

Investment Manager Commentary

Financial Markets Update – September 2008

The cause of the present troubles lies in the sub prime mortgage market, both in America, and closer to home. The remarkably benign economic conditions of the last fifteen years created a false sense of security. Global economic growth has been strong, aided by the development of China and India, and this is set to continue. Unusually, this growth was also deflationary, leading to very low levels of interest rates. This, in turn, encouraged people to borrow far more than they would usually be able to afford, encouraging massive bubbles to build in property, and many other asset classes.

Some appeared to believe that these conditions were here to stay for ever; economic history had become just that. What we are now seeing is the painful reversal of these positions, or “deleveraging”. The difference this time round is the speed at which this change has occurred.

The events of this week have, we believe, marked a sea change; the Central Banks are acting in concert to stabilise markets. They have clearly worked out which institutions are worthy of rescue, and which are not, and that is positive. This is not a pleasant process, but it has to happen.

In due course, fundamentals will reassert themselves. Global growth for 2009 is forecast at 3.5%, and outside the financial sector, dividends are still expected to increase. Commodity prices have fallen steeply since the peak in July, and we expect them to continue to do so. Inflation rates are therefore likely to tumble, leading to a reduction in interest rates. History is a guide in these circumstances. Back in March 2003, the yield produced by equities exceeded that available from fixed interest investments, a rare occurrence, but interestingly, that is where we are today. This marked the turning point for markets, and may well prove to do so again.

At Mercater, we identified the gathering storm clouds of the sub prime crisis in the spring of 2007 and since that time, have been moving our clients’ portfolios to an increasingly defensive position. Whilst the scale of recent market declines and the short term volatility of markets have meant we have been unable to offer complete immunity from the turmoil, we have broadly been able to mitigate the downside. Equally, our clients’ portfolios are now generally well placed to take advantage of the opportunities and value which will become apparent as the current difficulties unwind and visibility improves.

The immediate future is obviously uncertain, but please be assured that our team here will remain ever vigilant.

David Oakes – 18th September 2008
Chief Investment Officer