

## Market views



Derek Mitchell, Fund Manager

- UK Special Situations Fund
- UK Mid-Cap Growth Fund

UK equities could well trade in a narrow band over the summer as the problems of sovereign debt and increasing public unrest play against a still improving earnings outlook. With European Sovereign CDS spreads collapsing to pre-bailout levels, the confidence that was around only a few weeks ago has evaporated. However, the reaction to the UK emergency budget has been very positive, which will help Sterling and Gilts, and should mean that the UK avoids the credit downgrades that have plagued Southern Europe.

We have reached an interesting point in this market cycle. With leading indicators such as the ISM rolling over, investors are starting to wonder whether we have seen an end to the rally in cyclical stocks. All eyes will be on the US as we move into the Q2 reporting season to see whether the improving earnings trend of Q1 will continue. High expectations mean there is scope for disappointment.

The outlook beyond the summer is positive, as loose monetary policy and high corporate cashflows will continue to support risk taking in the equity market. Cyclical and financials should be the main beneficiaries of this policy. There are clear signs that this cashflow is being spent. Companies are investing in their businesses - for example, advertising is greatly improved, benefiting the media sector, and travel and IT budgets are being expanded. Capital expenditure is picking up, following almost two years of no investment and, with the exception of BP, most companies are again growing their dividends, which in turn will be reinvested. All of these measures are positive for the market. Finally, there is an expectation that M&A will pick up. This has been disappointing so far, particularly given the weakness of Sterling, but should improve in the second half now that businesses are more confident about investing their cashflows.

### Bull points

- Emergency budget has provided more certainty
- Cashflow being deployed by businesses

### Bear points

- Questions over US and Chinese growth
- Contagion risk from Europe

Source: rlam as at 25th June 2010 unless otherwise stated.

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