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Market and Currency Update – 1st June 2009
(A Personal View by R B Skepper)
(For professional investors and businessmen/women only)

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Investment Outlook:

We are in a world of experiment.

Never before has about 5% of world GDP been hurled into the world economy by collective governmental action to stimulate it.

Never before has the banking system entered a recession with reserves that have been decimated because a portion was invested in toxic assets of dubious value, and they face the usual write-downs on their normal loan books as the recession unrolls. The enforced recapitalisations by government injection and capital raising has only gone part of the way to plugging this hole.

Never before have we had a situation, anyway since the war, where short term interest rates are virtually zero in the three leading currencies. It should be noted however that government irredeemables have fallen in value by 13% or so since December, an early warning signal that raising all this government borrowing may not be that easy.

Never before except in wartime have any major economic blocks run government deficits which this year in the U.K. and U.S.A will reach about 12% of G.P.D.

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Nobody frankly knows how all these new known unknowns are actually going to work out. However it is nearly inevitable that such a massive monetary stimulus will lead to a recovery of sorts, at the very least.

In the first instance the created liquidity tends to feed much more quickly into stock markets than the underlying economies. Hence the sharp recovery we have seen in markets since the March low.

Other home truths might be that we are now in a world where no leading currency looks particularly attractive, as the printing presses whirl at a record rate everywhere. So the conditions for GOLD look more favourable than in previous recessions.

According to Merrill Lynch we may be in year 9 of an 18 year secular bear market such as the 1966 to 1982 market - in that market, the place to be was equities because inflation wiped out 70% of the value of bonds. War loan fell from nearly 100 to 35 at one point. Those who held bonds or, worse still, long dated government securities lost most of their wealth. Equities fared far far better. No overall real growth, but they preserved their purchasing power. Skillful equity fund managers made huge real returns in this overall static market by exploiting the considerable ups and downs or by choosing the well run companies that outperformed.

Merrill Lynch also point out that (short term) all three indicators that have never failed in the past to signal the end of a cyclical bear market in equities, and in the economy, have turned positive since Christmas:

The Institute for Supply Chain Management (ISM) Manufacturing Index
The Conference Board coincident-to-lagging indicator ratio
The University of Michigan Consumer Sentiment Index

The ISM Manufacturing Index bottomed in December 2008 at 32.9, now 40.
The Conference Board's coincident-to-lagging ratio has just turned in three successive lows. Data going back to 1960 showed recessions ended within two months of this event.

The University of Michigan Consumer Sentiment Index bottomed in November at 55 and is now 65. Typically recessions end within 6 months of this lagging indicator.

In stock market terms at the very least it has become more dangerous to be short of the market.

The other positive for equity investment in a future still so blurred is that well managed companies always offer good protection against monetary inflation because they have real assets.

The U.K. – A huge opportunity to reform:

The removal of Michael Martin, The Speaker, looks to be an event of seminal importance for the economy of this country. The central abscess has now been lanced.

Up till now everything to do with the public sector has been seen as a sacred cow beyond criticism or reform. Now this sacred cow has been well and truly exposed as a sordid pig with its snout firmly in the trough of everybody else's painfully produced tax payments.

The tide of public opinion is now sufficiently strongly aroused to create a tidal wave of support for the first government that takes the necessary axe to the whole public sector waste machine that currently threatens to sink our economic prosperity.

There is no country whose finances can be more easily put back on their feet than that of the U.K. because we, alone, are known to be wasting something of the preposterous order of £100billion a year on completely non productive expenses in the public sector – its costs having ballooned under Labour from £370bn in 1998 to £680bn tin 2007.

In the now changed atmosphere, the head of the CBI dared to say in front of the prime Minister at their annual dinner last week: "What about the £65billion a year being wasted on QUANGOES?"

As The Daily Telegraph stated after Martin's resignation:

"A government with an overwhelming parliamentary majority has burdened the country with pointless and dangerous legislation. People feel their political representatives are aloof and arrogant. Now in addition they think they are venal. We have put up with this for far too long. We all know the time for it has come to an end; and The Speaker's resignation is the beginning of the end."

Another example of just how wrongly things are being done in the public sector came out last week. An efficiency quango was set up April 08 with the purpose of improving Police efficiency and reducing bureaucracy. What has it done? In its first year it has spent, apart from its own costs, £70million on consultants, and currently is advertising for 344 vacancies while police recruitment, when everyone is clammering for more police, has been frozen.

Clearly the foreign exchange market, which is often a very early indicator, has scented possible change ahead in the U.K. economy, and the £ has now risen quite sharply since the House of Commons upheaval, to close to $1.60 and to Euro 1.15.

In the short term further strength is likely. The medium term will depend on the courage of the next government to lance all the other abscesses that have grown on the public sector since Labour came to power.

R.B. Skepper
29th May 2009
Brewin Dolphin Securities

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