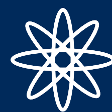

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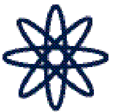
ASSET MANAGEMENT (C.I.) LIMITED



Investment Memorandum

International equity markets have consolidated the previous quarter's advance, although they tailed off towards the end of the period and, at the beginning of June, experienced a significant sell off. We do not regard this as unhealthy because of the trajectory of the previous ascent in international equity prices. We would expect investors to use this setback to add to equity holdings, albeit that the atmosphere has become quite febrile. The bond market has spooked investors with a big sell off in recent days but this should not be surprising given the extreme overvaluation of bonds. In the currency markets, sterling moved higher, especially against the yen and Australian dollar. Commodity prices were generally weak on concerns about the Chinese growth rate, but the upside is that this fall in commodity prices releases some pressure on households and businesses which should be helpful to growth.

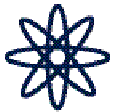
The tables below detail relevant movements in markets:

International Equities 28.02.13 - 31.05.13

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-2.2	-8.3	-8.4	-7.6
Finland	+6.0	+5.2	+5.1	+6.0
France	+8.5	+7.6	+7.5	+8.5
Germany	+7.5	+6.7	+6.6	+7.5
Hong Kong, China	-0.2	-0.1	-0.3	+0.6
Italy	+9.5	+8.7	+8.5	+9.5
Japan	+17.6	+7.6	+7.5	+8.4
Netherlands	+8.7	+7.8	+7.7	+8.7
Spain	+2.0	+1.2	+1.1	+2.0
Switzerland	+6.7	+3.9	+3.8	+4.7
UK	+4.8	+9.8	+4.7	+5.6
USA	+8.2	+8.3	+8.2	+9.1
Europe ex UK	+6.5	+5.0	+4.9	+5.6
Asia Pacific ex Japan	-0.3	-3.7	-3.8	-3.0
Asia Pacific	+7.2	+1.2	+1.1	+1.9
Latin America	-1.6	-6.8	-6.9	-6.1
All World All Emerging	+0.3	-2.8	-2.9	-2.0
The World	+6.8	+5.2	+5.1	+6.0

Source FTSE World Indices

FT Government Securities Index All Stocks (total return) : +0.3%



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

Currency	28.02.13	31.05.13
Sterling	1.97	2.03
US Dollar	1.89	2.17
Yen	0.67	0.86
Germany (Euro)	1.45	1.51

Sterling's performance during the quarter ending 31.05.13 (%)

Currency	Quarter Ending 30.04.13
US Dollar	-0.1
Canadian Dollar	+0.5
Yen	+9.1
Euro	+0.8
Swiss Franc	+2.7
Australian dollar	+6.6

Other currency movements during the quarter ending 31.05.13 (%)

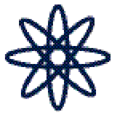
Currency	Quarter Ending 30.04.13
US Dollar/Canadian Dollar	+0.6
US Dollar/Yen	+9.2
US Dollar/Euro	+0.9
Swiss Franc/Euro	-1.2
Euro/Yen	+8.3

Significant Commodities (US dollar terms) 28.02.13 - 31.05.13 (%)

Currency	Quarter Ending 30.04.13
Oil	-9.9
Gold	-11.5

Markets

Despite some weakness at the end of the quarter, international equity markets recorded a positive quarter. The FTSE World Index returned 6.8% in local currency terms, 5.2% in sterling terms, 5.1% in US dollar terms and 6.0% in euro terms. Looking at local currency returns firstly, we note a spectacular return of 17.6% from the FTSE Japanese Index spurred on by "Abenomics". The USA returned an excellent 8.2% as measured by the FTSE USA Index whilst the FTSE Europe ex UK Index returned a creditable 6.5%, slightly below that of the FTSE World Index but still good. Relative weakness, where it occurred, can be seen in the FTSE Latin America Index, -1.6%, the FTSE Asia Pacific ex Japan Index, -0.3%, and the FTSE All World All Emerging Markets Index, +0.3%. Weakness in the commodities sector caused a negative return from the FTSE Australia Index, -2.2%.



Turning to the sterling adjusted figures, the two currencies which were particularly weak were the yen and Australian dollar. As a result of the yen's weakness, the sterling return on the FTSE Japanese Index was reduced to a still very good 7.6% but, unusually for what has been a very good market, the FTSE Australia Index returned -8.3%. Returns from the FTSE Latin America Index, FTSE All World All Emerging Markets Index and the FTSE Asia Pacific ex Japan also suffered with sterling adjusted returns of -6.8%, -2.8% and -3.7%.

International bond market weakness was a feature towards the end of the period as concerns about the gradual withdrawal of QE in the USA became apparent. Taking ten year government bonds as the yardstick, the gross redemption yield on UK government bonds rose by 6 basis points to 2.0%, on US Treasuries by 28 basis points to 2.17%, on Japanese government bonds by 19 basis points to 0.8% and on German Bunds by 6 basis points to 1.51%.

In the currency markets, sterling rose by 9.1% against the yen, by 6.6% against the Australian dollar, by 2.7% against the Swiss Franc, by 0.8% against the euro and by 0.5% against the Canadian dollar. It was almost unchanged against the US dollar, down by just 0.1%.

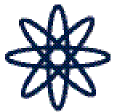
Weakness in commodities was a feature over the quarter with oil, as measured by Brent crude, falling by 9.9% and gold by 11.5%.

Economics

Although the problems which have beset the world economy remain, there have been developments which could be significant in certain countries, notably the U.S.A. and Japan. The chronic problems of the eurozone remain but there are also slight flickers of hope in the U.K. The slowdown in China's growth rate has concerned investors, with the fall in some commodity prices being related to this, and the commodity sector has underperformed a generally firmer international equity market.

Towards the end of the quarter, we had an interesting but not unexpected development in the international bond markets, namely a sharp rise in yields. Our clients will know from many past reviews that we regard the bond markets as very significantly overpriced and that they were and remain an accident waiting to happen. It may already have started as yields rose very significantly in May. The big issue for the international bond markets is that the extreme nature of the standard and non standard monetary policy being followed by central banks to offset the financial and economic crisis and now tough fiscal policy in many countries, has distorted fundamental values dramatically. There are many forced buyers of bonds for regulatory or matching reasons, i.e. banks, insurance companies and pension funds, but it is almost impossible to believe that, in pure investment terms, the results of bond purchases at anything like the levels we have seen in recent times will be anything other than very poor. This goes for central banks as well. Under quantitative easing, they have been enormous buyers of bonds at the same unrealistically low yields and, as yields rise towards more realistic levels, central banks' balance sheets will sustain a heavy hit. Investment is, by its nature, highly subjective but, if we wanted to go out on a limb on one aspect of investment policy, it is that bonds are dangerously overpriced.

Whilst we have been confident that equity markets have been the right place to be since the 2008/9 financial crisis, we have been more than aware why this would be so, namely the very aggressive monetary policy which central banks were often practising. Very low interest rates and money printing, although not widely trumpeted at the time, were meant to raise asset prices in order to encourage a positive wealth effect in households and businesses who might spend to offset the recession. The main explicit stated aim at the time was to help borrowers but, as time has moved on, the asset price target policy has been more widely publicised. But, whilst we have felt and still feel that equities remain the best asset class (independent of reasons why there are forced buyers of fixed interest stocks), we have always realised and said that they have not risen for the best quality reasons. Loose monetary policy has forced some investors to search for yield and it must be remembered that amongst individuals there



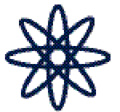
are more savers than borrowers. All of this cheap money chasing a finite pool of suitable equity assets has helped to drive up equity prices in what might be termed a "sugar rush". The same has happened to certain bond classes, corporate and emerging markets come to mind as well as high yielding "junk bonds", but here the fundamental justifications are less good in our view. For equities, as we have said on a number of occasions in these reviews, their attraction has been, in a negative sense, that other asset classes look so unappealing, to us at least anyway, but, on a positive note that we think share ratings both in price/earnings ratio terms and dividend yield terms have been reasonable enough to feel confident of investing. If, as some argue looking back on cyclically adjusted p/e ratios, shares in some markets like the USA, look expensive, we would say that although profit margins are historically high and the share of profits in GDP high, we do not see a reversion to mean in the foreseeable future in these indicators. Companies have their costs well battened down, although they will need revenue increases to keep the bottom line moving up. We do not see any need to be too negative on this score.

We have also felt that monetary policy in most countries and regions where it has been very loose will continue that way for the foreseeable future. Although the international economic outlook is not wholly bad, the eurozone and the UK come to mind as countries and regions where it is likely to be necessary to keep monetary policy very loose and probably for the time being in the USA too. We know that an extreme form of monetary easing is taking place in Japan, so we can be reasonably confident in our forecast about monetary policy. The relative attraction of dividend yields against those available on good quality bonds or cash should remain for a while.

However, we should be acutely aware of what spooked the bond markets and, by extension, the equity markets, at the end of the month, if only temporarily. In answer to a question, Ben Bernanke, the Chairman of the Federal Reserve, gave a very obvious answer to a question about a slowing down of QE in the USA, currently US$85 billion a month, which was that the pace of QE would depend upon economic conditions. Because the economic outlook is slightly better in the USA, it was taken that a throttling back of QE was on the horizon. That may or may not be the case, for only time will tell, but what is certain is that, if inflation is not going to be ignited at some later stage, QE has to be reversed. The nervousness which Mr Bernanke's statement induced shows the dependence of bond and equity markets on the existence of such an extreme monetary policy. What we would prefer to see as a much sounder base for rising equity prices is economic growth leading to good quality earnings and dividend rises. There has been earnings growth, and the dividend experience is encouraging, but both of these two supports need a sounder base.

The leading question is how markets will adjust to more normal conditions for interest rates where they are not artificially suppressed as they are now. This may be some time away from happening, but it is necessary that the adjustment takes place to reduce the unwanted effects of the distortions caused to the economy and financial system by the present policy. We have, indirectly, referred above to the "quality" of the rise in stock markets since very loose monetary policy became the norm. It would be desirable to move to something more sustainable. If interest rates rise because economic growth is resuming, that should be able to be handled by the international equity markets because interest rates are rising for the correct reason. Markets could also probably take more inflation in such circumstances but, beyond a certain level, it would become a problem because high inflation would call for a policy response. At the moment, there is an output gap in most industrialised countries, meaning that production is below potential, so that inflationary pressures do not yet pose a threat. However, if economies recover and production comes up against capacity constraints, then inflation can be expected to pick up. More confidence could get the money, which has been created moving (it is not really doing so at the moment, one reason why inflation remains subdued) and that is when the output gap and inflation problems will occur.

Undoing QE will be an enormous task. Leaving aside Japan's new plans, the Bank of England holds about one third of outstanding government debt on its books. Unwinding that will be an enormous task. That is a domestic issue but the international implications of extreme monetary policy are sizeable. In isolation, printing money can be expected to lead to currency debasement, but it has led to problems in international currency markets

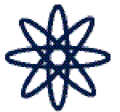


and driven capital inflows into countries which do not want them. Although it has sparked, so far, relatively little controversy, the extreme monetary measures being carried out by the Bank of Japan, effectively at the instigation of the new Japanese government, although it is not supposed to be that way, have driven down the value of the yen dramatically, causing problems to other Asian countries' manufacturing industries. In such circumstances, countries are likely to become more protectionist, whether in currency markets or in trade. These "beggar my neighbour" policies became highly undesirable as they cause distortions in the economic systems.

Whilst the current extraordinary economic and financial environment can easily make an investor pessimistic, the world economy will eke out some growth, albeit appearing very unevenly. In its latest economic outlook, recently published, the OECD forecasts growth amongst its members at 1.2% in 2013 and 2.3% in 2014. These are not great figures, but at least they point to some growth and many companies in which our clients are invested can benefit from exposure to countries and regions of above average growth. The IMF's latest forecast for world economic growth was 3.3% and the latest EC forecast is for growth of 3.1% in 2013. Unsurprisingly, the real problem area remains the eurozone where the OECD foresees economic contraction of 0.6% this year, recovering to modest growth of 1.1% next year. Amongst the largest eurozone economies, it sees only growth in Germany this year, +0.9%, but, elsewhere amongst this group, it forecasts only economic contraction with France at -0.3%, Italy -1.8%, Spain -1.7% and the Netherlands -0.9%. The latest European Commission forecasts are not greatly different although, in line with the latest thinking, it is less optimistic about Germany's prospects this year, forecasting growth of just 0.4%.

The eurozone represents a drag on the whole world economy and, whilst both sets of forecasts see a return to modest growth next year (1.1% for the OECD at 1.2% for the EC), it is very easy to see why these forecasts may be too optimistic given the dreadful state in which the eurozone finds itself. Whilst the EU finds time, at various levels, to busy itself with highly damaging economic measures like the proposed Financial Transactions Tax which, if enacted as planned (unlikely now), will be likely to reduce economic activity even further, it fails to address the eurozone's fundamental problem, a monetary union which cannot work as it is presently established, and which is causing severe social distress in countries like Greece, Spain, Portugal, Ireland, Cyprus and Italy where youth unemployment levels are simply obscene and which will blight a whole generation all in the name of preserving a monetary union which those in authority refuse to recognise as a failure. The inability of countries to run their own monetary policy means that exchange rate flexibility is lost and that the internal devaluations being forced on these countries mentioned above is causing unemployment and falling living standards. The EU is now beginning to row back on its austerity programme in terms of extending the budget deficit adjustment timetable in return for commitments on structural reform (France is a country about which this is highly relevant) which can help to improve the longer term economic growth prospects of these countries. There has to be some scepticism about the extent to which structural reform will be enacted, particularly in France, but it is fair to say that, in countries such as Spain, there has been progress in the labour market and improved competitiveness which has resulted in additional business for the Spanish car industry, as one example. But, if we look at the eurozone as a whole, it is difficult to see any real catalyst for growth and plenty of reasons why it will continue to struggle. It will continue to represent a drag on the world economy.

Elsewhere, the position looks better, although hardly rosy, but it does provide room for modest encouragement. The OECD sees the USA growing at 1.9% this year and 2.8% next year (the EC's forecasts are broadly similar at 1.9% and 2.6% respectively). Outside its membership, the OECD sees growth in China of 7.5% this year and 8.4% next year and India of 5.3% and 6.4% respectively. The EC sees China growing at 8.0% this year and 8.1% next year ; and, of course, there is Japan where we want to see the outcome of Abenomics. For the moment, the OECD forecasts that Japan will grow by 1.6% this year and 1.4% next year, whilst the EC's figures are reversed at 1.6% and 1.4% respectively. In the UK, there are tentative signs of "green shoots" with the OECD forecasting growth of 0.8% this year and 1.5% next year against 0.6% and 1.7% for the EC. What one can say is that, difficult though conditions are in the UK, they are even worse in the eurozone, and the UK economy is likely to grow this year.

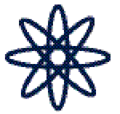


There is not a lot more to say about the eurozone. Apart from Germany, the EC has made recommendations to the major eurozones about how they tackle their deficit problems and increase long term economic growth prospects. It will be interesting to see if their recommendations are acted upon and, if they are not, what the EC is prepared to do to enforce its recommendations. The real concern is France where resistance to change is strong. So far, France has retained support in the international bond markets but it would not take much to change this comfortable situation. France's loss of competitiveness is a major concern and this is enhanced by a deteriorating current account position which has to be financed. At the same time, Germany runs an enormous current account surplus, expected to be around 6.0% of GDP this year. There is considerable nervousness about the French economic position and countries like Germany have not been shy to mention it.

Let us move on to a country where there is modest cause for optimism, the USA. It will be recalled that the concern was that the tax rises, payroll tax restoration and sequester would damage the US economy when these measures started to come in on 1st January this year and the sequester later. So far, the effects have been limited, but it is early days. First quarter GDP growth of 2.4% annualised was marginally revised down from the first estimate of 2.5%, but the components of the change were not significant. On the positive side, US non farm payrolls rose by 165,000 in April with unemployment falling to 7.5%. The February and March figures were also revised upwards by 114,000. At a time when disposable incomes are under pressure from tax and payroll increase factors, a release of inflationary pressures provides some offset. With petrol prices weakening, the cost of living in the USA declined sharply. The CPI fell by 0.4% in April and the core figure rose by just 0.1%. Influences like this are helpful in sustaining economic activity when other factors are regularly affecting take home pay. There is also good news on the crucial US housing market, the source of the financial crisis back in 2007/8. According to the Case-Shiller index, house prices were 10.9% higher in March than a year ago and, in another statistic, house repossessions were 24% lower than a year previously. This reduces the supply of houses and, hence, raises prices. Rising house prices reduce the effect of the negative equity problem and should, slowly, lead to a positive wealth effect. At the same time, households are deleveraging quite rapidly. According to the New York Federal Reserve, households reduced their debts by US$110 billion in the first quarter of 2013 and that the loan arrears position was improving, when the number of loans which are more than 90 days behind on a payment fell from 6.3% to 6.0%.

Ideally, one would like to see the USA's budget deficit coming down, as it has to do, and the economy holding up well in the face of this, as there is some modest evidence that it is doing, as we have noted from some of the data above. The non partisan Congressional Budget Office showed the budget deficit falling to 4% of GDP this year against 7.0% last year. The improvement of US$203 billion should be seen in the context of the US$1.1 trillion deficit last year. Its forecast next year is for a further reduction in the budget deficit to 3.4% of GDP and 2.1% in 2015, after which the trajectory moves up again. Higher tax revenues and payments from Fannie Mae and Freddie Mac were significant factors in the improving trend of the USA's public finances. It is likely that the deadline for increasing the Treasury's borrowing facility to avoid a debt default will be shifted from August to October or November.

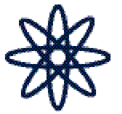
As we said earlier, what spooked the markets at the end of May was a suggestion by Ben Bernanke, in a Q & A session, that the tapering of asset purchases could start soon. In truth, this was a neutral answer to a question because the outcome will depend upon the course of the US economy, but the mere possibility struck a sensitive chord with investors. When they know that an asset is overvalued, i.e. bonds, their sensitivity and nervousness increases. All of this should be placed in the context of the FOMC's statement, at the beginning of May, where it said that the pace of asset purchases could go up or down, depending upon what happened to prices and jobs. The FOMC said, in its statement, that "fiscal policy is restraining growth", although with the economy continuing to grow at a modest pace. It also referred to a further strengthening in the housing sector, to which we alluded earlier. In short, future Fed action is dependent upon the economic data coming out of the USA, which was always going to be the case. The skittishness of the market in recent days is a function of the basis upon which part of the stock market's rise has been based, i.e. the rather low quality reason of very loose monetary policy.



In many ways, at present, the most interesting country economically is Japan, with its mind blowing monetary policy experiment. Following the election as Prime Minister of Mr Abe late last year, and the pressure he placed on the Bank of Japan to change policy and targets to try to get the Japanese economy moving, we now face a make or break time for Japan. To recap how monetary policy has changed, the Bank of Japan, under its new Governor, intends to double the country's monetary base from the equivalent of US$1.43 trillion by March 2015. It will follow a much less cautious bond buying policy. Normally, if central banks are buying bonds in the market, they will keep the maturities short to avoid the risk of losses caused by adverse interest rate moves. The further out the maturity spectrum the bond purchases take place, the greater the risk of capital losses for the purchaser if interest rates rise. That is a threat to any bond buyer whether it be a central bank or commercial bank or any private purchaser. To try to control interest rates, the Bank of Japan intends to purchase longer dated bonds in order to lengthen the average maturity of bonds which it holds from three years to seven years. In a timely warning, the Bank of Japan calculated that a 1% rise in interest rates would lend to mark to market losses equivalent of 10% to Tier 1 capital at big banks and 20% at weaker regional banks. It is also raising its target inflation rate from 1% to 2%. The reason for this, which may seem counterintuitive when governments and central banks around the world have in the past been trying to bear down on inflation, is that the Japanese experience of deflation has been very corrosive. Deflation raises the real value of outstanding debt thus putting financial pressure on individuals and businesses, but it also discourages economic activity as businesses and individuals held back on purchases and investment which are not essential because they expect to be able to buy them cheaper later on. But there is no doubt that this is a very high risk strategy for Japan. Its gross level of public debt as a percentage of GDP is expected to be around 240% this year and it has a deteriorating current account position as its trade deficit worsens as a result of the need to import more energy related items following the nuclear meltdown in March 2011 as a result of the tsunami and earthquake in Japan. It is estimated that the current account surplus might be down to around 1.0% of GDP in 2013. Whilst Japan has enormous foreign exchange reserves, the devaluation of the yen, another important aim of Japanese economic policy, will cause the trade balance to deteriorate in the short term as imports cost more. Furthermore, with a budget deficit estimated to be around 9% of GDP in 2013, there is a big risk to financial stability with Japan's "go for broke" economic policy.

It is very early days for Japan but there are some early encouraging signs for the Japanese economy. The latest quarterly economic growth figures, issued on a preliminary basis, show a 0.9% quarter on quarter increase in red GDP, representing an annualised rate of 3.5%. This follows an upward revision to the figures for the final quarter of 2012 where the quarter on quarter increase was 0.3%. There were some encouraging components contributing towards last quarter's rise in GDP. Exports were strong, up 3.5%, although what Japan's manufacturing competitors might say is a different story. Importantly for the government, consumer spending rose, up 0.9%. Deflation was still present as measured by the GDP deflator at -1.2%. However, probably because of the lagging effect and a "wait and see" attitude, business investment fell during the quarter. The news on industrial production in the first quarter was better as it rose by 1.9%.

So far, Japan has not been accused of currency manipulation. Its currency is moving about all over the place and, as our table at the beginning of this review shows, it moved down very sharply over the quarter. One downside of the financial repression we now see is that very low interest rates become increasingly ineffective in influencing an economy's path, so the temptation is to move to protectionist measures which include currency manipulation. This has consequential effects on other countries, particularly in the case of Japan on its Asian competitors, and the danger is that this action could escalate. It may seem a strange thing to say about a currency that has historically been strong, but this extreme monetary policy risks currency debasement. With such a vast level of government debt, Japan is following a high risk strategy. If it is to work, Japan has to embark on meaningful structural reforms to enable the country to raise its potential growth rate. Sustained faster economic growth is the best way to rectify the imbalances in the Japanese economy but it is a long and difficult task.

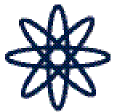


Even though China is now the second largest economy, having overtaken Japan, the startling change of economic policy in Japan has attracted some attention away from China, although this can only be a temporary phenomenon given the importance of the latter's influence on the world economy. Although the Chinese growth rate has been, at least temporarily, below what was expected, it is a rate of growth of which troubled eurozone economies, for example, can only dream. The latest year on year growth rate from China is 7.7% to the end of May and the latest annualised quarterly growth rate was 6.6% (1.6% quarter on quarter). The closely watched Purchasing Managers Indices at the end of May showed only a very slightly positive bias in the manufacturing reading at 50.8 against the previous month's reading of 50.6 and for the non-manufacturing sector the reading was stronger, even though slightly lower than that of the previous months, at 54.3 against 54.5. The authorities in China are naturally very sensitive to the inflation rate, especially food, and this latter component has pushed up the rate of inflation as measured by the Consumer Price Index. The overall rate, however, is not high at 2.4% compared with 2.1% the previous month. The core inflation rate was lower at 1.6% whilst the producer price index was in negative territory at -2.6%. The Chinese authorities are keen to try to keep a lid on house prices because of the knock on effects on inflation and, here, we have seen a slight acceleration in the rate of increase in house prices. In 70 cities, the year on year increase in prices was 4.3%, up from the previous month's 3.1%. For international investors, who are very sensitive to the state of the Chinese economy in so far as it affects international stock markets, the ideal situation is slightly faster growth than is currently being seen but at low inflation rates, the reason being that the authorities are less likely to take offsetting measures which could reduce the growth rate and have a knock on effect on the world economy. In the more febrile conditions which currently exist, at least temporarily, in markets, we can expect investors to become more sensitive to the economic news from China.

Turning to the UK, there has been a perceptible change in sentiment based on some encouraging economic numbers. These are very early days and nobody should be carried away by them because the UK's public and private debt problems are horrendous but they are an antidote to the pervasive air of pessimism which always seems to surround the UK economy and the contrast with the eurozone is becoming more marked. Going back to the time before the first quarter's GDP figures were published, there was much talk of a "triple dip", i.e. three successive quarters of negative growth. In the event, the first and second estimates of first quarter GDP growth came out at 0.3% to give an annualised quarterly growth rate of 1.3%, a great improvement on the eurozone's equivalent figure of -0.9%. Unemployment, although far too high at 7.8%, compares very favourably with the eurozone's level of 12.1%. The most encouraging recent data comes from all three of the Purchasing Managers Indices just published. That for the most important one, services, which accounts for around three quarters of the UK economy, showed a reading of 54.9 in May against 52.9 in April. The manufacturing PMI rose to 51.3 in May against 50.2 in April, whilst construction, which had been particularly weak, tipped over the 50 mark, the difference between expansion and contraction. The hope of the Chancellor must be that the stream of better economic news will encourage a "feel good" factor which encourages companies to invest and give a further boost to the economy.

As we show in this review, there is a significant contrast in the performances of different countries and regions. We would reiterate what we have often said before which is that, bad though the economic conditions in some countries may be, one must distinguish between the sovereign and the countries domiciled in them. It is possible to invest in world class companies based in the eurozone, which can avoid many of the problems faced within their countries by virtue of their exposure to much faster growing markets.

After a very strong start to the year, markets have experienced a reasonably significant setback in recent days, spooked by talk of a possible reining back on QE in the USA. This shows that the quality of the market rise has not been of the best, propelled as it was by cheap and printed money. A straight line upward movement in markets is not healthy and a shakeout should provide a firmer foundation going forward as there is, understandably, a lot of cash on the sidelines waiting to be invested. At the same time, the shakeout in the bond markets should serve as a warning about holding grossly overvalued securities. With modest economic growth likely to continue in



the world economy, albeit very unevenly spread, there should be scope for a modest uplift in corporate earnings and dividends, and we do not consider share ratings to be extended. With any significant levels of cash which have built up, albeit in the context of a fairly fully invested position, we would look to use any further falls as the opportunity to top up holdings. As before, the positive factor favouring equities is that they look reasonable value for long term investors, and the negative factor favouring them is that everything else, particularly bonds, look seriously overvalued. Cash represents just a holding position pending its disposition but, as an investment, it can only be for the very nervous, satisfied with losing money in real terms at current levels of interest rates.

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