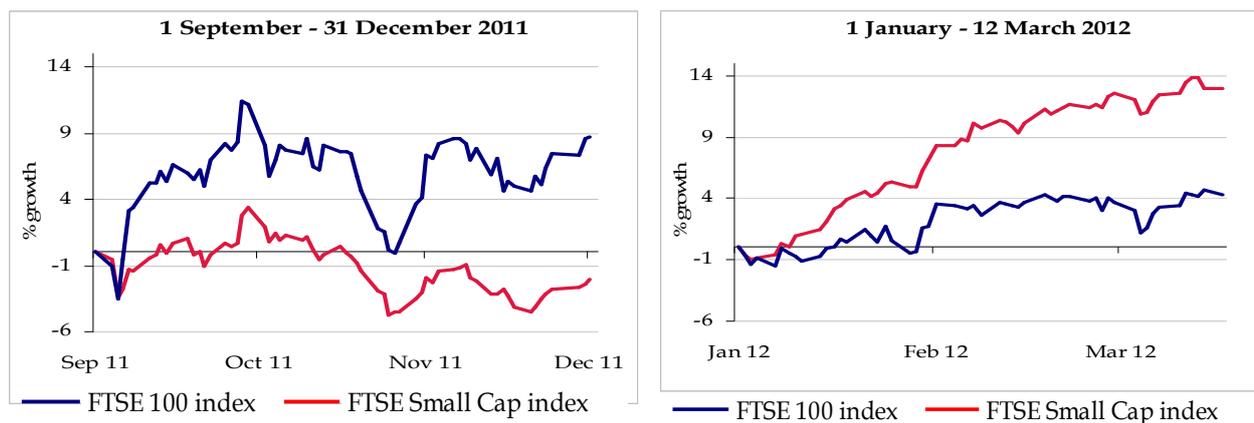
With the indicators pointing to growth in the US being between 2 and 3% this year, Gleicher predicts more positive returns from US multinationals in the long term, particularly those exposed to the faster-growing emerging economies. “If you look at the S&P 500, about 60% of those companies’ earnings are generated outside the United States. Increasingly these are global business able to use cash cows from US or European sources to grow elsewhere. We see that as attractive over the long term.”

### Sector rotation

- **Large-caps fall out of favour as investors regain risk appetite**
- **Corporate activity offers good potential for small-caps**

The strong performance of small-caps since the turn of the year is a further signal that investors’ risk appetites are returning. The final few months of 2011 saw the blue chip, large-cap stocks leading the way as investors moved back towards equities but sought a degree of safety in the shape of the slow and steady rather than the, traditionally, more dynamic small-cap part of the market. With his ‘barbell’ approach to portfolio construction and balanced weightings in large-, mid- and small-cap stocks, George Luckraft of AXA Framlington, investment manager for the St. James’s Place Diversified Income funds and Allshare Income Unit Trust, has benefited from this shift.

“2011 was a very mixed year. On one aspect the background for large-cap, traditional equity income stocks was very good. Investors felt the need for defensiveness and stocks with a decent yield and strong company characteristics actually performed very strongly and the core part of my portfolio did very well. But in total contrast, and driven mainly by fears over the future of the eurozone, small-caps struggled significantly in the later part of the year, underperforming the FTSE 100 Index by 12 or 13%.”



Source: Bloomberg. Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise.

Yet, as Luckraft confirms, despite a disappointing period at the end of 2011, the encouraging outlook for equity markets provides an exciting backdrop for small caps. “It is always frustrating to have underperformance but the one benefit is that the small-cap part of the market is now trading at a significant discount to that of the broad market. I am finding some compelling opportunities. These are companies with leading positions in their market, extremely robust balance sheets, trading on price-to-earnings ratios of five times and yielding, in some cases, more than 7%. As there is further evidence that the problems in Europe are containable and that global economies are improving, I suspect that we’ll see significant takeover activity. Encouragingly, in the early part of this year there have been some very large moves in some of my positions that underperformed last year. A number of stocks in the portfolio are up 50% already over the period and, even after that rise, still look attractively valued.”

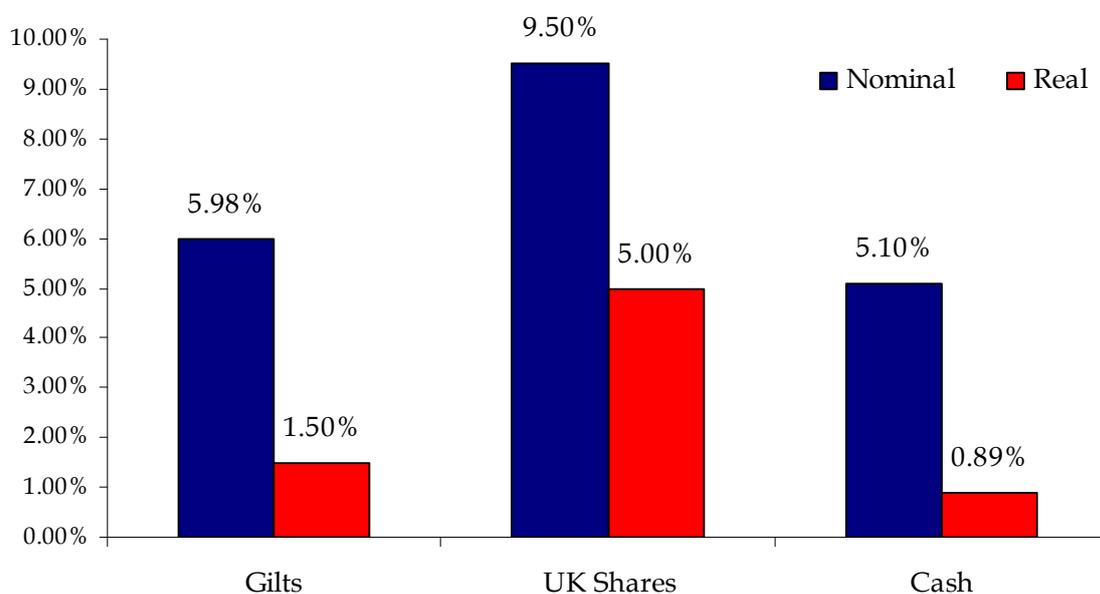
## A century of disappointment?

- **Inflation the key consideration for long-term investors**
- **Valuing the benefits of ‘real’ assets**

With the Budget just two days away, the thoughts of many will turn towards the latest round of spending cuts, or tax increases, and how Mr Osborne’s proposals will impact our cost of living. Yet last week the chancellor announced proposals for new super-long-dated government bonds that would be detailed in this week’s Budget, part of a wider plan to take advantage of Britain’s low interest rates and (current) AAA credit status.

These new issues are likely to offer higher yields than other existing issues – reflecting the fact that bond holders must wait longer for a repayment of capital. The 10-year benchmark gilt index currently yields 2.27%, while the longest-dated conventional bond, which matures in 2060, yields 3.22%. But despite a higher headline rate, Andrew Humphries, Head of Investment Marketing at St. James’s Place, suggests that investors should exercise restraint and consider the implications of such a long-term vehicle. “On the face of it, the issue of 100-year bonds is a win-win for all involved. The government is able to secure its borrowing requirements at a very competitive rate and investors are rewarded with a decent income from an extremely secure issuer. But the key factor to consider, as always, is the impact of inflation.”

And over time the impact of inflation can be devastating. Gilts are vulnerable to any increase in inflation during the period before they are redeemed because this will reduce the ‘real’ value – the purchasing power – of both the income they pay and their maturity value on redemption. “Real assets, those which have the characteristics to make inflation-proof returns, should be the focus for investors looking to protect and grow their wealth over the long term,” insists Humphries. The data in the chart below shows how equities outperformed gilts over the past century on both a nominal basis and after allowing for the effects of inflation.



*Source: Barclays Equity Gilt Study 2012. Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise.*

So is it all bad news for gilts? “Not at all,” continues Humphries. “As part of a diversified strategy, holding gilts or any fixed interest securities is sensible. But avoiding concentration in a single asset class, particularly one which is reliant on the fortunes of other economic markers – such as inflation or interest rates – must be a key consideration for investors.”

## A world of income opportunities

- **Investors should consider looking outside the UK for a diversified equity income solution**

Investors looking for equity as income have traditionally sought out FTSE 100 companies as the mainstay of this approach; but as they become increasingly aware of the risks of holding a concentrated portfolio, many have begun to look further afield.

Whilst the dividend culture is well established in the UK and other developed markets, one of the key drivers for this has been the change of corporate focus in developing parts of the globe and the greater realisation by many companies of their shareholder obligations.

Asian markets, particularly, have become more investor-aware and now recognise the importance of paying dividends. This alignment between the company becoming a better guardian of its balance sheets, and the expectation of shareholders being rewarded for investing with the management team, has seen a big shift in where the high-yielding companies are based. In 1995, according to data from Newton, 20% of companies in the FTSE World Index yielding greater than 3 per cent were UK-based, whilst just 16% were based in Asia. Yet today, the picture is dramatically different – Asian companies now account for 29% of the total and UK-based companies now make up only 7% of the total.

But, as Doug McGraw of Invesco Perpetual, co-manager of the St. James's Place Global Equity Income fund, points out, simply buying into a high-yielding region isn't the only consideration. "Looking at the yield on a particular market doesn't give you the whole story. Investors need to consider the sustainability of the income and whether the company is positioned to continue or preferably grow the dividend in the future. A great deal of our research effort is spent with company management, understanding their strategies for capital allocation. Our goal is to understand the growth opportunities for the company and find out if the management team is on the same page. We want them to invest as much as possible in sensible growth opportunities and, after that, return as much capital as possible to shareholders in the form of dividends. We push them for a stable and rising dividend policy."

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