



## Pictures Can Tell a Thousand Words

## Do economic fundamentals support equity valuations?

The recent equity market rally has come as a welcome relief for many investors. Since hitting lows in mid-March the UK stock market (represented by the FTSE 100 index) has roared over 45%, with a similar pattern repeated across the globe. Many attribute this rise to improving economic fundamentals, whilst others simply to liquidity; too many side-lined investors chasing the market up and maintaining the momentum; interestingly both are true.

Positively net investors' inflows in to investment funds clearly increased as the year progressed (indeed 2009 may prove a record year) and some important economic indicators are certainly showing signs of improvement; unfortunately some are not. The decline in GDP growth seems to have bottomed (although the UK is still technically in recession) and the pace of growing unemployment has slowed (although it is still at ten year highs!). Worryingly the liquidity that is returning to the corporate credit



markets has not yet filtered through to the consumer credit markets with significant falls in the level of secured and unsecured lending this summer. A revival in retail spending (including cars and housing) will be a vital component to sustaining any recovery. Equity valuations have reached multiples last seen pre-Lehman brothers, optimistically factoring a sustained economic recovery and improvement in corporate earnings. Should these earnings improvement not materialise valuations could tumble very quickly.

This is where the debate now centres; have the equity markets disconnected from economic fundamentals and more relevantly will they be pressured should new money inflows fall? Certainly further weakness in the labour markets and housing sectors could incite a double-dip recession but thankfully we consider this unlikely.

We continue to stand by our prediction that the recovery in growth will be slow and occasionally painful. The Bank of England will maintain an accommodative policy well into next year; to both stimulate growth and inflation (Inflation will certainly reduce their government debt burden) and may well have to extend their current quantitative easing programme. This environment of slow growth and accommodative monetary policy will support equity valuations and generate a gradually re-rating of corporate earnings expectations. Unfortunately volatility has notability increased over recent weeks and it would be naive not to expect a short-term pull back in equity markets before year end.

This document is not intended in isolation as an offer or solicitation or recommendation to use or invest in any of the services or products mentioned herein. Investors should be aware that the value of the portfolio and the income from it can go down as well as up so you may get back less than you invested. Past performance is not necessarily a guide to future returns. The value of investments denominated in foreign currency may fall as a result of exchange rate movements. The investments and services referred to in this document may not be suitable for all investors and, if in doubt, you should seek qualified independent financial advice. Any opinions, expectations and projections within this note are those of TAM Asset Management International Limited, represent only one possible outcome and do not constitute investment advice.

TAM Asset Management International Limited is regulated by the Financial Services Commission of Mauritius and is an authorised Financial Services Provider regulated by the South African Financial Service Conduct Authority.



