

Professionals' View July 2011

Greece: Sticking plaster or longer-term solution?

Judging by TV pictures of increasingly large and hostile demonstrations in Athens, it was by no means certain that the Greek Parliament would vote in favour of the required austerity measures, a necessary condition for receiving the next tranche of aid. However, in the end they did, and by a larger majority than expected.

The vote should allow the IMF, EU and ECB to agree a second bailout that is rumoured to be in the region of €120bn. This together with the original bailout could enable Greece to fund its debt until 2014 and hopefully prevent a default, in the short term at least, which has been threatening to disrupt financial markets during the last few weeks.

Whilst this is good news for the Euro in the short term, because things could have been so much worse, it does not mean that any of the the P.I.G.S (Portugal, Ireland, Greece, and Spain) will be saved from possible default restructuring further down the road. Many see this as a short term sticking plaster attempting to hold things together until a longer term solution can be found - although what this solution will actually look like is far from clear, and indeed whether it will work.

F&C's fund manager, Ted Scott, argues that "each time the IMF, EU, & ECB provide a bail-out, it becomes more difficult to convince markets and the country concerned that it is the correct strategy. What the authorities are doing is adding more debt to existing debt and, combined with the strict austerity measures, has led to slowing economies and even higher public debt to GDP ratios. (Source: F&C website)

Mad Markets

Markets seem to have been almost schizophrenic recently. Firstly, there was sustained heavy selling over the consequences of an imminent Greek default, followed swiftly by sheer relief and a significant market bounce

back as the Greek government secured support for more austerity measures.

On a wider scale the debate about the "investment glass" being half full or half empty rages on, as epitomised by two very different currencies, the Swiss franc, and the Australian dollar. The first is potentially a safe haven and during the latest euro crisis the Swiss franc repeatedly gained in relation to the US dollar, although it pulled back a bit after the good news from Greece. The second is heavily exposed to China and to commodities. The Australian dollar depends on global economic growth to justify its strength and this has also been gaining against the US dollar. In fact over the 12 months from 4th July 2010 to 4th July 2011, the Swiss franc rose 18.7% and the Australian dollar 19.7% (source: Financial Express Analytics).

It makes little sense for both the riskiest and the safest currencies to do well at the same time.

It is almost as if investors are in two minds, or split into two completely separate camps. One thinks the world is doomed and is prepared to pay for secure currencies or assets such as Gold. The other thinks we are back to business as usual, and wants to buy risk assets.

Is it too late to buy Gold?

It is no coincidence that the gold price has shot up since the financial crisis broke in 2008. Gold is a "real" asset, and there is a finite amount of it. You can print money endlessly. You can't dive down 3 miles below the Earth's crust very easily to dig up more gold. Therefore it fits into that supply and demand category which quite simply states that if more people want to buy than sell the asset, the price should go up. In USD terms, the current gold price (\$1550) is at record levels. If you inflation-link it from the last time it was this high (around 1979-80) then you'd get nearer \$2000 an ounce.

You could argue that gold is more akin to a currency than other commodities, so at a time when most other currencies are battling it out

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for the “least worst” title, gold can be expected to appreciate. If you believe that the World’s debt woes are soon to become a thing of the past, then don’t touch gold. If you believe, as we do, that the Eurozone problems are going to take a while to sort out, then some exposure to gold and precious metals could potentially make sense if you have none so far.

Europe: A Contrarian bet?

Markets in Europe may have already factored in the likelihood of a Greek default, but with the coming together of both governments and banks in Europe to try to avert this, might this collective co-operation be the catalyst for a continued rally in asset prices?

Some European fund managers think so. For example, **Charles Montanaro**, manager of **Montanaro European Smaller Companies Trust** sees Europe as a contrarian investment and argues that, “Contrarians should buy when others are afraid to do so.” Austerity measures are expected by some to be positive as a cut in public spending should stimulate economic growth.

Another manager who echoes this view is **Vincent Devlin, of BlackRock Greater European Investment Trust plc**, “Despite the peripheral problems, the European region contains some of the healthiest economies in the developed world and a high number of world-leading franchises. Europe as an investment region has the highest exposure to emerging market growth in the developed world, and has seen some of the highest GDP revisions over the past 6 months. If confidence returns back to the region, we would expect Europe to perform very well as an investment region.” (Source: Association of Investment Companies).

Its tough out there

After a lull, our high street stores are taking a bashing again with Jane Norman and Habitat joining the growing list of UK retailers going into administration. In addition, HMV is selling Waterstones, and Carpetright has announced that they need to rethink the number of stores

from which they operate. To cap it all, Marks & Spencer has started its summer sale early (Source: Schroders).

This year has been, and will continue to be, tough for both consumer and retailers alike with the VAT increase, rising direct taxes, higher fuel costs, rising food prices, and continued job uncertainty in the public sector.

Against such a backdrop it seems likely that there will be further casualties particularly amongst highly indebted firms. However for those UK retailers who have a strong balance sheet, experienced and cautious management, and a stable franchise, then survival should be assured. Moreover, such firms could be an interesting contrarian bet as current share valuations are depressed and offer may considerable upside as and when trading conditions improve.

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