Investment update

10 October 2011

Richard Watts, manager of the Old Mutual UK Select Mid Cap Fund

Richard Watts was appointed manager of the **Old Mutual UK Select Mid Cap Fund** in December 2008, having been deputy manager since 2006. Prior to joining OMAM in 2002 he was an equity analyst at Orbis Investment. Richard is IIMR qualified and a CFA Charterholder.

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Opportunities for stock pickers

It may not seem the most obvious thing to say at this point, but UK mid cap equities continue to offer opportunities for stock pickers

Global equity markets suffered significant falls in August – from which they are yet to recover – pushed down by on-going weakness in economic data combined with concern about the scale of Europe's sovereign debt crisis and its potential to push major developed economies back into recession. In my view, economic forecasts have become more polarised but continue to reflect the consensus that has prevailed for some time: slow growth in developed economies and faster growth in emerging markets.

We expect economic growth in developed economies is likely to be in the range of 1%—2% going forward, while developing economies are more likely to be in a range of 5%—6%. This will give an overall global growth rate of around 3%—4%. This is in line with the International Monetary Fund's September forecasts and it is consistent with continued corporate profit growth.

I believe a bias towards international growth markets remains valid, as does favouring structural growth, that is, companies which are able to increase their earnings independently of the wider economy. I also believe it is important to favour quality stocks and to be alive to the possibility that a worst case scenario could unfold, which would require a more defensive positioning.

I continue to prefer sectors such as chemicals, oil services and software, which offer the attributes consistent with my top-down outlook, whilst the fund is underweight a range of UK consumer and government exposed areas.

Mid cap stocks have had a strong run over the past couple of years. I think this should continue once we have clarity on the global economy and, in particular, sovereign debt in the large developed economies. When you look at the fundamentals of the mid cap market, it is trading on around 10-times forward earnings, a cheap multiple in my opinion. Company news flow remains strong despite the recent economic weakness, while company balance sheets are in much better shape today than they were three years ago.

In summary – global growth is reasonable, balance sheets are good, corporate news flow is strong and earnings valuation metrics are attractive.

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