

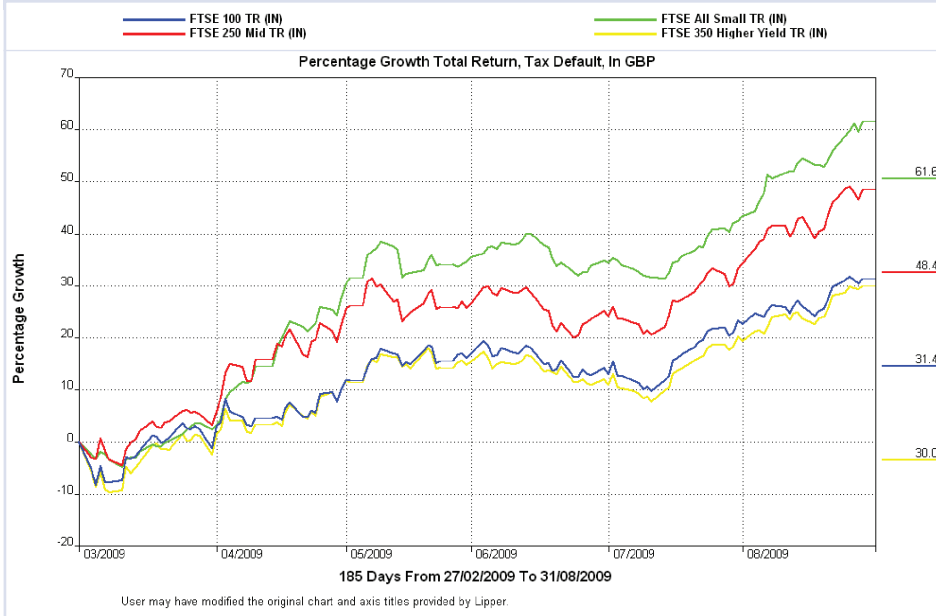
SEPTEMBER 2009

UK EQUITIES

Equity prices in the UK are beginning to look a little high relative to potential growth and earnings capacity; this is certainly a feature of the middle and smaller capitalisation tiers. The FTSE 350 Higher Yield remains good value whilst both the FTSE 100 and FTSE 350 P&A are overvalued.

"In the United Kingdom, the recession appeared deeper than previously estimated and GDP fell further in the second quarter of 2009. But the pace of contraction moderated and business surveys suggested that the trough in output was near. The prospects for domestic economic activity are underpinned by the considerable stimulus from the easing of credit conditions, both in the United Kingdom and abroad. Credit conditions are likely to remain tight as banks continue to repair their balance sheets, and past falls in asset prices and high levels of public and private debt will weigh on spending. On balance, the stimulus should lead to a slow recovery in economic activity, but the timing and strength of that recovery remains highly uncertain."

As reported in the August Report. As balanced as this outlook is, the Bank has decided to push ahead with an expanded quantitative easing (QE) programme. The Bank is concerned that the liquidity constraints in the credit market will weigh heavily on the potential pace of recovery, and increase unemployment. Along with a rise in the amount that the Treasury has authorised for QE (from £125 billion to £175 billion) the minutes from the August Monetary Policy Committee meeting reveal that the Governor, Mervyn King, voted for a larger increase in the programme. So far, the considerable stimulus package that has been rolled out, including the VAT cut, has exceeded, and the VAT cut is nearing an end. It looks as if the Bank's worst fears are averted and the economy looks fragile.



US EQUITIES

Ben Bernanke's reappointment as Chairman of the Federal Reserve, assuming the role from Alan Greenspan, and his nomination Ben Bernanke released a statement thanking the President

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EUROPEAN EQUITIES

French economic output surprised the equity markets with a second quarter increase of 0.3%. Although the value of the French economy remains 2.6% lower than at the same time last year this is a marked improvement on the 1.2% contraction in Q1. This positive trend was also matched in the euro zone's largest economy, Germany, which is also estimated to have grown by 0.3% in Q2. Prior to this, Germany had suffered a 3.5% contraction in Q1 – its worst post-war quarterly contraction, largely due to the collapse in global trade. Better performance in Q2 was due in part to a mild recovery in net trade (owing to a relatively high reduction in imports) and, in common with France, increased private consumption owing to government stimuli, notably the car scrappage scheme. There is perhaps more positive news on the horizon, both business and consumer sentiment indicators have steadily improved and the Purchase Managers' Index suggests that the service sector is expanding once more. Manufacturing indicators are also on the boundary of positive ground.

It seems that a recovery in Germany and France is underway, but it is likely that it will be protracted and fragile. The massive combined stimulus package cannot be sustained and further substantial government support will not be possible.

JAPANESE EQUITIES

The Japanese economy has shown signs of recovery since the end of the post-war period. It also presided over nearly two decades of economic output verging on the recessionary and, under the leadership of Taro Aso, had abandoned the promising reform agenda. Following an impressive victory by the Democratic Party of Japan (DPJ), the new Prime Minister, Yukio Hatoyama, must now deliver his promised reforms. Unemployment reached a record high. These reforms include an attack on the cosy relationship between senior bureaucrats and large corporations and a shift from massive infrastructure spending

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