

INVESTMENT NOTE

August 2011

Insider Trading?

Conspiracy theorists of the world unite!

As we highlighted in our investment note of Friday there was no one piece of economic or fundamental news that should have caused an almost ten percent sell-off in global equity markets. Mostly the news, whilst not particularly negative, was “tepid” and we were ourselves somewhat surprised at the depth of the reaction. Our thoughts last week were there may be much to consider in the coming 7-10 days as it all seemed a little too contrived.



And lo! After trading hours, late into the Wall Street night following the closure of markets on Friday, ratings agency Standard & Poor’s (S&P) choose to announce a downgrade to US Sovereign Debt from AAA to AA+! It would appear that during the week there was much negotiation between S&P and the US Treasury regarding the possibility and need to take this course of action. The US Treasury seemingly vigorously defending their position that no such action was necessary and strong rhetoric over the weekend that S&P does not appear to understand correctly the country’s finances and have to a degree actually miscalculated in their analysis.

The US Politicians are having a field day culminating in calls for the resignation of both the Treasury Secretary and even the President. Typically many of these have emanated from the very same protagonists, whose actions only ten days ago prevented the raising of US taxes as part of a debt reduction package, effectively caused the S&P action. No surprise there then!

The question on everyone’s lips is, did someone know and trade this market down during the week before the announcement? If so this would have been effectively an Insider Trading activity of the highest magnitude. Why did the market rally some 300 points in the last hour of trading in the US on Friday? Was there a last ditch effort to retain the coveted AAA rating which scared the Insiders to cover their positions having expected the announcement during the week but not having seen or heard a thing?

Conspiracy theorists of the world unite – something was very, very strange with the markets reactions last week and the timing of the S&P announcement.

Insider Trading or not – where does that leave us and what to do from here.

Whilst we reduced our US weightings last week (no, we were not told by the US Treasury in advance of this announcement) we do think this is the potential last tail of this present market decline unfolding now!

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An important point to emphasise is that both Fitch and Moody's – the other combatants in the ratings field - retain their "AAA" rating at this point and do not appear to be ready to change that stance. This is a significant decision as most structured deals based on AAA rated instruments state that two out of the three main agencies must retain that rating. Therefore any global sell off in Bonds in our opinion is unlikely on this announcement.

Already the US Treasury Secretary has declared the S&P actions as "A terrible judgment and showing a stunning lack of knowledge of fiscal matters" – the war or words begins!

What do we expect in the coming days?

- **Currency intervention** to ensure stability where needed
- **A volatile equity market** that will potentially bottom in the next 1-3 days
- **Government buying of Euro Bonds** (ECB Action already announced)
- **Enormous political rhetoric** in the US that will lead to QE3 discussion/announcements
- Possible Euro (and Global) **bank liquidity concerns will be proved unfounded** despite the technically higher lending rates.
- Weaker commodity prices (except Gold) leading to a **dissipation in inflationary fears**.

Conclusion

Despite corporate earnings and corporate balance sheets being the strongest for 3-4 years; equity markets have fallen some 10% based on little economic and fundamental change. Somebody, we submit, knew something?

In our opinion there will be undoubted ongoing volatility in equity markets necessitating some calming statements or action by way of Government and Central Bank intervention. We see that this will unfold by way of specific intervention, and possibly a QE3 strategic announcement and therefore expect to see pockets of real opportunity develop very quickly. This is not therefore, in our opinion, a time to sell into the lows of the next 1-3 days - the news is already out.

We took some defensive action last week – perhaps with hindsight not enough – but then we were not party to the information. We feel somebody was but it wasn't UK asset managers!

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