meridian

ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

The remarkable movements in equity markets shown in the table below gives investors some respite from the dreadful conditions experienced in the previous quarters. The sharp upward movements are, of course, from a very depressed level but do reflect the fact that markets do anticipate the next phase of the economic cycle. In our review, we rationalise these strong movements and look at issues which investors must now consider.

The tables below detail relevant movements in markets:

International Equities 27.02.09–29.05.09

Total Return Performances (%)

Country	Local Currency	£	US$	€
Australia	+14.9	+27.3	+44.0	+29.2
Finland	+43.9	+41.8	+60.5	+43.9
France	+24.3	+22.5	+38.6	+24.3
Germany	+28.9	+27.0	+43.7	+28.9
Hong Kong, China	+44.5	+27.8	+44.5	+29.7
Italy	+29.8	+27.8	+44.6	+29.8
Japan	+20.6	+9.3	+23.6	+10.9
Netherlands	+23.7	+21.9	+37.9	+23.7
Spain	+25.6	+23.8	+40.0	+25.6
Switzerland	+17.6	+13.5	+28.4	+15.2
UK	+17.3	+17.3	+32.7	+19.1
USA	+25.8	+11.2	+25.8	+12.8
Europe ex UK	+26.0	+24.2	+40.5	+26.0
Asia Pacific ex Japan	+31.7	+32.8	+50.3	+34.8
Asia Pacific	+25.6	+19.7	+35.4	+21.5
Latin America	+34.4	+39.8	+58.1	+41.9
All World All Emerging	+41.4	+40.7	+59.1	+42.8
The World	+25.4	+17.5	+33.0	+19.3

Source FTSE World Indices

FT Government Securities Index All Stocks (total return): +0.2%

International Bonds—Benchmark Ten Year Government Bond Yields (%)

Currency	27.02.09	29.05.09
Sterling	3.61	3.76
US Dollar	3.04	3.47
Yen	1.27	1.50
Germany (Euro)	3.12	3.59

Sterling's performance during the quarter ending 29.05.09 (%)

Currency	Quarter Ending 29.05.09
US Dollar	+13.1
Canadian Dollar	-2.3
Yen	+10.4
Euro	+1.5
Swiss Franc	+3.6

Other currency movements during the quarter ending 29.05.09 (%)

Other Currency	Quarter Ending 29.05.09
US Dollar/Canadian Dollar	-13.6
US Dollar/Yen	-2.4
US Dollar/Euro	-10.3
Swiss Franc/Euro	-2.0
Euro/Yen	+8.7

Significant Commodities (US dollar terms) 27.02.09–29.05.09 (%)

Significant Commodities	27.02.09–29.05.09
Oil	+41.4
Gold	+0.8

Markets

During the latest quarter, international equity markets have staged a significant recovery. In local currency terms, the return on the FTSE World Index was 25.4%, in sterling terms 17.5%, in US dollar terms 33.0% and in euro terms 19.3%. Looking at various areas of the world in local currency terms, we note that the FTSE USA Index returned 25.8%, the FTSE Europe ex UK Index 26.0%, the FTSE Japanese Index 20.6%, and the FTSE UK Index 17.3%. Elsewhere, we note exceptionally good performances from the FTSE All World All Emerging Markets Index which returned 41.4%, the FTSE Latin American Index which returned 34.4% and the FTSE Asia ex Japan Index which returned 31.7%.

Currency movements made a significant difference this quarter. Weakness in the yen and US dollar reduced sterling returns in the two markets to 9.3% and 11.2% respectively, whilst the Europe ex UK return in sterling terms was only slightly lower at 24.2%. The strength of the Australian dollar meant that a very respectable 14.9% local currency return on the FTSE Australian Index became an exceptionally good one of 27.5% in sterling terms. Returns on the FTSE Asia Pacific ex Japan and FTSE Latin American indices were enhanced slightly in sterling terms, for the former to 32.8% and, more significantly, in the latter to 39.8%. The return on the FTSE All world All Emerging Markets Index was trimmed slightly to 40.7%.

Bond yields, as measured by those on ten year government bonds, rose sharply towards the end of the quarter having endured something of a roller coaster ride on the back of the initial euphoria caused by the announcement of quantitative easing in the USA and UK. Quantitative easing is one reason why we have a negative outlook on medium and long dated bonds and we shall discuss this in the main body of the review. Taking the quarter as a whole, yields on sterling government bonds rose by 15 basis points to 3.76%, on US government bonds by 43 basis points to 3.47%, on Japanese government bonds by 23 basis points to 1.50% and on German government euro denominated bonds by 47 basis points to 3.59%.

In the currency markets, sterling made a partial recovery and the US dollar and yen were particularly weak. Against the US dollar, sterling rose by 13.1% and against the yen it rose by 10.4%. Against the Swiss Franc, it rose by 3.6% and against the euro by 1.5%. Sterling fell by 2.3% against the Canadian dollar. As implied by the above, there was a dramatic movement in the US dollar/Canadian dollar cross rate with the US dollar declining by 13.6% as commodity related currencies recovered.

In the commodity markets, oil rose by 41.4% but gold was little changed up just 0.8%.

Economics

Notwithstanding continued poor economic news, it is refreshing to report better sentiment in international equity markets at the same time as it appears to be deteriorating in international bond markets. Why might this be the case?

Markets hate uncertainty. They like to know what problems they are facing and, in this respect, things have improved. If we go back to last October, when the banking crisis was raging, there was genuine fear about the security of bank deposits because of fears about the stability of banks themselves. That is broadly not the case now. Through a mixture of government and central bank actions, the vast majority of depositors now feel safe. This feeling of security has been achieved at huge cost but it was a necessary condition of economic stability. If bank deposits are not considered safe, the economic consequences do not bear thinking about. In a strange way, the severe deterioration of the world economy is rather less important in relative terms because a collapse of the international banking system would certainly have led to a dangerous international economic depression. A return to more normal economic conditions will occur more quickly from a recession, however serious, and this one is serious, than from a full scale depression with mass unemployment. Although there are still many questions to be answered about the banking outlook, a combination of measures such as nationalisation and part nationalisation of some banks, deposit guarantees, actions to isolate toxic debt, money market operations and stress testing leading to banks having to raise more capital, have calmed nerves. Much work still remains to be done but, if we may use a medical analogy, the patient's situation has been stabilised but the treatment and the costs of it have some potentially very nasty side effects. We think that equity markets, which have risen strongly since early March, have responded to the stabilisation of the patient's condition. However, investors must now consider how to deal with the side effects.

We have hinted earlier on at the diverging performance of equities and bonds (we are talking about government bonds here). Whilst equities have recovered sharply from their March lows, government bonds have been weakening. One of the side effects is that the economic patient has needed an awful lot of treatment and this has been very expensive. Most visibly, financial support for the banking system has been very costly and this cost, together with that of the move into world recession, has resulted in a very serious deterioration in most governments' domestic finances. What we may broadly term budget deficits fall into two parts, structural and cyclical. A cyclical deficit arises from the effect of automatic stabilisers on a weak economy. This is because tax revenues suffer in an economic downturn, whether they be direct or indirect taxes, and expenditure on items like social security rises. By not attempting to address the resulting deteriorating budgetary position these "automatic stabilisers" help to prevent a bad position becoming worse and provide a base for economic recovery. But the converse should also apply. When economic times are good, the buoyancy of tax revenue and reduced pressure on government expenditure on items like social security (because unemployment is lower) should not be compromised by government overspending. The improvement in government finances should be used to provide for the budgetary pressures which inevitably arise in difficult economic times. Structural deficits which have been run, for example, by the USA and UK are a much more serious and threatening matter. As their name implies, these are in place whatever the state of the economy. They are built into the system. They mean that governments in this position are consistently overspending relative to tax revenues. Whether governments like it or not, structural deficits have to be addressed. If they are not, government borrowing grows and grows, servicing costs rise and the level of public debt in relation to GDP rises. The creditworthiness of such governments becomes called into doubt and economic crisis is likely to result eventually. The reason why the public finances of the USA and UK are in such serious disorder is that they were running significant structural deficits coming into the financial crisis. Both countries were very badly prepared for what eventually happened. This is not said with the benefit of hindsight. For example, in these reviews, we consistently pointed out that UK public spending was rising too quickly in relation to the growth in GDP. The Treasury consistently underestimated the level of government borrowing. With economic growth levels, on the surface, satisfactory, a much more prudent policy towards spending should have been followed. The same goes for the USA. Now, both countries are spilling red ink at an unbelievable level, with the combination of structural and cyclical deficits producing a toxic effect on public finances.

If this is the most unpleasant side effect of the treatment necessary to stabilise the world economy, what is going to be done about it and what are the economic implications? Whilst investors should understand cyclical deficits and the beneficial effects of automatic stabilisers and be prepared temporarily to finance debt incurred on this basis, they will not be so tolerant of debts built up through large structural deficits which politicians are not willing to address. With a finite life in power, politicians are tempted to put off unpleasant economic decisions for those who follow them by which time the deficits have become even worse.

Fortunately, there is a constraint on such reckless behaviour, the markets. The UK had a reminder towards the end of May when Standard & Poors lowered its medium term outlook on the UK's debt from "stable" to "negative". This does not necessarily mean a downgrade but the mere possibility of losing its AAA long term credit rating outfit ought to ring alarm bells in the government and the Treasury. Without being specific to any country and, whilst obvious, it is still worth spelling out the dangers of ever spiralling debt levels, whether on a current year borrowing basis or on an overall outstanding public debt to GDP basis. First of all, unless there is a marked drop in interest rates (as, at present, at the short end of the market), the servicing cost of the increasing debt rises year by year. Other things being equal, that can be expected to lead to higher taxation or public expenditure cuts or, at the very least, restraint on spending. Efforts to bridge the budget gap, whilst desirable and necessary if the deficit is of a structural nature, depress economic activity. Ever increasing levels of government borrowing threaten to raise the costs of medium and long term borrowing. We can see this phenomenon in government bond markets. Now that investors are feeling slightly less risk averse, the flight to perceived safety in government bonds when the financial crisis was at its worst, which led to absurdly low yields on any objective terms (but justifiable if investors felt that bonds were unsafe and their deposits were going to be lost and equity investments collapse), is being reversed. With huge issuance of government debt in the USA and UK and elsewhere, it is hard to see how yields cannot rise substantially. The more they rise, the higher the cost of servicing them and so the process goes on, making the level of debt and servicing costs even higher.

But even higher interest rates will not persuade investors to buy government debt if they have any doubts about the ability of the borrower to repay it. With governments and the world competing to sell their debt, the advantage lies with the most creditworthy. A good example is the wide difference in the interest rates paid by different eurozone members. The difference has narrowed considerably in recent weeks, but it is quite possible that the differentials will widen again. Within the eurozone, the yield on ten year Irish government bonds is 1.73% higher than on German government bonds. Considering that German government ten year bond yields are relatively low at 3.63%, at the time of writing, that represents an enormous yield premium and the yield premium was around 100 basis points higher at one stage recently. If one takes the UK, where government borrowing as a percentage of GDP is expected to be over 12% this year and net government debt as a percentage of GDP could approach 100% within a few years if the costs of the banking bail out are considered, holders of gilts are bound to be worried. It is estimated that around one third of gilts are held by foreign investors and it is vital that confidence in the UK government's ability to repay debt is maintained. If foreign confidence in any government's ability to repay debt is in doubt, the consequences do not bear thinking about.

Unpleasant though actions to reduce government borrowing may be, they are far better than being forced to take action by foreign creditors where draconian action could be imposed in order to correct the position.

So, for many countries, efforts to rein in deficits in future years will mean a combination of higher taxes and public spending cuts which will depress economic activity. The faster an economy can grow the better in terms of addressing the issue of fiscal deficits as tax revenue becomes more buoyant and some items of government expenditure such as social security payments are reined in as unemployment responds to a faster growing economy. But what will help these economies to grow at a more desirable rate if domestic fiscal policy has to be restrictive in order to tackle the level of government borrowing? The answer has to be in those economies which are in a position to benefit from their relatively good financial position. Asian and some Middle Eastern economies come to mind. However, there has to be confidence to spend. If one takes an economy like that of Germany which has a high savings rate and a large current account surplus, there would be many advantages for other countries if consumers spent more freely. Without confidence, they will not but a source of growth will be those economies which are not constrained by their financial position from growing faster.

As mentioned above, one of the unpleasant side effects of stabilising the financial and economic position is the alarming increase in debt levels and associated servicing costs. Bank lending was constrained by uncertainty about counterparties and the risk of lending money. Companies found it difficult to borrow in the bond markets. Enter quantitative easing, the modern way of printing money, which we are seeing being adopted in the USA, UK and, soon, the eurozone. In its basic form, central banks will offer to buy assets, say bonds, from the private sector. Instead of, literally, printing money, a deposit is created electronically for the vendor. It is hoped that two things will happen. One is that the purchasing of bonds from the private sector will drive down interest rates in the bond market thus making it easier and cheaper for corporate borrowers to raise money. The second is that the money deposited as a result of the private sector bond sale will be put to good use in raising economic activity in different ways in the economy. It could be lent, creating a money multiplier effect or it could be used to buy equities which, if successful in raising the level of the equity market, could create a positive wealth effect. As a general rule, the objective of increasing the money supply will be to induce a modest amount of inflation into an economy at a time when there has been talk of deflation. A low inflation level, say of around 2%, is about right. It does not act as a discouragement to spending because consumers and businesses expect price levels to be rising so there is no advantage financially of saving what businesses and individuals might be prepared to spend on a discretionary basis as there is in a deflationary environment. 2% is not a level of inflation about which policy makers would normally be concerned so policy would not have to be restrictive and, for governments, it has the advantage of slowly chipping away at the real value of debt. For individuals, borrowing does not seem so burdensome if the real value of their debt gets inflated away and borrowing, provided it does not get out of hand as it has in some countries, gives an extra injection of activity into the economy.

If printing money or its modern day equivalent, quantitative easing, is so easy, why does not every country in trouble do it? The answer, of course, is that it is a highly risky project borne out of the extreme circumstances in which many countries now find themselves. It risks being seriously inflationary in due course and this will be one reason why the international bond markets have started to weaken. To reduce the risk of inflation caused by quantitative easing, central banks, which have created the money, will have to withdraw it at some stage by selling bonds back into the market and taking back the original cash created. This is easier said than done. Although the major central banks are independent, they will be aware of political pressure which it is hoped they can resist but it may not be easy. Creating the money seems painless but selling bonds into a market awash with them is likely to push up yields, an unwelcome side effect. If inflation results from quantitative easing not being reversed in time, then the cure will be higher interest rates which will have a restrictive effect on the economy. Interest rates have to rise to more normal levels in any case. It is unhealthy that they are so low. They risk inflation later on if not reversed as soon as it seems possible to do so and they cause significant problems for savers, depressing their purchasing power significantly.

For politicians, being in government at a time like this is a difficult task. Whilst the temptation is to let borrowing rise significantly in the hope that the economy will recover leading to a reduction in government borrowing as tax revenues start to recover and government expenditure starts to stabilise, markets will not let them get away with this in the worst cases and action will have to be taken. In the most serious cases, outside help may have to be sought, perhaps from the IMF, and severe strings will be attached. In certain cases, this may be an unexpected economic blessing if recalcitrant governments are unwilling to act. The correct economic medicine will then be imposed from outside.

Actions to correct excessive government borrowing tend to make governments unpopular. Cutting public spending and/or raising taxes are not normally ways to endear politicians to their electorates so, paradoxically, actions imposed by markets are likely to lead to a better long term result.

The situation is made worse by the electoral cycle. Two examples which come to mind are Germany and the UK, with elections due in Germany in September and in the UK no later than the beginning of June 2010. The situation is more acute in the UK simply because the level of current borrowing as opposed to the overall level of public debt in relation to GDP is far higher than in Germany. The recent OECD forecast for the general government financial balance, as a percentage of nominal GDP, in the UK next year is -10.5% and in Germany -6.8%, whilst it is -11.9% in the USA. Although the German figure is bad it is not in the same league of seriousness as that of the USA and UK. Whilst the fact that the USA has recently held elections may seem to be an advantage in terms of the executive and legislature having the authority to act, the UK political system is actually better in providing the mechanism for quick action. Put simply, the government, providing it can maintain the support of its MPs, can act quickly to effect the necessary policy changes. It is much more difficult in the USA where special interest groups are adept at tagging on expenditure to unrelated bills. In Germany, at present, coalition politics in the run up to the election make decisive action difficult.

But it is about the UK that we remain most concerned. The USA has in its favour that the US dollar is the major reserve currency. In the size that it is held in other countries' foreign exchange reserves, it cannot just be dumped without these countries damaging themselves financially. The UK has much less support from this aspect. Sterling generally does not have to be held. After its sharp fall last year, which was not unexpected, it has been surprising that sterling has made some recovery this year. It is difficult to forecast short term currency movements but we think that sterling has little in its favour at the moment. That can be said for the US dollar and euro as well but it is a zero sum game and we think, relatively speaking, the UK has more problems.

Most independent observers believe that the state of the UK's public finances is so serious that a credible policy has to be put forward to reduce borrowing so that there will be confidence in the UK's ability to service and pay down its debt. S&P fired a warning across the UK's bows. S&P said that it might review its decision not to withdraw its AAA rating if "the next government's fiscal consolidation plans are unlikely to put the UK debt burden on a secure downward trajectory over the medium term". The problem for the UK, clear for a long time but brought into focus by the financial crisis, is that public spending was growing far too quickly for the economy's good. Significant tax increases are pencilled in for the future as well as severe restraint on public spending but the latter is not happening before the General Election which, we must assume, is about a year away. Objectively, whoever wins the next election is going to have to make severe public spending cuts and, in terms of confidence, these should be outlined now. If delay means lack of confidence in the UK government bond market and rising bond yields, which is what we expect, the cost will be even higher. In front of the election, the government appears reluctant to act on public spending, and the delay could prove costly. Whilst one month's figures cannot be considered statistically significant, the horrific public borrowing figures for April, £8.5 billion, should, at the very least, cause alarm that the £175 billion borrowing forecast for the current financial year is too optimistic. That figure itself is, of course, shockingly bad.

Throughout the world, it is growth in the private sector which will provide the tax base for improvement in public sector finances but the present position is that government borrowing almost everywhere threatens to "crowd out" the private sector. If, as we expect, government bond yields in most countries continue to rise, that makes it more expensive and difficult for the private sector to borrow, thus stultifying economic activity. For investors, this is not a good outcome. In the struggle to move public finances everywhere to a more sustainable footing, the balance between public spending cuts and tax increases is crucial. In most countries, it will be a combination of the two methods but, generally, investors would prefer to see the balance tipped, as far as possible, towards reductions or severe constraints on public spending. Ignoring the politics of the situation, in the debate about the balance between spending cuts and tax cuts/no tax increases/modest tax increases, the argument should be in favour of the first option, action on public spending. If public spending is reduced, it will have a negative effect on economic activity. So, too, will rises in taxation. If we take the very simple option between cutting public spending and cutting taxes, the reduced economic activity caused by the former is likely to be outweighed, if not immediately, by a greater increase caused by the latter. The incentive effect in the private sector is likely to lead to greater multiplier effects in economic activity. We have expressed this in a very simplistic way but investors need to consider the implications of the different possibilities for addressing the size of excessive public deficits in those countries where there are unmistakable structural deficits piled on top of cyclical deficits.

Bad behaviour impacts on the financial sector which has helped to cause huge anger towards it and many politicians have happily keyed into the public mood which has potentially created a dangerous situation whereby "big government" has come to be accepted. This is unlikely to prove conducive to the level of economic growth which is necessary to sustain the taxation base for the level of public spending which voters desire and investors consider necessary for their required investment returns. This is not an immediate investment issue but will become an increasingly relevant one. What has happened has given governments excuses to interfere more in the economy and increase regulation as well as some unwelcome bows in the direction of protectionism, a really serious threat to the world economy. The anger of voters at what has happened has been largely channelled against the financial sector but business, by association, also suffers if it gives governments the opportunity to interfere and regulate more. Amongst the many failures in the financial sector was one of regulation, and the inevitable tightening up of financial regulation to try to prevent the catastrophes which have occurred is correct provided it is channelled into the correct areas and not used as an excuse for governments to meddle more extensively and for a wider move to "big government". For in the same way as large increases in government borrowing threaten to "crowd out" the private sector through competition for funds and related increases in the cost of money, so "big government" through micro management, greater regulation and accounting for a greater proportion of GDP has an equivalent effect, not through interest rate increases, but raising the costs of doing business in other ways. The effect of tax increases, whether corporate or personal, is relevant here. We need to keep a close eye on developments here.

Whilst, in recent economic reviews, we have not been analysing various items of economic data in the same way as we have routinely done in more normal economic times, we have started to list some of the items of economic data which might represent, if not "green shoots", then at least signs of some economic stabilisation. As we have noted before, stock market cycles do not move in tandem with economic cycles and it may seem, on the surface, surprising that the equity markets have recovered so strongly since March, given the dire position of the international economy which is in serious recession. But markets look ahead and, by definition, the downturn in this cycle will end at some stage. The rate of deterioration of various indicators will decline, then they will stabilise and then they will start to improve. These processes will take place amongst a small number of indicators first and then the numbers will expand. Equity markets have responded eagerly to these signs even though the numbers are very limited at present. Linked with this is the absence of major new shocks. Everyone knows how bad things are economically but the ability of news to shock has been lessened. Markets do not like unpleasant surprises and there have not been any major shocks recently.

That being the case, if we look at the various asset classes, equities to us retain the edge, even if they pause for breath after their sharp recovery over the past quarter. Their attractions relative to bonds we believe are particularly great. The combination of vast issuance, together with the potentially inflationary affect arising from quantitative easing and loose monetary and fiscal policy, to us make present yields in medium and long dated bonds far too low. If top quality government bond yields rise, as they have been doing recently at the medium and long dated end, we find it difficult to believe that yields on good grade corporate bonds can move in the opposite direction for long. With the yields on cash being almost nil, the only advantage for cash forming a very significant part as an asset class in a portfolio is because the prospects for other main asset classes are so poor. As against bonds, we would agree, but not against equities. Given the very steep rise in equities over the quarter, as demonstrated by the table at the beginning of this review, it is reasonable, if one is significantly overweight in cash, to wait for a setback before committing more funds. It may be that equity markets need to consolidate to allow economic events to catch up with them but the combination of decent yields (strikingly so, of course, against cash) and modest ratings, notwithstanding difficult prospects for dividends and corporate earnings, demonstrate long term value. Apart from a possible sharp "V" shaped recovery from the severe recession currently being experienced, the need to pay down some of the huge deficits now being run by most major economies will mean restrictive economic policies for a long time ahead. This implies fairly low growth rates compared with pre-financial crisis levels, and only modest increases in corporate profit and dividend levels. However, this looks likely to be the most rewarding investment option compared with the alternatives. If inflation accelerates, perhaps because quantitative easing is not reversed, calls on real assets like shares, commodities and property (although there remains an enormous overhang here in the commercial sector) are likely to be popular, as well as inflation linked bonds.

Finally, as we have done in recent months, we list some of the data which show that a turning point in the world economy may be in sight if only because the economic data is deteriorating at a slower rate than previously. As we mentioned earlier, this is a necessary condition of being able to state confidently that a turning point in the world economy is in sight. The data mentioned after this is from May, starting with the USA, where, in early May, a survey by the US National Association of Realtors showed that pending sales of existing US homes rose by 3.2% in March compared with 1.1% a year earlier. The NAR attributed the rise to first time buyers taking advantage of favourable affordability conditions including a US$8,000 tax credit. In April, the rate at which US employers were laying off staff slowed down. 539,000 jobs were cut which is the lowest figure for six months. The rate of decline of US industrial production fell in April. It declined by 0.5%, compared with 1.7% in March and 1.0% in February. Consumer sentiment registered a strong increase in May. The Conference Board's headline index of confidence rose to 54.9 in May from a revised 40.8 in April. Existing home sales in the USA rose by 2.9% in April following a fall in March. The Commerce Department reported that durable goods orders rose by 1.9% in April although the decline in March was revised to show a 2.1% fall rather than 0.8% as first announced. In the eurozone, Markit's final eurozone manufacturing purchasers managers index for April rose to 36.8 from 33.9 in March. This was the highest reading since last October and, although it indicates decline, the rate of decline is shown to be decreasing. The Markit purchasing managers survey for the eurozone services sector in April stood at 43.8 compared with 40.9 in March and the same comment applies here. The eurozone's purchasing managers index for eurozone business activity for May rose to 43.9 compared with 41.1 in April, an eight month high. The Conference Board research group's leading economic index for the eurozone rose by 1.8% in April to 93.8. The European Commission's eurozone sentiment index rose from 67.2 in April to 69.3 in May. In Japan, the Bank of Japan upgraded its assessment of the Japanese economy for the first time in three years. It declared that the worst of the recession could be over as rising global demand helped to lift the economy. In April, Japanese retail sales rose for the first time since last September. Seasonally adjusted April sales rose 0.6%, the first rise since last August. In the UK, the CIPS/Markit purchasing managers index of industry conditions rose to 42.9 in April from 39.5 in March. There were signs of a slowdown in the rate of decline in activity in the construction industry. The CIPS/Markit purchasing managers index rose to 38.1 in April from 30.9 in March. The latest CIPS/Markit purchasing managers survey in the services sector rose to 48.7 in April from 45.5 in March. The index of new orders registered its biggest rise since March 1999 and the best reading since April 2008. The RICS said that its index of enquiries in the housing market rose to 41 in April from 32 in March. Agents sold an average of 10.6 properties between February and April compared with 9.7 in the three months to March. Retail sales in April rose by 4.6%, according to the British Retail Consortium, although the figures were flattered by the incidence of

Easter in April. There was evidence of a slowdown in the rate of decline in the manufacturing sector where output fell by 0.1% in March, which is the slowest rate of decline for thirteen months. The National Association of Estate Agents said that the number of homes sold by its members averaged an agreed ten sales in April compared with eight in March and only five last August.

In themselves, these figures are unremarkable and in another environment mostly they could be considered disappointing. But their value lies mainly in showing that the rate of decline in economic activity in whatever form appears to be slowing down and this is a necessary prerequisite for forming a base in the cycle before economic recovery can start. It must be emphasised that bad news is still overwhelmingly in the ascendant but in looking for pointers as to why equities have staged a sharp recovery in the quarter, it is evidence such as this which is important. We now watch for further evidence that the downturn is bottoming and then for evidence of actual recovery.

May 2009