

Market update – 11th August 2011

After substantial falls last week, stock markets have remained volatile over the first couple of days of this week and - during Tuesday morning - the FTSE100 fell below the 5000 level for the first time in a year. By contrast the UK bond market and the precious metal markets have remained strong as investors seek safety during this period of uncertainty.

The key macroeconomic event over the weekend was the downgrading of United States sovereign debt from an AAA status by the rating agency *Standard & Poors*. We were not surprised by this occurrence given the continued high fiscal deficit of the US government. Nor were we surprised by the reaction of President Obama and his key financial colleagues in condemning the decision. Nevertheless the reality of the occurrence of the downgrade did introduce more risk averse behaviour into the financial markets. Policymakers around the world, in particular the Fed, have therefore started to enact support mechanisms to try to improve the tone of financial markets with the aim of building confidence amongst individual consumers and corporations and supporting growth in the face of economic statistics which have surprised on the downside.

Following the US downgrade, attention then returned to the European fiscal deficit issues, in particular events in Italy and Spain. After a lengthy meeting of leading finance ministers on Sunday evening, the European authorities announced a new initiative to formally support the Italian and Spanish bond markets by buying sovereign debt from the two countries. This had the impact of pushing Spanish and Italian bond prices sharply up (yields down), alleviating some of the pressure on these economies. While the ECB is technically not the lender of last resort and not by charter allowed to print money (i.e. quantitative easing), this policy of buying bonds could well in the future lead to more overt quantitative easing as we have seen by the Fed in the United States. Given the sharp decline in financial markets over the past week and the need to restore confidence, it is our belief that policy makers will do whatever it takes to avoid further deceleration in economic activity as long as debt levels remain at these precarious levels.

However, despite the volatile economic situation we now face, there are still areas where our investment team feel opportunities can be found.

- At a micro level, we believe companies in general are in a healthier position than the markets themselves. While corporate earnings may suffer somewhat in the short term, we see opportunities starting to build in selected equity investments on a longer term view.
- Our favoured equities are currently those of a more defensive nature; high quality companies with strong balance sheets, high and sustainable dividend yields, good market positioning and exposure to emerging market growth.
- We are also looking at some of the more cyclical blue chip companies in the industrial and resources sector and some highly specific stock picks within both the Asian and Emerging Markets.
- Precious metals, and in particular gold, remain an attractive proposition in our opinion. Our focus has switched away from bullion to gold equities as these have underperformed the rally in bullion.

We have been selectively buying into the market in recent weeks, having entered the latest decline defensively positioned with a higher than normal level of cash within the discretionary portfolios we manage for our clients*.

In conclusion, we remain concerned about the fragile state of the Western world and believe that the crisis in confidence and ongoing market volatility will continue as the Western world perseveres with the difficult process of reducing long-term debt levels. However, we believe that investment opportunities remain available, in particular where investors are taking a longer term perspective and focusing on defensive funds and stocks.

Nancy Curtin

Chief Investment Officer

Close Asset Management Limited

*The “Cash Reserve” option on the Cofunds and Funds Network platforms enables you to hold cash arising from the liquidation of investments in “wrappers” (such as ISAs) without having to exit the wrapper itself.

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