

# Investment Comment December 2011

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Most equity markets rallied as 2011 drew to a close, though it did little to disguise what had been a testing year for all investors. The MSCI World Index rose during the month by 1.15% and the FTSE100 by 1.25% as December volumes were typically low. In Sterling terms, only Commodities as a whole and the trouble spot of Europe (ex-UK) posted negative numbers from the major asset classes. In what was a significantly quieter month than the previous ones, market volatility fell to its lowest level since the crisis of the summer, driven in part by improving economic figures from the US, but also helped by less going on at a political level, and the traditional end of year stock market rally.

It is fair to say that the major concerns of 2011 will spill over into 2012, with fiscal austerity and the sustainability of the euro project at the forefront of investors' minds. It is natural therefore to remain gloomy but there are some positives around which are not receiving as much attention as they otherwise would. One of the benefits to the Euro crisis, and China's slowdown, should be a fall in inflation over the coming months which could provide a boost to real disposable incomes. In the United States, job creation statistics have improved, which has helped to lower the unemployment rate and with sales of both new and existing homes up slightly too, consumer confidence is growing. In addition, manufacturing and services indices point towards an expansion in activity such that the threat of a global recession seems to be dissipating.

However, the region that is unlikely to avoid a recession is Europe; with the EU's political deadlock eroding confidence to the extent that the real economy will be affected. Whilst the European summit in December edged the Euro countries closer to fiscal union, it did little to fix the solvency issues of the periphery, and until that starts to happen, it will weigh heavily on market sentiment. The "Merkozy" plan is to apply fiscal rules to balance budgets, keep debt to GDP at 60% and apply automatic sanctions on those countries that break the rules. However, most members are already in breach, and whether the sanctions are enforceable is highly debateable.







The stock market though is a discounting mechanism, and the likelihood of a European recession gets factored into stock market valuations before it appears in GDP data. It was interesting therefore to note that from the perspective of earnings forecasts, estimated 2012 profits of the Euro Stoxx 600 index (excluding financials) were, for the first time since May, almost stable for the month, bringing at least a pause to the net downward revisions. The upcoming yearly announcements of corporate results, and the 2012 estimates, will be scrutinised by investors and should provide a steer to European stock markets.

With the prospect of a solution in Europe looking further away, we established a position in short-dated Gilts in December using part of the cash balance built up during October and November. Whilst we have made our negative view on Gilts clear in the past, we see the largest dangers in longer-dated Gilts, where yields have reached levels that only the prospect of a prolonged Japan-style deflationary environment could justify. At the short-end, the yields are still better than interest on cash, and there is the optionality of capital appreciation should market sentiment turn negative.

The recent BofA Merrill Lynch Global Fund Manager survey suggested that the cash balances of investors were at the high levels last seen at the beginning of 2009, and given the likelihood of cash rates exceeding inflation at any time soon being slim, the pressure to move out of cash remains strong. However, like ourselves, investors need to see the beginnings of a solution to the European sovereign crisis, coupled with data that at least shows some global growth before really engaging with risk-taking again.

This is why we currently have portfolios that are balanced between risk and safety. The cash balance and the position in short-dated gilts will help if we see markets such as those of August and September again, whilst we still have equity funds that will participate in any rally. At some stage there will be a time for greater risk taking, but we see that time coming later in 2012 and given all of the world's uncertainties, we feel that capital preservation has to be the focus in the short term.




### Asset Class Performance – End December 2011 (in Sterling terms)

	Dart Position	1 Month	3 Months	12 Months	Benchmark
Cash		+0.04%	+0.13%	+0.50%	BoE Base
Fixed Interest		+1.69%	+4.27%	+10.99%	FTSE UK Gilts
Equities - UK		+0.78%	+7.67%	-6.69%	FTSE UK Share
Equities - International		+0.79%	+6.66%	-9.38%	FTSE All World Index (Ex UK)
Property		+0.06%	-0.37%	+2.01%	FTSE UK All Property
Alternatives		+0.04%	+0.13%	+0.50%	BoE Base

FTSE Benchmarks are capital return

Property benchmark returns lag one month

End of period 31 December 2011

-  Overweight
-  Neutral
-  Underweight

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