Investment update

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Ashton Bradbury, Head of Equities

Ashton Bradbury joined OMAM in September 2000, focusing on UK mid cap and smaller companies funds prior to being appointed to his current position in April 2008. Before this he was at Hill Samuel Asset Management, initially as Head of UK Smaller Companies and subsequently as Head of UK Retail. Ashton has a BSc in Banking & Finance from Loughborough University.

Market outlook

By Ashton Bradbury, Head of Equities

Equity market volatility in 2010 has been caused by two conflicting themes competing for investors' attention. On the one hand a set of broad brush macro concerns ranging from Chinese policy tightening to tighter banking regulation and most recently eurozone sovereign debt fears continue to periodically unnerve financial markets. In contrast, current economic data remains strong, company results have been at least up to best expectations and the UK market trades on less than 10 times forward earnings. When investors focus on current economic and company data, markets rally; when their attention switches to the potential downside risks created by the macro concerns, risk appetite diminishes and markets fall.

Arguably the most serious of the concerns troubling markets is the risk of sovereign debt restructuring (default) in one of the 'peripheral' eurozone nations, typically cited as Greece, Portugal or Spain. The fear is that any such default would lead to heavy losses for European banks, resulting in a loss of confidence in the financial system once again and restricting the ability of commercial banks to fund themselves through the wholesale markets. At best this would reduce the ability of commercial banks to provide credit to their third party customers and at worst could lead to a spate of banking failures. Either result could impact heavily upon the nascent European economic recovery.

Many commentators agree that ultimately the most indebted of these nations, Greece, is likely to restructure its debts in some way. However, a potential restructuring in two or three years time when the global economic recovery is well established, banks have strengthened their balance sheets and other debtor nations have had the opportunity to reduce their borrowing requirements through fiscal retrenchment would have nothing like the same impact as a default today.

Policy measures announced in recent weeks, including the proposed 750 billion financial aid package for eurozone countries, increase the likelihood that it is the more benign of these two outcomes that will come to pass. This in turn should prevent what is today essentially a crisis of confidence in financial markets from becoming self-fulfilling through transmission into the real economy. Of course this does require other heavily indebted nations to have the political will to take difficult and, at least domestically, very unpopular fiscal decisions (higher taxes and lower spending) to significantly reduce their own borrowing requirements over the next couple of years. The political element to the decision making process only heightens the uncertainty for equity markets.

Away from the maelstrom surrounding eurozone sovereign debt, current economic data remains very encouraging. PMI surveys (a good indicator of future GDP growth) globally remain strong with, in a number of regions, the employment intentions component starting to improve, helping to support the view that the recovery is sustainable. Importantly, industrial production globally continues to improve, with signs that this is leading to a recovery in business investment (aided by the strength of company balance sheets), again pointing to a continuing economic recovery.

Unsurprisingly, against an improving economic background, company newsflow has been generally positive with most results either in line with or exceeding expectations. Analysts'

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forecasts for profits growth over the next 12 months have continued to rise, particularly for the more cyclical parts of the market.

And so the debate continues. The bears argue that economic recovery will be curtailed by growing concerns over sovereign debt in particular, whilst those of a more bullish disposition believe that the weight of evidence points to a recovery that is clearly becoming self-sustaining. In the short term continued market volatility seems to be a near certainty until this debate is resolved.

On a longer view, I continue to side with the more optimistic commentators. I expect that sovereign debt fears will gradually subside as it becomes clear that there is the political will to rein in fiscal deficits. That will leave investors to focus on a UK market trading on less than 10 times earnings and offering a dividend yield higher than the yield on UK government debt against a background of gradual economic recovery and rising profits expectations.

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