

Investment Note

April 2009

Green Shoots of Recovery

Will Swine Flu derail the rally?

Equity markets around the world have enjoyed six weeks of gains with the UK FTSE 100 index rallying over 20% from the lows reached in mid-March. A number of positive events have led some in the financial arena to herald the bottom in equity markets and the possible arrival of the end of the global recession. Whilst we support the thesis that in 2009 will witness the bottoming of the equity markets and support much of the positive commentary, we are still concerned that the UK faces mounting problems that may curtail further market appreciation over the summer. Incidents like the recent outbreak of Swine Flu, fears over Building Society strength and similar unknowns may add additional restraints to equity market growth.



So what caused one of the most aggressive rallies in equity seen for many years?

A positive conclusion to the recent G20 conference resulting in an unprecedented global fiscal stimulus response begun to ignite investor sentiment. A fairly benign first-quarter earnings season, spattered with a number of positive numbers (particularly amongst some financial institutions) helped maintain the momentum, with the release of less horrendous economic data (including rising consumer confidence) adding to the short term jubilation.

However some cracks have already begun to emerge, particularly in the UK. Figures released last week revealed that the UK GDP in the first quarter fell by 1.9% putting the current recession on course to be the worst peak-to-trough (now down 4.0%) economic downturn since the second world war (the recession in the early eighties currently holds that dubious title at 5.9%). Considering that the fall in the first three months of year represents more than half of the government's 3.5% predicted decline (for the year as whole), the IMF forecast of minus 4.1% looks more realistic.

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We are now seemingly faced with a biological threat; “Swine flu,” a type of flu transmitted from pigs and mutated into a human strain known as “H1N1,” and has so far claimed the lives of over 80 people in Mexico, and infected 1,400 since April 13th. The weekend saw the first cases of the Flu in the UK, Europe and Asia. Should this develop further it could certainly affect an already fragile global economy. In 2002, an Asian flu virus known as severe acute respiratory syndrome, or SARS, claimed the lives of 774 people and sickened another 8,096, according to the World Health Organization. While that’s a relatively small number of people compared to Asia’s total population, the virus wreaked havoc on Asian stocks, which were just recovering after the 1998 emerging markets crisis. In less than 12 months, Hong Kong’s Hang Seng plunged 17.3% while the Japanese Nikkei fared worse, dropping 33%. Notably spring is a common season for animal flu viruses to emerge; In March last year, another Chinese avian flu bug, which was a mutated form of the H1N5 avian strain, claimed the lives of four school children in Hong Kong and gave investors the jitters for a bit. The point of our comments being that the impact of such developments can be further destabilizing.

The World Health Organization has since raised the risk warning from 3 to 4 (out of six) causing investors to consolidate profits from the recent rally and dampen a little the market sentiment. As one would expect airlines and other travel-industry companies suffered while healthcare companies benefitted.

On balance we believe that this period (2nd and 3rd quarter) may be decisive for the economy; should their be further special influences – as with swine flu- or further signs of economic deterioration the market may retrace to test the 2009 lows. Should the regulatory “stress testing” of US banks result in further capital raising requirements, sentiment may deteriorate somewhat more quickly. We remain committed that the equity market is in a bottoming process.

In conclusion we are therefore continuing our methodology of seeking to capture short term gains (where appropriate) in our satellite position whilst building our core exposures to levels which will benefit investors when market strength returns – and it will – it is merely a matter of time.

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