# MONTHLY INVESTMENT COMMENTARY

CARTLIDGE MORLAND

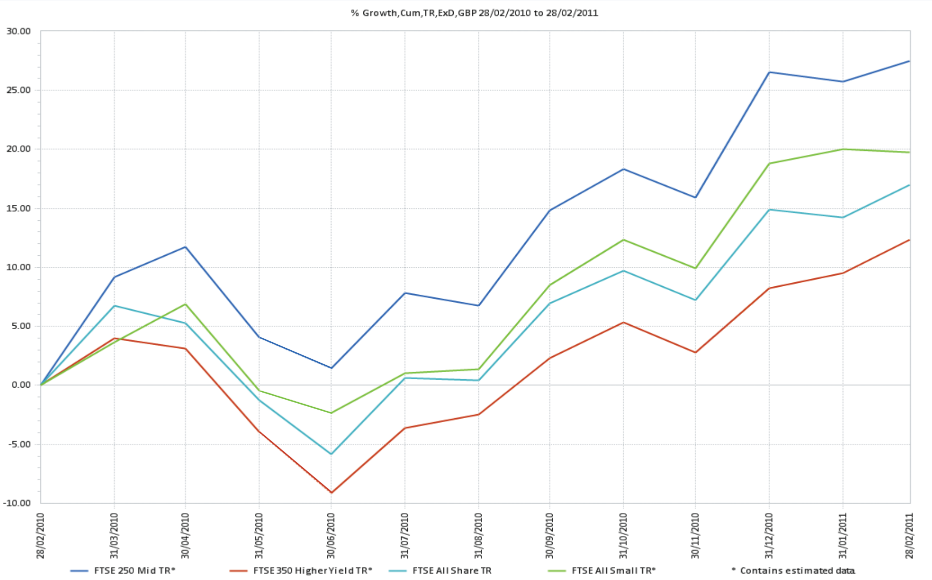
## MARCH 2011

## UK EQUITIES

Inflation continues to rise with the Consumer Price Index (CPI) now showing an increase of 4.4% year on year. The index has risen due to mainly external factors including oil, the price of which has soared following civil and political unrest in the Middle East. Various surveys suggest that growth is likely to remain muted with the Office for Budget Responsibility (OBR) now predicting growth of 1.7% for 2011, down from 2.1% following the contraction in the last quarter of 2010. The impact of public spending cuts are yet to be felt and consumer spending will be squeezed as National Insurance increases take effect in April.

However, there is positive news. The Manufacturing Purchasing Managers' survey for February remained high, a benefit of the steep decline in sterling's exchange rate. The Budget has introduced further measures to incentivise new business expansion as well as cutting corporation tax. Hopefully, this will lead to improved corporate spending and employment growth. It is vital that the private sector creates jobs to compensate for those lost in the public sector and to strengthen a weak recovery.

Short term investors risk appetite will be affected by developments in the Middle East, Japan and the on-going euro zone crisis. We expect the market to remain volatile.




Source Lipper. % Growth, £, Total Return, 28/02/10 to 28/02/11

## US EQUITIES

As payroll gains strengthened in February the Bureau of Labour Statistics reported that around 68% of those industries it tracks increased employment levels which is the highest percentage in ten years. The latest survey revealed that the unemployment rate fell to 8.9% and household employment grew by 250000. The Institute for Supply Management employment index also provided strong growth indicators, rising at its fastest rate since the 1980s for manufacturing but also seeing strong gains in

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## JAPANESE EQUITIES

The human cost of the catastrophic earthquake and tsunami in Japan has been terrible. Therefore, we have kept our comments in respect of the market short given the appalling loss of life and the devastation of communities. The impact of such a calamity on a major economy is guesswork. With the population suffering and infrastructure of the affected region severely damaged, economic growth will be impacted significantly in the short term. Japan's growth has been poor for years with a strong Yen and deflation being contributing factors. The public debt stands at 220% of GDP. The reconstruction costs are likely to further exacerbate this position when fiscal consolidation was really required. The immediate aftermath of the disaster led to market uncertainty and consequently markets fell. However, the Bank of Japan had made $265bn available to financial institutions and doubled its asset buying programme to $122bn to support the market by easing liquidity and to avert short selling. The government is likely to announce emergency fiscal stimuli to support the economy. The yen has strengthened as institutions have repatriated assets following the earthquake to fund reconstruction. This is problematic as a strong yen could impact severely on Japan's export dependent economy. The G7 countries have moved to assist in helping to stablise markets by selling the yen with the aim of weakening the currency.

## EMERGING MARKETS

Problems in the Middle East and North Africa have led to negative sentiment across these volatile markets. Interest rates have risen in many countries to address rising inflation as economic growth continues although at a reduced pace. India raised its key lending rate

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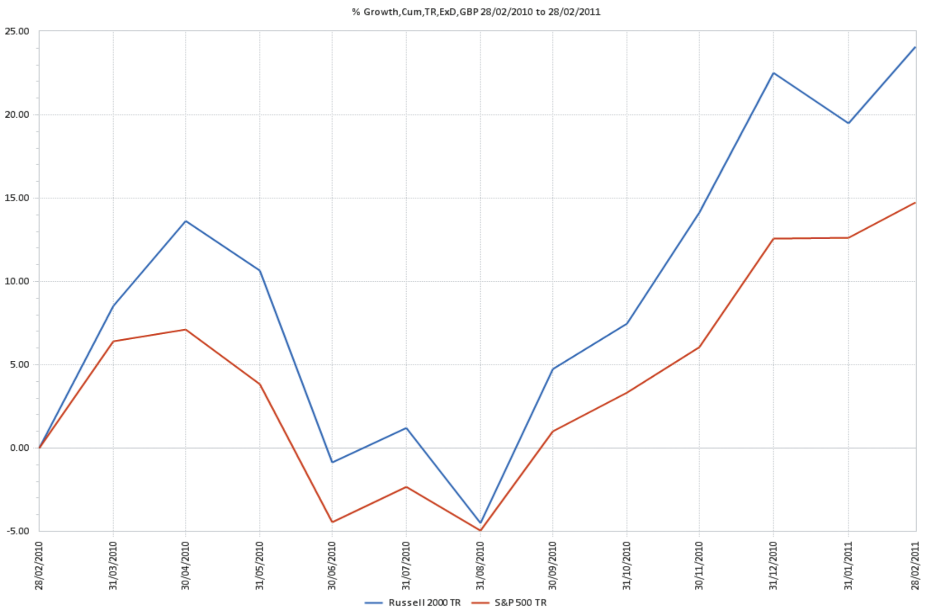
the services sector. While there are some disappointing trends in the detail behind these headlines it is the breadth of improvement that is most significant. Job growth is beginning to expand in the US. If it continues to do so at anything like its current pace we can be confident that a recovery is real and self-sustaining. Risks exist on the downside caused by unstable oil prices.




Source Lipper. % Growth, £, Total Return, 28/02/10 to 28/02/11

## UK FIXED INTEREST AND MONEY MARKETS

The Bank of England's Monetary Policy Committee again voted to maintain both the policy rate of interest and the quantitative easing limit (£200 billion) at current levels. The three-way split in the voting pattern deepened further. As far as maintaining the interest rate at its current level, Andrew Sentance and Martin Weale were joined by Spencer Dale in voting for an increase in the policy rate. Adam Posen voted to increase the quantitative easing programme by £50 billion. The March minutes show that there is growing concern over the uncertainly of both the growth and inflation outlook. Consumer Price Index (CPI) inflation is expected to reach around 5%. The recently announced reduction in fuel duty should help reduce inflation in the short term. Against this background coupled with events in Japan and the Middle East, there is now the possibility that the expected interest rate rises may be delayed.

The UK gilt market remains well supported by investors, particularly international investors. The government has adhered to its fiscal consolidation plans with the Budget reconfirming its resolve.

## ASIA PACIFIC EQUITIES

From the start of the year, markets have slipped. The repercussions of the Japanese earthquake unsettled markets in the Pacific region. This poor sentiment has also hit initial public offerings (IPOs) in Hong Kong and Singapore. Central banks continued to tighten monetary policy to combat inflation. The People's Bank of China increased its interest rate and an increase in reserve requirements was announced. Growth is likely to slow in the shorter term. The trade pact between China and Taiwan in September 2010 seems to be having an effect. Since then four Chinese and six Taiwanese banks have opened in each other's countries.



to 6.75%. There have been indications from the Indian Finance ministry that the expectation is for inflation to ease in the near term and the tightening cycle would then pause if this is the case. Russia has been a beneficiary of the problems in the Middle East and North Africa as the oil price has been pushed up. The country's federal budget was in surplus for the first two months of 2011. Russia's Central Bank has increased interest rates for the first time in two years as inflation hit an annual rate of 9.7% in February. Inflation expectations in Brazil have increased and remain well above the target rate of 4.5%.

## EUROPEAN EQUITIES

The Purchasing Managers' indices for both manufacturing and services remain firmly positive, suggesting growth in the first quarter of 2011 will accelerate. The key risk to continued expansion remains a sustained sovereign debt crisis. At current yields it seems the Portuguese government may be forced to resort to a European Union (EU)-International Monetary Fund (IMF) rescue package. It is uncertain whether interest rates in the euro zone are set to rise. There have been mixed messages coming from the European Central Bank (ECB). Most recently Jean-Claude Trichet, President of the ECB, has commented that inflation rates are "durably" above the region's target rate. This could indicate, against market expectations, that an interest rate rise is not imminent.

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