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THE SCOTT REPORT

Macroeconomic Sovereign Debt fears spook markets

Current Overview

The warning signs have been there for weeks, maybe even months and the correction in the market has not been surprising; perversely it is almost healthy. The level of complacency a few weeks ago was ringing short term alarm bells. The final straw came (in an already falling market) when a newly suggested 40% tax on Australian miner's profits from 2012 was announced.* With the FTSE 100 loaded with miners this news (whilst not completely unexpected), coupled with ongoing caution relating to Eurozone debt levels, meant the sell button received quite a work out. Although it is not much fun at the time (watching a bright red screen), investors need reminding that markets seldom go up in straight lines. We have now fallen from a high of 5830 to a recent low of 5055; this equates to a 13.3 % fall in short order. * I had thought a 10% correction lower to be perfectly possible (if only on profit taking) further to a massive rally in shares over the past 12 months. Needless to say the cash on the sidelines has been filtering selectively back into the market and I have been buying into the weakness. Timing one's entries and exits is key. Equities relative to bonds look cheap basis achievable income yields and capital growth potential. Whilst economic challenges of significance remain for the UK and Europe at large, with a new coalition government in place, low interest rates set to remain and improving economic indicators from the US, investment appeal remains. I personally remain bullish in general as I said last month.

A big question at this juncture relates to whether (tackling) high sovereign debt levels will trigger a dip back into recession? Spain has just agreed to implement austerity measures, of course Greece has too. Indeed the UK is next to announce spending cuts and tax rises. Such actions will naturally impact domestic productivity levels and likely increase unemployment. But at some point such action was always going to be required. Should it be actioned now or next year? With the new Tory / Lib administration in place, it seems it will happen sooner rather than later. At a minimum, this should go some way to keeping the rating agencies from downgrading our AAA rating. Short term pain for long term gain maybe.

Other thoughts and ideas

The market as I write has recovered somewhat from the low level referred to above. For the nimble this short term volatility is providing some excellent trading opportunities. For the longer term investor, some very attractive valuations remain still. A significant pullback in the mining sector should probably not be ignored if one has little exposure to this group of companies. Utility stocks such as Scottish & Southern Energy and National Grid also look interesting options, both paying over 6% by way of dividend.* Glaxosmithkline near £12 is also tempting. The company transacts significantly in dollars and is also positioning itself increasingly in the emerging markets. This seems a sensible strategy. Defensive earnings streams, trading under 10 times forward earnings and yielding a well covered 5.25%, the shares look tasty for the future.*

Finally, I mentioned BT Group last month as looking attractive for yield and capital growth potential. Whilst the shares traded as low as 109p recently, full year results today are robust. I continue to rate this as a solid total return investment from current levels near 130p. Management seem to have got a handle on costs and the company is set to move into the entertainment domain.

Clearly all shares carry a degree of risk to capital.

*Source – Simple investments Internal

This report was written by Philip Scott - Head of Advisory Stockbroking at Simple Investments on 13/05/2010 when the FTSE100 was trading at 5400. (contact: philip@simple-investments.co.uk). The writer does not hold a position in any equities mentioned above, although his clients may.

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