

Trader Talk

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Chart Source – Simply Charts 02.07.2010

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A glance at the above chart of the FTSE 100 highlights the weakness in equities, as growing concerns about the global economic recovery and Europe's banking system spook investors.

Disappointing economic data out of Japan and worries about slowing growth in China added to the downbeat mood in Asia. Japan's unemployment rate rose unexpectedly in May, factory output declined and household consumption fell, illustrating the fragile nature of its export driven recovery.

Weak US data provided a further blow to the markets after a period of resilient company announcements. Consumer confidence slumped to 52.9 last month from 62.7 in May, well below analysts' expectations and a report from ADP Employer Services showed that private sector jobs had increased by the smallest amount in four months, prompting fears of a double-dip recession.*

The Eurozone was also hit by renewed concerns over the fiscal health of peripheral countries, with the cost of insuring against a default in Spanish government debt reaching a record high. Worries over the liquidity of banks within the region also weighed heavily on the sector, although data showed they had borrowed less than feared from the ECB.

The Vix volatility index, a key indicator of broad investor risk aversion, jumped almost 50% this week to 35, a reading that is seen as elevated.

Technical analysis shows the blue chip index has traded fresh lows for 2010 this week, breaking through the medium term uptrend and recent support levels. The moving averages (MA's) have also formed a "death cross", with the 200 day MA is sloping down and the 50 day MA crosses down through it, which is commonly regarded as a bearish signal for trend followers.

However, despite the index trading fresh lows, the relative strength index (RSI) remains above the levels traded in May and this divergence indicates that there is little momentum behind the recent weakness. The stochastic is also in oversold territory and appears to be levelling off.

**Source – Simple Investments Internal*

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In summary, lingering doubts about the outlook for the global recovery pushed the FTSE 100 to its worst quarterly performance since 2002. However, valuations are not demanding, with European company profits growing at above average levels and the yield on equities has rarely been so compelling. I believe the global recovery remains intact and the market is overreacting on low summer volumes.

Tobacco stocks have outperformed the market this week, following positive legal news for the industry. The US Supreme Court has rejected an appeal by the Federal Government in a long running case in which it sought huge damages of up to \$280 billion against the main tobacco firms. *

British American Tobacco (Epic: BATS) is the world's most international tobacco group and the largest listed on the UK market, with brands including Dunhill, Kent, Lucky Strike and Pall Mall.

The company has expanded in emerging markets and its biggest regions are Central and South America and Asia Pacific. These are seen as further growth areas following this weeks announcement that Mr Adams, the current chief executive is due to retire next year and will be replaced by Mr Durante, who joined BATS in 1981 and has led its business in Africa, the Middle East and Brazil.

The UK Governments decision to freeze alcohol and tobacco duty in last weeks emergency budget was also welcomed by the tobacco sector. Analysts had feared a further rise in duty as Chancellor George Osborne attempts to cut our budget deficit.

**Source – Simple Investments Internal*

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As can be seen from the above chart of BATS the shares have been trending steadily higher over the past year and have more than tripled since 2004.

The stochastic appears to be bottoming out, with the faster stochastic intersecting the slower to the upside, indicating a change in momentum. Support is likely to come from the 200 day MA and the trendline, which has been in place since April 2009.

BATS offer attractive defensive characteristics and robust cash flow. Dividend payments are progressive and at current levels it is yielding 5.4%. On 12x earnings it is not expensive compared to European peers and I believe the recent legislative benefits should offer a further boost to the shares.

At the time of writing the share price is 2091p, with near term targets seen at 2194p, 2245.5p and 2312, with a stop loss marginally below the recent low at 1947p.

This report was written by Mark Allen – Head of derivatives at Simple Investments Stockbrokers. The writer does not hold a position in British American Tobacco, but client accounts may. The material in this report has come from Simply Charts and British American Tobacco's corporate website.

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