



SOCIALLY RESPONSIBLE PORTFOLIOS

INVESTMENT REVIEW



OCTOBER 2009

REVIEW

At long last there is good news for our investors. Over the past six months markets have recovered from the extreme low experienced in March. In the graph below, you can see that the FT World Index rose 21.7%. In the UK the FTSE was up 25.8%. In the US the Dow Jones Index was up 11.7%, and in Japan the Nikkei was up 14.1%. The depths seen in March reflected an outlook which was far too pessimistic. Many companies saw their share prices marked down to levels that virtually assumed they were going to go bust. It was these same shares that have done the best in the market rebound.

There are four reasons why markets have done well in the last six months. Firstly, the show of unity by the world's leaders at G20 changed market sentiment. The fact that our leaders decided to act together meant that investors no longer feared that there would be financial Armageddon. The second reason was that, by reducing interest rates to historical low levels, the authorities forced investors who relied on income to look for alternatives to cash. This inevitably led to money moving from low yielding cash, towards fixed interest investments and even shares. Thirdly, when they looked into the abyss of a depression last year, companies cut costs savagely. The cost cutting was so great, that it was greater in many cases than the fall in sales caused by the economic slowdown. As earnings were announced this year they surprised on the upside. Shares in particular responded positively, as analyst expectations proved to be too pessimistic in many cases. Finally, and probably most importantly, the level of money available for investment increased considerably. In our last *Investment Review* we noted that governments had started the process of Quantitative Easing (QE). This has continued. We said that when money supply increases it 'leaks' into the market, and that is exactly what has occurred. Prices have effectively been pushed up by QE.

OUTLOOK

There is a clear division between economists. There are those that think that QE will be overdone and that eventually inflation will return. If that happens shares are one of the assets which will give some protection. Then in the other camp are those that think that the dislocation in the financial

system is so great that deflation will be the order of the day, in the same way that it happened in Japan in the 1990s.

Normally when we have two opposite views from economists, the economy moves between the two. We think that in the Western economies the level of debt had risen to unsustainable levels. Governments did not recognise the obvious, that is if someone borrows to buy something today, you are effectively bringing future consumption forward. You can not continue to borrow money, eventually it has to be repaid. As borrowers repay debt, they divert their money from spending to saving. In our view, this means that the economic recovery will be anaemic. That is not bad news from the perspective of markets. If the economy is growing, albeit anaemically, companies will be able to increase their profits. Because they have cut their costs, there can be some profits, which will be good for markets. Additionally, if the economy doesn't get too strong, the authorities will keep their measures in place to ensure economic growth is maintained. That means QE will continue, so too will interest rates be kept low. As we have said above, these measures are supportive of markets. There will be periods of doubt as sentiment switches to worrying about inflation or deflation, which will cause times of consolidation in markets. However, overall the markets should be well supported.

PORTFOLIOS

In the short term we have decided to crystallise some profits in our growth portfolios and increase cash. We believe that markets have got a bit ahead of themselves. We are aware that in the

longer term we should not 'fight the Fed'. That is to say that, whilst the US Federal Reserve are providing liquidity to markets like the Bank of England are, it is unwise to withdraw too much from markets.

Markets never go up in a straight line. The recent quarterly results in the US have been better than anticipated. Markets have done well on these announcements. However, there is now likely to be a lull in markets as they digest the news they have already received. Markets look forward. They are likely to start asking questions about how long the central banks will continue to provide liquidity, and what will happen when they start to withdraw their support. They will also question the nature of any economic recovery. If, as we believe, markets start to think that economic recovery will be anaemic, then companies that will do well in that environment will be sought. Some of the poorer quality shares that have done well recently are likely to come under much closer scrutiny. We anticipate keeping the higher cash position until mid-December.

ENCOURAGING

After the shift in attitude by the Chinese and Indian governments, the climate change conference in Copenhagen in December could create a further beneficial impetus for companies involved in alternative energy production and 'cleaning' existing energy production. This will be on top of the US government's economic stimuli which are being targeted at 'Green' industries. This bodes well for the future of the companies which are invested in by the funds we buy.

