

# Alan Boswell & Company Ltd



## Market Update – 7 April 2009

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## Outlook

Another month passes by for investors and with it more massive injections of capital from the US Treasury via the Federal Reserve (\$1trn) and the same amount from the recent G20 meeting in London via the IMF and other agencies. Alongside this we have more market volatility and sentiment problems, more bank scandal (in the form of the Fred Goodwin pension saga along with the massive HSBC rights issue of some \$12bn), continuing credit/liquidity issues for most businesses and the ever present threat of regional geopolitical violence in this case presaged by the attack on a visiting cricket team in Pakistan, further car bomb attacks in Iraq and the posturing of North Korean missile tests. Against these negative aspects global markets, and some particular sectors have rallied strongly, perhaps counter-intuitively so, although any hopes of strong market wide recovery are still fragile.

With the (as yet) untested President Obama embarking on a diplomacy campaign in the hope of saving the future of the US as the predominant economic power, it seems clear that certainly some major economies (particularly in the G20) are lining up to take a stand with the US on short term economic policy. The UK and Japan especially have now adopted a liquidity program designed to flood liquidity into certain assets in the hope that eventually this will help ease the difficult credit conditions being experienced by many, and not just the financially weak. QE, or quantitative easing, may just save the world as you know it but as with all experiments, no one is absolutely sure of the outcome.

The very banks that are being protected by capital injections from the state (not just in the UK) are exposing the taxpayer to the bulk of the risk whilst protecting their own margins to some degree. By not being prepared to lend to each other they are effectively restricting credit access to the general public. That is the price the economic majority have to pay to maintain the status quo in their financial lives and hence the difficulty in accessing credit. Without it, there is 'just' a remote possibility of the banking system failing us and all that that entails. One shouldn't doubt how interdependent we all are on access to capital markets now.

The Bank of England inflation reports have more detailed charts based on the key differences in base and inter bank lending rates for those of you who may be interested.

## Inflation

There was a surprise rise in the level of CPI inflation in February 2009, against another fall in the level of RPI inflation. The March data released by the National Statistics office revealed that CPI inflation had risen from 3% to 3.2%<sup>1</sup> for that period with RPI falling to 0% from 0.6%<sup>2</sup> over the same period. This could hurt future pensioners as the state scheme is linked to RPI which was over 4.5% last September when the pension was revalued for this year. Next year, the rise might conceivably be zero despite the costs of daily living increasing regardless (as measured by CPI).

Surprised? Given the fall in the traded weighted value of sterling against a basket of global currencies recently (much to do with investors doubting the UK government can afford to pay all the new debt issuance off) has led to speculation about the possibility of joining the Euro for protection or indeed the AAA rating on UK sovereign debt being downgraded.

As we import a considerable amount of our resources, CPI inflation (which includes food bills) will often rise when sterling falls in value. It costs more to import the materials. The same with energy supply and transmission and to some degree even water supply given that most UK water supply is owned by foreign investors. As interest rates remain historically low (down to 0.5%<sup>3</sup> in March 2009) and with the amount of gilts to be issued by the UK government CPI inflation may increase for some time to come as a function of a weak currency. By contrast, RPI inflation may well stay negative due to the effect that much lower borrowing costs have on the whole basket of goods itself. The government CPI target is 2%.

Structural UK economic inadequacies may haunt the outlook for inflation over the medium term as we continue to import much of our consumption, but investors can still take opportunities to make money out of both the UK and overseas with careful selection of fund managers and asset classes.

## Commodities and Property

The two sectors have been recent beneficiaries of stronger market sentiment to some degree. Both have most likely suffered over selling pressure and there may well be technical valuation bounces in both asset classes. Businesses

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<sup>1</sup> Statistics.gov.uk – 24 March 2009 inflation release data

<sup>2</sup> As above

<sup>3</sup> bankofengland.co.uk – 5 March 2009 news release

involved may well have seen the worst of price falls for their stock in trade but caution should be urged over the short term. Supply and demand for some basic resources (including land) have reached a more natural balance given reductions in economic output globally but pressure points remain.

Oil continues to flirt with \$50<sup>4</sup> per barrel but any sustained prices above this level might be an early signal of an uptick in global activity or a shortfall in production. OPEC have maintained their production stance to try to stabilise the price effects in the near term but no doubt would be happy if the price were to increase steadily.

Agricultural staples including soya beans remain a victim of tight markets in terms of (weather related) supply and forecasts suggest that prices may rise here in the short term. This will have a knock on effect on secondary industries such as meat production or bio-ethanol for industrial usage which will spread to other areas as well.

There are now signs that some property assets are stabilising a little. Investors seem to be favouring the REIT structure which trades more like an equity, along with a global bias but perhaps a sign that the asset class is turning an important corner. Liquidity remains key and investors will continue to see moratoriums and queues for release of capital should they wish to switch asset classes at some fund providers. Despite this clients should continue to accumulate suitable exposure to these areas where pricing power may persist for some time and their own risk appetite allows for it.

### **Index Linked & Gilts**

Many market commentators feel a bubble has begun to develop in the asset class (and maybe also in corporate bonds) due to the flight to perceived safety being offered in the former, and the income yields in the latter. Nearly all gilts and most overseas government stock is therefore trading well above par value (that is you will see capital losses if held to redemption) which is not a good sign. The income yields are therefore very low for investors and this will be reflected in continuing falls in annuity rates which again will hurt those retiring in the near future. Resilience continues despite this paradox and many investors will likely remain in the assets despite the UK and other governments needing to issue massively to use for their borrowing/spending plans over the next few years. The bank asset protection scheme is the major factor here. Politics could become a major force for change in prices if any divisions begin to show between the G20 governments particularly. In corporate debt, the main risk is that of default of the company and this is a major function of why the yields are so high at present. Attractive they may be, but do not be led into believing the return is without extra risk. Caution is advised on significant additional investment in both asset classes at present unless your circumstances and risk profile suit but for those without exposure it could add further diversity. Many clients will already hold such exposure through a variety of managed funds with individual managers or through an insurance based scheme such as a pension plan.

### **Summary**

Clients should remain focussed on their own circumstances and future and not be swayed by popular opinion. No two people have the same outlook so please bear this in mind and continue to have dialogue with your adviser as necessary. We do have access to interesting generic investment literature that may help educate on certain topics. As ever, we will be pleased to assist clients where such assistance is required. As current financial concerns show, a spread of investments and risk levels within a portfolio can help to mitigate some of the issues which are affecting all at present, and leave investments open to generate future returns when economies recover somewhat.

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<sup>4</sup> [bbc.co.uk](http://bbc.co.uk) – market data 7 April 2009