21 July 2009

For professional investors only

Old Mutual UK Select Equity Fund

Simon Murphy, manager of the Old Mutual UK Select Equity Fund reflects on the equity market rally and outlines some of the latest investment opportunities

Simon Murphy, manager of the Old Mutual UK Select Equity Fund

Simon Murphy has been the manager of the Old Mutual UK Select Equity Fund since he joined OMAM in March 2008. Prior to joining OMAM, Simon worked for almost 10 years at M&G Investments, spending the last three as the manager of the M&G UK Growth Fund. He is a qualified chartered accountant and a specialist in corporate taxation.

The UK equity market has rallied strongly from its March lows and we believe that share prices can move higher still if economic indicators continue to improve over the course of the summer. The global slowdown has been so severe that the subsequent initial recovery is likely to be stronger than expected. The UK economy typically reacts well to interest rate cuts and the recent period of monetary easing has left interest rates at their lowest level in the Bank of England's 315 year history.

The improvement in sentiment has not been just an equity market phenomenon, but reflects a sharp increase in risk appetite globally. This has led to a major rally in commodity prices, with crude oil breaching $70 a barrel for the first time this year, while the US dollar has given up some of its risk aversion-inspired gains in the currency markets. Meanwhile in fixed interest markets, credit spreads have narrowed significantly.

The best performing areas during the recent rally have included some of the most economically sensitive, or early cycle, stocks, including many consumer-related companies. Although we believe that they have largely run their course for the time being, investment opportunities are still to be found in those areas where volumes have been extremely depressed and are expected to exhibit a degree of recovery, such as within automobiles & components and housebuilders. The decline in car production in May was the smallest so far this year, while Taylor Wimpey, the UK's largest housebuilder by volume, reported a rise of over 70% in its order book from the end of 2008.

Another top performing sector has been financials, where many stocks have bounced back from very depressed levels following the government's recapitalisation of major banks in the UK and the subsequent return to profitability of a number of leading international financial groups in the first quarter of 2009. This suggests to us that although the banking system is not yet out of the woods, it is much further along the road to stability. We are generally more positive towards the sector, albeit that we are being very selective. Our favoured companies are those with strong franchises, such as Standard Chartered and Prudential, two internationally diversified groups with a focus on Asian markets.

A key move for us at the sector level during the past few months has been to increase exposure to resources stocks, which are benefiting from a strong recovery across emerging markets and a positive outlook for future infrastructure spending. Here we favour large international mining groups, such as Rio Tinto, BHP Billiton and Xstrata, oil exploration & production stocks including Tullow Oil and Premier Oil, and steel industry supplier Cookson.

Contact details
+44 (0)20 7332 7500
www.omam.co.uk

Please see important information on page 2

In contrast, we continue to avoid traditional defensive sectors, such as utilities, food producers, beverages and food retailers. While their premium valuations have come down after a period of underperformance, we believe they still offer limited value relative to the wider equity market. In addition, we are also cautious on sectors heavily dependent on government spending, such as aerospace & defence and support services, as the difficult economic environment is likely to result in significant constraints on public spending for several years to come.

On balance, we believe that mid-March marked the low point for UK equities and that they will continue their recovery over the coming months. Given that the market rarely rises or falls in a straight line, the strength of the advance so far suggests that it may well pause for breath before moving higher. However, given attractive equity valuations relative to other assets such as cash and gilts, and high levels of cash on the sidelines, we do not anticipate a significant pullback as any weakness here is likely to tempt investors back into the market.

Contact details
+44 (0)20 7332 7500
www.omam.co.uk

Important information: Past performance is no guarantee of future results. The value of an investment and the income from it can fall as well as rise and investors may not get back the amount originally invested. OMAM has no house market view and opinions expressed are the views of individual fund manager(s) as at the time of writing. These views may no longer be current and may have already been acted upon. Any underlying research or analysis has been procured by OMAM for its own purposes and may have been acted on by OMAM or an associate for its or their own purposes. OMAM is the appointed investment adviser for Old Mutual Fund Manager's in-house OEIC funds. Old Mutual Asset Managers is the trading name of Old Mutual Asset Managers (UK) Limited and Old Mutual Fund Managers Limited. Old Mutual Fund Managers Limited, 2 Lambeth Hill, London EC4V 4AD. Authorised and regulated by the Financial Services Authority. A member of the IMA. Old Mutual Asset Managers (UK) Limited, 2 Lambeth Hill, London EC4P 4WR. Authorised and regulated by the Financial Services Authority. Telephone calls may be recorded for security purposes and to improve customer service. U4763/07/09