

MARKET OUTLOOK FOR MARCH 2011

Global Investment Strategy

Through February, the FTSE 100 Index made two attempts to scale the 6100 level, which would have been the highest level reached since May 2008 and the month ended a rather unremarkable 0.6% ahead as the World's media focused on events unfolding in North Africa and the Middle East.

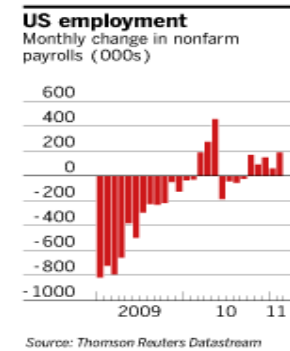
The March Monetary Policy Committee (MPC) meeting is the 24th since the committee lowered rates to their current level of 0.5%. Commentators remain divided on the outlook, as do the committee members with a third, Spencer Dale, joining the Hawk's camp and calling for an increase in rates. The revised fourth quarter GDP figures showed the UK economy contracted by 0.6% against expectations of -0.5% although part of this fall was attributed to December's bad weather. February's Purchasing Manager's Index (PMI) figures remained at a series record of 61.5, indicating a robust recovery in manufacturing and slightly contrary to the GDP figures.

Inflation remains high, making the task of curbing inflation and possibly destabilising the anticipated recovery in the economy, a finely balanced decision although the Governor of the Bank of

England, Mervyn King, has stated he expects inflation to be "pretty much back to target by around the middle of this year". Despite his optimism, he concedes there remain risks to the upside if the tensions in the Middle East and North Africa intensify and lead to further increases in the price of oil.

On the Corporate front, UK PLC remains in rude health with forecast beating profits from a number of sectors, with a further improvement in particular from our major Banks. Analysts are now suggesting dividend growth of between 10-15% for the year ahead which, in the absence of any further geo-political shocks, should bode well for the UK equity market during the course of the year.

In the US, non-farm payroll figures for February were strong, pointing to an encouraging trend for employment across a range of industries and this led to unemployment falling to 8.9%, from 9%. Signs of job creation in the





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private sector suggest that the Fed is unlikely to expand its Quantitative Easing policy beyond the current second round, which is expected to expire in June this year.

In the Eurozone, the ECB president, Jean-Claude Trichet has given the clearest signal yet to markets that interest rates will be moving upwards in the short-term, when he stated the Bank was exercising “strong vigilance” as inflation risks remained to the upside.

This has led some economists to draw parallels with the last Eurozone rate increase, in the summer of 2008, when the region was in recession and only months before the collapse of Lehman Brothers, which led to the financial crisis. Whether this turns out to be a policy mistake, or not, remains to be seen. Separately, as Irish and Portuguese government bond yields approach their highest levels since the inception of the EU, it is envisaged that the new Irish government will be pressing for lower interest rate terms on their €85 billion bail-out package from the IMF-EU, at two meetings scheduled this month for Euro bloc leaders.

In China, growth has again slowed for the second month in the manufacturing sector and the authorities have announced another interest rate increase to stave off rising inflation and try to avoid a

perceived “property bubble”. India continues to witness strong manufacturing growth with the February PMI figure at 57.9, compared with 56.8 for January. In India, the country still faces a battle with inflation, as input costs are increasing combined with tight labour markets and higher material costs, and economists are still clamouring for further fiscal tightening from the central bank.

Commodities

Oil will continue to dominate headlines, as North Africa experiences disruption to supply with the price recently spiking to around \$120 per barrel. In reality, Libya only accounts for around 2.3% of world oil production while the Saudi oil minister has already indicated that the

Kingdom is ready to turn on the “taps” to increase production and replace any shortfall. The fear for investors is a possible contagion effect having any impact on neighbouring countries’ production.

In a recent report, the IMF warned that following a rise to historical highs (as indicated by the UN’s Food and Agriculture Organisation index of world food prices which increased for the eight consecutive month in February), the world may have to become used to higher food prices due to a structural change in demand rather than just temporary factors such as weather affecting harvests.



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Interestingly, this has led to some scientists suggesting that developing and emerging economies may turn to increased usage of GM crops to boost yields and ensure food security, although a drive to GM has so far been resisted by China and India.

Currencies

With interest rates more likely to rise in the UK and Eurozone sooner than in the US, which does not face the same inflationary headwinds, both sterling and the euro have risen against the dollar to around £1.61 and €1.40, respectively. Should the price of oil remain above \$100, it is likely that oil producers will be more willing to sell reserves and the subsequent sale of their “petrodollars” could lead to further pressure on the Greenback, which potentially may have lost its haven status among investors.

Bonds

With “risk on/risk off” attitudes changing on an almost daily basis and being led by North African/Middle East developments, UK Government bonds have been the best performing sovereign issues among the main European issuers, having previously been the worst.

Coupled with this, gilts have seen strong international buying, as investors seek to reduce exposure to the Eurozone debt crisis in the perception they are a safer alternative.

Conclusion

The importance of secure food and energy supplies throughout the world have been highlighted by recent events in Yemen, Egypt and Libya and this adds conviction to our longer term thematic investment approach which focuses on these areas together with water supply. Natural Resource stocks should continue to flourish in light of the price of oil and equity valuations in general remain fair value although in these uncertain geo-political times, a period of volatility can be expected in the short term. Inflation has been very much a watchword over the past few months and we have positioned portfolios accordingly to take advantage of any rise in CPI.