



Derek Mitchell
Manager,
Royal London
UK Opportunities
Fund

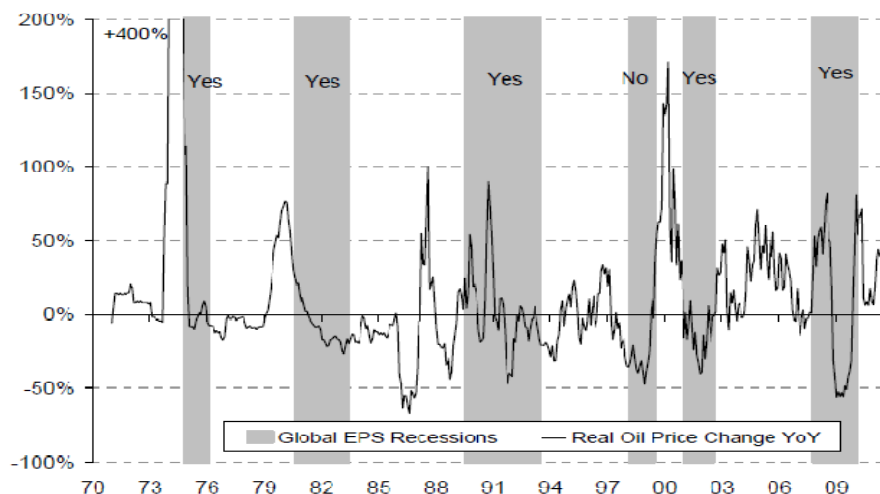
Derek Mitchell believes the global growth environment remains intact and that with volatility comes opportunity

Rising oil price less likely to trigger recession now than in 2008

Given recent events in the Middle East and North Africa, the oil price represents a significant tail risk for investors, who have in a short period of time had to become experts in MENA geopolitics. Although a rising oil price has previously triggered recessions, (see Chart 1), it does not necessarily follow that it will do so this time around. The issues driving higher oil prices now are a little different to those we witnessed in 2008. While global demand remains strong, it is now being accompanied by supply concerns, and political tensions in the MENA region may cause major disruptions to supply. Furthermore, governments are re-thinking nuclear power generation after the disaster in Japan and any reduction in the supply of nuclear energy could also boost oil demand. Compounding investor concerns is that other commodities have rallied along with oil; metals prices are up almost 10% year to date, while food prices have rallied 12%. All of these commodities add to consumer price inflation and increase corporate costs.

Chart 1

Was a global earnings downturn preceded by a 50% spike in oil prices?



Source: Datastream, MSCI, CIRA

Less dependence on oil now, but a Saudi disruption would be a concern

However, given that there is less dependence on oil now than there was before, we believe that the recent increase in the oil price will have only a modest impact on the global economy. The industrial bias within the portfolio therefore remains unchanged as our top down view continues to be supportive of global growth, especially in emerging markets, Germany, and the US. What would cause us to change our view - and the positioning of the portfolio - would be a rise in the oil price to nearer \$150. Although Saudi Arabia can pump enough extra oil to take up the slack for Libya and Egypt, spare capacity is limited and if Saudi itself were disrupted there really is nobody else to help out.

Retail environment already severely depressed

Closer to home, another concern for investors is UK interest rates, and the debate on the likely timing of the first rate rise appears to be finely balanced, until one considers the potential impact of an early increase. The market is currently factoring in a 0.25% hike in May as the worsening inflation outlook leaves the MPC increasingly behind the curve, but recent profit warnings from Dixons and Sainsbury's reveal the extent of the slowdown in consumer expenditure in the last couple of months. Concerns over unemployment and the impact of austerity measures have severely impacted retail spending. For example, at a recent meeting with soft furnishings company Dunelm, management suggested that consumers were opting out of shopping on the basis that if they went out they would only spend money they didn't have. Meanwhile retail entrepreneur Sir Philip Green has also commented that conditions on the High Street are some of the worst he has ever seen.

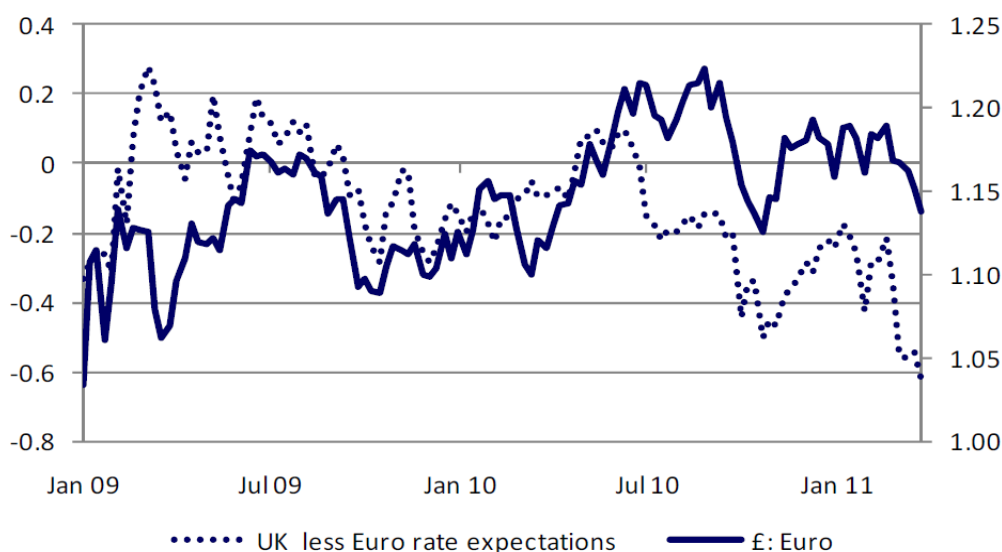
Early rate rise could weigh on a range of consumer-related areas

Any early move in interest rates would therefore only increase pressure on household budgets, and with savings levels having been run down in the approach to Christmas, consumers are simply running out of cash. This poses problems not just for general retailers and for food retailers, but could also weigh on other consumer sectors such as pubs & restaurants, travel & leisure and betting. As a result, we are very underweight all consumer-facing areas.

Rate differential with Europe to persist as UK inflation declines

With the ECB indicating that they will start tightening in April, Chart 2 shows that investors have already priced in an additional 40bps of rate tightening in Europe relative to the UK, as the MPC expects that the temporary factors driving inflation in the UK will soon ease.

Chart 2



Source: Shore Capital Stockbrokers, Datastream

Continued accommodative UK monetary policy will keep sterling depressed, favouring companies with overseas exposure

Our view is that UK rates will remain on hold, keeping sterling weak and in particular causing it to decline against the euro, to enable the UK economy to rebalance away from its dependence on the consumer towards more export-oriented industrial and service-based areas. As a result our a clear preference is for holding companies with overseas exposure, as they become more competitive as sterling weakens. We therefore favour companies such as IMI and Logica, which generate 93% and 81% of revenues respectively from outside the UK. In conclusion, we expect earnings and share prices to remain robust, and are finding many opportunities amongst the current volatility.

Contact Details



Ian Goulsbra
Head of Wholesale
Relationships
020 7506-6775
ian.goulsbra@rlam.co.uk



Jonathan Rehbein
Business Development
Manager
020 7506-6657
jonathan.rehbein@rlam.co.uk



Tony Taylor
Business Development
Manager
01904 701-444
tony.taylor@rlam.co.uk



David Billyard
Business Development
Manager
020 7506-6559
david.billyard@rlam.co.uk



Nina Redfern
Head of Consultant
Relationships
020 7506 6558
nina.redfern@rlam.co.uk



Alan Bunce
Head of Institutional
Business Development Direct
020 7506-6570
alan.bunce@rlam.co.uk



Dean Heaney
Institutional Business
Development Manager
020 7506 6568
dean.heaney@rlam.co.uk

Source: **rlam** as at April 2011 unless otherwise stated.

rlam is a marketing brand including the following companies: **Royal London Asset Management Limited** registered in England & Wales number 2244297; Financial Services Authority (FSA) register number 141665. **Royal London Pooled Pensions Company Limited** registered in Scotland number SC048729; FSA register number 110456. **Royal London Unit Trust Managers Limited** registered in England & Wales number 2372439; FSA register number 144037. **Royal London Cash Management Limited** registered in England & Wales number 19632; FSA register number 121844. All of the above are authorised and regulated by the Financial Services Authority.

It also includes **Royal London Asset Management Bond Funds Plc** registered in Ireland number 364259 and regulated by the Central Bank of Ireland.

All these companies are subsidiaries of **The Royal London Mutual Insurance Society Limited** registered in England and Wales number 0099064 (FSA registration number 117672). Head office: 55 Gracechurch Street, London EC3V 0RL