meridian

ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

As the tables below show, the position for equity investors has improved compared to the position earlier this year and we analyse in our review the reasons for this. For investors in high quality bonds, the reverse is true and, again, we discuss the reasons for this. The economic situation remains poor but there are modest grounds for muted optimism, tempered with warnings, which we discuss below.

The tables below detail relevant movements in markets:

International Equities 31.03.09—30.06.09

Total Return Performances (%)

Country	Local Currency	£	US$	€
Australia	+10.6	+12.0	+28.7	+21.8
Finland	+26.9	+16.7	+34.1	+26.9
France	+15.5	+6.7	+22.1	+15.5
Germany	+18.6	+9.1	+25.4	+18.6
Hong Kong, China	+37.0	+19.2	+37.0	+29.7
Italy	+18.9	+12.6	+29.4	+18.9
Japan	+20.1	+7.0	+23.0	+16.4
Netherlands	+23.6	+13.6	+30.6	+23.6
Spain	+27.4	+17.2	+34.6	+27.4
Switzerland	+12.2	+2.2	+17.4	+11.1
UK	+10.1	+10.1	+26.5	+19.7
USA	+15.9	+0.9	+15.9	+9.7
Europe ex UK	+19.5	+9.8	+26.2	+19.5
Asia Pacific ex Japan	+21.0	+13.6	+30.5	+23.5
Asia Pacific	+20.5	+10.1	+26.5	+19.8
Latin America	+22.2	+21.3	+39.4	+31.9
All World All Emerging	+25.4	+18.4	+36.1	+28.8
The World	+17.1	+6.3	+22.1	+15.6

Source FTSE World Indices

FT Government Securities Index All Stocks (total return): -1.3%

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

Currency	31.03.09	30.06.09
Sterling	3.13	3.69
US Dollar	2.70	3.52
Yen	1.36	1.35
Germany (Euro)	2.99	3.38

Sterling's performance during the quarter ending 30.06.09 (%)

Currency	Quarter Ending 30.06.09
US Dollar	+14.9
Canadian Dollar	+6.1
Yen	+12.2
Euro	+8.8
Swiss Franc	+9.9

Other currency movements during the quarter ending 30.06.09 (%)

Other Currency	Quarter Ending 30.06.09
US Dollar/Canadian Dollar	-7.7
US Dollar/Yen	-2.3
US Dollar/Euro	-5.4
Swiss Franc/Euro	-1.0
Euro/Yen	+3.2

Significant Commodities (US dollar terms) 31.03.09—30.06.09 (%)

Significant Commodities	31.03.09—30.06.09
Oil	+40.8
Gold	+2.4

Markets

The stock market recovery, which dates back to early March, has seen the gains consolidated in the current quarter. In local currency terms, the total return on the FTSE World Index was 17.1%, 6.3% in sterling terms, 22.1% in US dollar terms and 15.6% in euro terms. Looking at local currency performances firstly in various countries and regions, we see above average performances from Japan, Europe ex UK, Asia ex Japan, Latin America and emerging markets. Surprisingly for us, sterling performed strongly during the quarter and, as shown above, the return on the sterling adjusted FTSE World Index, although satisfactory, was well below that in US dollar and euro terms. The return from the USA, nearly average in local currency terms, was barely positive in sterling terms at 0.9%. The very strong local currency returns from Japan and Europe ex UK became lower than the return on the FTSE UK Index. Asia Pacific ex Japan, Latin American and emerging markets, even in sterling adjusted returns, provided higher returns than the UK, whilst Australia, lower than average in local currency terms, returned a higher sterling return at 12.0% because of the strength of the Australian dollar.

A lower level of risk aversion, amongst other factors, resulted in a negative return in top quality government bonds, as measured by ten year issues. In the sterling government bond market, yields rose by 56 basis points to 3.69%, in the US government bond market by 82 basis points to 3.52% and in the German government bond market by 39 basis points to 3.38%. Only in the Japanese government bond market, which has a low correlation with other bond markets, do we see a different pattern, with the gross redemption yield actually falling by 1 basis point to 1.35%.

Although short term currency movements are very difficult to forecast, we have, nevertheless, been very surprised at how strongly sterling has risen, admittedly from a very depressed level at the turn of the year. Against the US dollar it rose by 14.9%, against the yen by 12.2%, against the Swiss franc by 9.9%, against the euro by 8.8% and against the Canadian dollar by 6.1%.

In the commodity markets, oil's recovery accelerated with a rise of 40.8% but gold was little changed, up just 2.4% in US dollar terms, which for some harder currency investors actually meant a lower price.

Economics

Although the world economic position remains serious as a result of last year's financial crisis, stock markets have experienced much calmer conditions. Not only have equities recovered strongly from March's low point but they have also experienced much reduced volatility. As one sign of investors' lessened risk aversion high quality medium and long dated government bond yields have risen sharply.

However, these two points, the continuation of serious economic conditions and a rising equity market, demonstrate that economic and stock market cycles do not move in tandem. Nobody should be fooled into believing that calmer stock market conditions mean that the problems have gone away. They have not, but they do suggest that the rate at which economic conditions are deteriorating is lessening, a necessary condition for a stabilisation and also that uncertainties are lessened. Because of lags in the economic cycle, the delayed effects of the events last year, and particularly in the autumn, are now being seen in terms of job losses and rising bankruptcies and the news will remain bad for the rest of the year and into next year as well. So, to give a broad generalisation, the news goes from being 100% bad to 95% bad etc, until it reaches stabilisation at 50/50, and then progresses to having the majority of the economic news being positive. We are a long way from the latter state, but we have moved on from the economic news being totally bad. Economists and investors are eagerly looking for "green shoots", indicators which suggest positive economic news. For markets to anticipate better economic times ahead, it is necessary to move only from the 100% bad position but the further away from that position one is in terms of the economic news the better the foundations of stock market recovery.

In one very important area, the banking crisis, we can be fairly sure that the background has improved. At its worst point last autumn, many bank customers feared for their deposits. The consequences of a run on the banking systems do not bear thinking about and, in different ways around the world, governments, central banks and regulators, to different degrees, allayed depositors' fears about the safety of their deposits. We can be fairly sure that this is not an issue now and, in that respect, the outlook is definitely better. At the end of this review, we will also be noting some of the indicators which could suggest "green shoots" and which have caused equity markets to recover sharply from their very depressed level at the beginning of March.

The immediate consequence of last year's financial crisis is the current severe recession in the industrialised world. Although the OECD's latest economic forecasts are slightly less severe than its previous one, they still underline the seriousness of the current position. Its latest forecast suggests a decline in its member states output of 4.1% this year against a previous forecast of a 4.3% fall. For next year, it now suggests a recovery of 0.7% whereas, previously, it was looking for a further decline in output of 0.5%. This improved forecast might be described as a derivative of a "green shoot" but it is a function of the news becoming slightly less bad in the way we described earlier. If we look behind the latest OECD forecast to individual components of it, we note that the USA is now expected to contract by 2.8% this year against last March's forecast of 4.0%. Instead of showing no change next year in the US economy, it now sees 0.9% growth. In the eurozone's largest economy, Germany, the forecast for this year has actually worsened. The contraction is now expected to be 6.1% rather than 5.3% with next year's forecast of growth of 0.2% being unchanged. Japan, too, has seen a slight deterioration in this year's forecast to a contraction of 6.8% against one of 6.6% forecast in March. However, the forecast for 2010 is now for growth of 0.7% against a contraction of 0.5%. Its forecast for the UK, too, has deteriorated this year, with the contraction expected at 4.3%, rather than 3.7%, although its forecast for 2010 represents a slight improvement to one of zero growth, rather than an contraction of 0.2%. But the two speed pace of the world economy, a source of some hope, is shown by the OECD's forecasts for China and Brazil. The OECD has raised its forecasts for Chinese growth this year from 6.3% last March to 7.7% now and for 2010 its growth forecast is raised from 8.5% to 9.3%. The outlook for Brazil is now considered to be slightly worse this year, with a contraction of 0.8% against 0.3%, but next year is forecast to show growth of 4.0% against its earlier forecast of 3.8%. If these forecasts prove to be in the right area, they do provide some ammunition for stock market bulls.

The improvements in economic conditions forecast by the OECD are the result of a massive fiscal and monetary stimulus given to the world economy by most governments. Fiscal deficits and interest rates at scarcely believable levels are having some effect on top of moves to try to make money markets work properly. We have seen the equivalent of printing money, quantitative easing, being used to try to increase money supply and bring down bond yields. In a sense, running huge budget deficits, cutting interest rates to virtually nothing and printing money is the easy part. The difficult part is reversing these actions and moving back to normality. Amongst other things, it is going to require enormous political will because acting to reduce unsustainable budget deficits is likely to bring substantial unpopularity to the government activating such a policy. In the UK, there is the bizarre spectacle of some members of the government attempting to avoid the word "cuts" when everyone knows that, amongst other things, action is going to have to be taken to curb public expenditure. It is just too emotive a word for some people to use.

But public expenditure cuts and/or tax rises, there will have to be almost everywhere to restore public finances. For politicians, whose time horizons may not extend beyond the next election, the political imperatives may seem more important than the economic ones and therein lies the concern. The UK is a good example. As the Governor of the Bank of England has indicated, a credible path for deficit reduction is necessary but there appears to be a marked reluctance to rock the political boat, with an election to be held, at the very latest, by the beginning of next June. But ten or eleven months is a long time in economics and lack of action now could impose a heavy economic price later on. The UK economy cannot wait.

It is worth recounting what are the dangers arising from the fiscal and monetary stimuli given to the world economy. In terms of fiscal stimuli and the resulting budget deficits, the dangers lie in the ability to service and repay debt and, therefore, a loss of confidence by creditors. If creditors lose confidence, economic collapse will follow. So, hard though it may be for politicians, it is better to act earlier rather than later. Generally, the need to have these large budget deficits as a temporary measure to stabilise economies is accepted but investors and creditors will want to know how these deficits are to be addressed in future. Rising debt will normally bring rising debt servicing costs which will place further pressure on budgets and slow down growth as taxes have to be increased or expenditure cut to pay for debt servicing costs. Borrowing more to pay these increased debt servicing costs exacerbates the problem. Levels of public debt in relation to GDP are a measure of a country's creditworthiness. If either the level of the current budget deficit or the overall level of public debt gives potential buyers of debt or creditors concerns, then a country's currency can collapse as it fails to sell debt and neutralises it and / or foreign investors dump their bond holdings. Then the currency would weaken and interest rates rise leading to the prospect of economic collapse. This is an extreme scenario but there are plenty of unpleasant scenarios on the way to this final one. Calls for assistance from the International Monetary Fund might be one course of action but strong economic strings would be attached.

Unless countries come forward with realistic proposals to deal with the explosion of government debt, the markets are going to lose patience with those countries which are dragging their heels. Some countries entered the financial crisis and its resultant economic crisis in a position of relative strength meaning that they could provide an economic stimulus without taking substantial risks for the future. Countries such as China, Australia and Canada come to mind. Investors will regard countries such as these as creditworthy because they have previously been prudent. Although part of the eurozone, where some member countries are being distinctly imprudent with their finances, Germany, in particular, seems to understand the dangers involved in excessive deficits with constitutional amendments being made to require a return to a near balanced budget. From 2016, absent exceptional circumstances, the budget deficit, over the economic cycle, will be limited to 0.35% of GDP. The states will also be constrained. There are get out clauses to allow for exceptional circumstances and cynics may say that politicians will not be slow to exploit these as they face elections. However, the value of these constitutional amendments lies in the fact that it shows that at least some people are sufficiently alarmed by the current level of debt being taken on in Germany (itself a relative paragon of virtue in this respect) to feel the need to act. The German attachment to sound money should be reflected much more widely within the eurozone but the Stability and Growth Pact seems almost irrelevant now.

If we look at the latest OECD Economic Projection, the caption for the various countries estimating the general government financial balance is instructive and, in a number of cases, frightening.

Least bad, and following a period of very small deficits, is Germany where the deficit this year is forecast to be 3.7% of GDP and 6.2% next year. Italy shows up relatively well at 5.3% and 5.8% respectively but Italy's problem is a very high level of public debt in relation to GDP so such levels are still serious. Canada, like Germany, has moved into deficit after a sustained period of surpluses and should act as a model of how to improve budgetary problems. Its forecast deficits of 4.8% and 5.9% look manageable. Interestingly, some UK politicians are examining the Canadian experience of how it eliminated severe budget deficits successfully. Similarly, Australia, which is moving into deficit after a sustained period of surplus. Its forecast deficits of 4.9% and 5.0% also look eminently manageable. Unlike Germany, France is not wedded to any residual affection for the Stability and Growth Pact in the present circumstances. Its budgetary position is significantly worse than that of Germany with the OECD forecasting deficits of 6.7% and 7.9% respectively. Japan is facing very large deficits forecast by the OECD at 7.8% and 8.7% respectively and, like Italy, it has a very high level of public debt in relation to GDP. The most shocking examples of the major economies are the USA and UK, both of which have entered this crisis with a string of budget deficits. The USA is forecast by the OECD to be in deficit by 10.2% of GDP this year and 11.2% next year, whilst the respective figures for the UK are eye watering at 12.8% and 14.0% respectively. Serious though the position is for the USA, it is far worse for the UK. The US dollar, being the world's major reserve currency, has an advantage over sterling. It has to be held by many countries and to sell it aggressively would be self defeating. Whilst the composition of countries' foreign exchange reserves can be refined, significant rebalancing cannot take place overnight. Sterling has no such advantage, one reason why the present position in the UK is of such concern.

Since the financial crisis broke, events have been so fast moving and unpredictable that our usual format in these reviews of discussing the latest economic data with a view to looking forward to what the information might predict has seemed redundant although, hopefully, that will not be the case for too long. We have also concentrated much less on specific countries and regions but, rather, consider what the unprecedented events might mean for the future in terms of economic policy and regulation etc. Because we are international in our investment approach, we have also not concentrated our attention especially on the UK, even though sterling is the base currency for most of our clients. However, the situation outlined in the previous paragraph laying out the severity of the UK's budget deficit position does, we feel, require some special attention.

Although we always try to avoid politics as far as possible in these reviews, except where political change may impact on the economy and stock markets of a particular country, any objective observer of the United Kingdom is bound to conclude that economic policy has got caught up in the political cycle. With the next general election less than a year away, the UK government appears very wary of discussing how it plans to address the deficit issue. For make no mistake about it, the risks to the UK economy of not having a credible plan for deficit reduction, both in current terms and in taking the overall level of public debt in relation to GDP, are enormous. It is estimated that foreign investors own around one third of the gilt market. If they are so concerned about the UK's economic prospects that they decide to reduce their holdings of gilts or not take up new issues, then the prospects for bond yields and sterling are worrying. One of the surprises of the last quarter has been that sterling has strengthened. However, no one should be fooled. It remains very vulnerable and, as we saw last year, sentiment in the foreign exchange markets can turn very quickly. All independent observers agree that a credible plan for deficit reduction must be put forward which will involve public expenditure cuts and/or tax increases. The UK needs to be credible in the eyes of its creditors so that they do not have doubts about its ability to service current debts or repay them.

This is why the current situation in the UK is surreal. The government seems unable to use the word "cuts". Whichever party or parties (if it is a hung parliament) form the next government is going to have to cut government expenditure. With the Treasury's eye watering and probably optimistic forecast of a deficit of £175 billion this year, no government is going to grow or "invest" out of that situation without the economy being subject to the gravest risks. Standard & Poors has already put the UK on notice about the risk of a possible credit rating downgrade from its coveted AAA status and we have already indicated how dangerous that can be because of its adverse effects on the cost of borrowing and probably the exchange rate. It also does not help that frictions between the Treasury, Bank of England and the regulatory authorities over management of the regulation of the banks and the financial system are clearly visible. If one can sum up the position of the UK, it is that the extreme politicisation of economic management is creating a very dangerous risk for the UK which could manifest itself at any time. Although most countries are in a bad situation, the UK is in a worse position than most. At its very simplest, investors should regard non UK exposure as some sort of insurance policy.

It is simply not possible for the build up of debt around the world to be allowed to continue because, apart from anything else, it would lead to defaults. In the shorter term, increasing debts means a greater proportion of government revenue being absorbed by debt servicing costs. The consequent means of dealing with this situation, tax rises and/or spending cuts, will themselves affect growth.

In terms of policy choice to address excessive budget deficits, the choice is public expenditure cuts and/or tax increases. Is there one route which is preferable to the other? Generally speaking, we believe public expenditure cuts are preferable to tax increases. The benefit to an economy arising from cutting public spending and avoiding having to raise taxes is that the incentive effect on the productive part of the economy is likely to produce growth which improves the taxable base of the economy. Both have adverse effects in increasing unemployment (that would be happening anyway), but future employment prospects are enhanced if the private sector can grow. This analysis is, of course, hugely oversimplified and the policy remedy is likely to be a mixture of both, but a bias towards cutting public spending is generally to be preferred.

Another effect of the financial crisis is self evident and that is an increase in regulation. The situation requires it in certain areas and taxpayers demand it after what they have to pay out. So banks will become more like banks used to be. But there is a political element here and politicians who have an axe to grind have been pushing their own agendas. Although, as a firm, we do not invest in hedge funds, we recognise that they were not the main culprits in the financial meltdown which ensued from the subprime crises. Yet European politicians with an agenda have been pushing for action in a proposed new EU law which will regulate them (and other entities coming under the heading of alternative investments) much more closely and, for a place like London, where most European managers are based, the proposed new directive poses a significant threat, and, by extension, to the U.K. economy.

Perhaps an even more dangerous threat is from protectionism, although it could be argued that the proposal above is protectionist in its intent. When times are difficult, it is easy for protectionist sentiment to flourish and for measures to be enacted which have populist support. So, for example, the "Buy American" clauses, in schemes funded federally to boost the economy, are a good example of quite blatant protectionism. Some EU countries, notably France, have also shown such tendencies, whilst the USA and EU have lodged a joint case with the World Trade Organisation about Chinese quotas and export duties on certain raw materials like coking coal. Whilst it might be a natural reaction of governments in an economic downturn to try and protect domestic industries, if widespread, everyone is a loser because it slows down trade and economic growth by raising costs since the benefits of free trade and lower prices are reduced leaving consumers, whether they be businesses or individuals, worse off. Sadly, in many countries, the time horizons of politicians are short and policy makers are directed by the desire to be re-elected, even if it means piling up even more problems for the future. The UK, to its credit, has actively espoused free trade and, in Germany, the Chancellor has warned about the dangers of piling up debt and has been cautious about some aspects of the ECB's monetary policy.

So, as we look forward, the challenge for policy makers, once short term stability has been restored, will be to have a credible policy for debt reduction and, where it has been applied in different forms, the reversal of quantitative easing. We have outlined the policy options for deficit and overall debt reduction. They involve hard but inevitable choices because the scenario of letting debt rip does not bear thinking about. Being in the hands of international creditors and denied access to capital markets is not a position which any country should want to contemplate. But, on the monetary side, very difficult decisions also lie ahead. Central banks will want to return to a more normal interest rate policy. Current minimal interest rates distort the balance between savers and borrowers and could lead to a misallocation of investment choices. Where quantitative easing has been effected, a credible policy for reversing it has to be articulated. The idea of creating money, for which quantitative easing is the euphemism, is, amongst other things, to create a modest level of inflation, the idea being to encourage spending. It is to offset the malign effects of deflation, whereby customers may hold off discretionary purchases, hoping to be able to buy them more cheaply later on. Such a state of affairs could led to a vicious downwards spiral for an economy. Modest inflation should avoid this situation. So, if consumers and businesses do spend, a beneficial multiplier effect should be created with spending creating additional demand, and so on. By effectively creating money to buy in assets such as bonds from the private sector, the objective is to drive down yields to make it cheaper for companies to borrow and thus counter the drying up of credit. Although the sums involved are large, with the UK setting aside £125 billion for quantitative easing to buy debt in the markets, that should be set against a deficit forecast at £175 billion and the need to issue £220 billion of gilts this financial year. Creating money will run serious inflationary risks for the future if it is not reversed. At the moment, the output gap, the difference between the capacity being used in an economy and its potential capacity, is large, which is what some commentators are saying about the inflationary risks at the present time. When the capacity limits are reached, the extra money in the economy which has been created is likely to lead to additional inflationary pressures. At some stage, before it is too late, quantitative easing will have to be reversed, with central banks in the relevant countries selling the bonds which they have purchased in order to withdraw the money, which they had created, from the economy. That would help to raise interest rates at a time when deficits are still likely to be large, and this would be unhelpful to economic recovery. Reversing quantitative easing is, therefore, going to be a very difficult task and it will have to be undertaken very carefully.

The risk of inflation developing from current monetary policy, whether it be exceptionally low interest rates or quantitative easing, if not reversed in time, or the vast amount of new debt being issued is the reason why we remain negative on any but short dated bonds. The yields set out in the table of ten year government bond yields at the beginning of this review seem to us to be totally inadequate for the risks involved. In the height of the crisis, when depositors were concerned about the safety of their deposits, the flight into government bonds, at any price, was an understandable reaction. Now that problem appears to have been resolved, with governments and central banks seemingly finding a way of ensuring the security of depositors' money, and the evidence gathering that, dreadful though things are economically this year, the prospects are less bad next year, investors should evaluate the attractions of bonds in a more conventional way. The risks do not in any way appear to be reflected in current yield levels.

We think that equities are a much more interesting asset class. Despite their rise from their March lows, ratings still appear reasonable, notwithstanding doubts about the level of dividends and uncertainties about corporate earnings. Economic growth in the years to come is likely to be modest as measures to reduce the debt overhang have their impact through cuts in government spending and/or tax increases. Paradoxically, that could mean more stability in markets as modest economic growth tempers more excitable expectations. As a result of the economic crisis, companies have had to engage in a severe round of cost cutting which could leave them well placed to benefit from even modest top line growth. As always, international diversification remains very important. We have expressed our fears about the huge risks being run with the UK economy which could manifest themselves in a sharp decline in sterling and problems with financing the UK's enormous budget deficit. In the same way as in 2008 unhedged exposure to overseas markets protected investors from even more serious declines so, despite the rise in sterling so far this year, could it do so in 2009.

Although the economic news remains gloomy, the reason that markets have perked up quite sharply from their low point in March is that a small part of the stream of economic news showed a decrease in the rate of deterioration and, now, we may even have gone beyond that. The majority of the news remains bad but it is now not all one way.

What we have done over the last few months is to detail items of economic news which have given investors some reason to believe that there is a ray of light at the end of the economic tunnel. The financial system still has to be sorted out, unemployment will continue to rise and the debt position both politically and amongst some households is horrendous. But, amidst all of this, there are some glimmers of hope.

Starting with items of less bad, or even better news, we look at the USA. In the housing market, the number of US home buyers who agreed to purchase a previously occupied home in April showed the largest monthly jump for nearly eight years. The National Association of Realtors said that its seasonally adjusted index for sales contracts signed in April was up by 6.7% and this was the biggest monthly jump since October 2001 when pending sales rose by 9.2%. In May, new housing starts in the USA recovered from record low levels. They rose by 17.2% to an annual rate of 532,000, compared with 454,000 in April. The number of new building permits rose by 4% to 518,000 units. New factory orders in the USA were up by 0.7% in April. The ISM's latest survey for the service sector showed the index rising to 44 in May compared with 43.7 in April. This is an example of things becoming less bad because, although a reading below 50 represents contraction, it is a slightly less negative reading than the previous month's figure. The University of Michigan's survey of US consumers' confidence showed sentiment rising to 70.8 in June compared with 68.7 in May. New York's Economic Cycle Research Institute said, on 19 June, that its weekly leading index rose to a thirty six week high of 117.1 for the week ending 12 June from an upwardly revised 116.2 the previous week. In Germany, business sentiment rose in June to a seven month high. The Ifo's business climate index rose to 85.9 compared with 84.3 in May. In Germany, the ZEW index of investor sentiment rose in June for the eight month running to reach 44.8 compared with 31.1 in May. In Italy, the National Statistics Bureau reported that industrial output rose by 1.1% in April, representing the first monthly increase for a year. Italian business confidence rose in June for the third month running, according to a survey by the Economic Research Institute, ISAE. Turning to Australia, an economy which is in a relatively good position because of its strong financial standing coming into the recession, first quarter GDP rose by 0.4% compared with a decline of 0.7% the previous quarter. This was a much better figure than expected. The Westpac-Melbourne Institute index of consumer sentiment rose to 100.1 in June from 88.8 in May. In China, annual growth in fixed investment accelerated to 32.9% during January and May from 30.5% for the first four months of the year. Annual industrial production growth in May rose to 8.9% compared with 7.3% in April. In Japan, the Ministry of Finance and Economic and Social Research Institute, part of the Cabinet Office, reported a marked rise in sentiment amongst large Japanese manufacturers over the previous quarter. In the UK, the CIPS said the Markit purchasing managers index for construction activity stood at 45.9 in May compared with 38.1 in April and 27.8 in February. The Nationwide measure of consumer confidence stood at 53 in April compared with 51 in March. The CIPS/Markit purchasing managers survey for the services sector showed a headline index of 51.7 for May compared with 48.7 in April. In the housing market, the Halifax reported that average house prices rose by 2.6% in May, cutting the annual rate of decline to 13.6% from 17.7% in April. The RICS reported that enquiries from prospective home buyers rose for the seventh month in succession in May. The Department of Communities and Local Government showed house prices rising by 1.1% in April although this was still 13% lower than a year ago. The Council of Mortgage Lenders reported that mortgage approvals rose by 16% in April reaching a six month high, although the overall figure was 28% lower than in April 2008. Industrial output in the UK in April rose by 0.3% and manufacturing output by 0.2%. However, factory output was still 13.2% lower than a year previously. Exports rose by 0.5% in April as a result of a 9% increase in exports to Europe. The Conference Board's economic index rose 0.9 in April to 92.2 having fallen the previous two months.

None of these figures is an any way exciting but they do mark some sort of relief from the string of dire economic news we were receiving until recently. Overall, the picture still looks bad but it is encouraging that independent forecasters like the IMF and OECD are adjusting their forecasts for next year to reflect what they consider to be slightly better prospects.

Investors, therefore, should continue to monitor the economic news closely for signs of a further increase in the balance of good news against the overwhelming amount of bad news. It does not have to get to a situation yet where the balance of news is positive but, rather, that it is working up towards this position, however slowly. That should keep investors interested in the stock market, especially when the alternatives are very problematical as we have indicated above

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