

We are all in a crisis!

The rain in Spain falls mainly on equities! “todos estamos en una crisis”; we are all in a crisis! - The popular, if slightly less catchy, Spanish media version of “We’re all in this together”

Perhaps the world was getting a little too complacent but speculation that Spain is heading towards a bail-out has re-surfaced. There isn’t much one can say about the ensuing sell-off in equities that hasn’t been written before. Like an Agatha Christie novel where the plot is always broadly the same but the characters change, there is striking similarity to media articles, comment and opinion trying to draw parallels between the events of the last few days and the systemic problems that everyone has been well aware of for months, if not years. However, Spain is a giant social and political beast and in no mood to be pushed around by the EU gang.

The trigger for the sharp sell-off in equities was the failed Spanish Bond auction on 6th April where only EUR2.59 billion was sold out of a maximum EUR3.5 billion and, at 4.319%, almost 1% higher than the

cost of borrowing from a similar auction last month. The 10-year yield shot back up to over 6% which is where it was prior to the EUR 1 trillion LTRO splash of liquidity that lowered rates across Europe and provided the much needed boost for equities. However, the Spanish authorities have been quick to deny the need for a bailout citing the fact that Spain has already met its financing needs for half of 2012. A frustrated Spanish Prime Minister, Mariano Rajoy, has demanded that other European leaders stop pointing the finger of blame at Spain. In a high profile speech clearly directed towards French president Sarkozy who is fighting for re-election and threatening would-be Hollande voters that the market would punish a left wing election victory and push France to a fate worse than Italy and Spain. A faintly implausible prediction even with the sporting chance of François Hollande winning it. Nevertheless, the ensuing flight back to quality has pushed German 2-year bonds to lower yields than Japanese yields for the first time since 1988 and the fall in equity markets saw the FTSE 100 Index retreat from around 5,900 to a shade above 5,600.

Taken against the rise since November last year, the technical charting pundits argue that this was due at some point, is entirely normal and represents a buying opportunity. The "due at some point" argument might have some merit but only insofar as a broken clock tells the right time twice a day. In the war of clichés, the observation that equities were "climbing a wall of worry", notwithstanding all the negatives, summed up the mood in Q1 perfectly. The TAM investment team agree with the latter view that this does represent a buying opportunity for equities as short, sharp sell-offs are usually fairly indiscriminate in nature and unfairly punish the share prices of perfectly healthy, growing companies. In a broader sense, equities already offered better value than Gilts before the sell-off, in our opinion, and our view remains the same today. Indeed, we note that Germany yesterday suffered a failed auction of its own Sovereign debt based, seemingly, purely on price. Figures near record lows of 1.63% for 10-Year German paper is apparently too rich even for the most nervous of investors. This was the first failed auction for Germany this year and, whilst unlikely to draw much comment, may mark a low watermark for yields for the foreseeable future.

Anyone watching the Spanish "crisis" too closely will have missed the first-quarter earnings announcement from Alcoa which was, happily, better than the market had been expecting. Whilst notionally a commodity linked play, the world's second-largest aluminium producer is not exactly the barometer of global economic health in the same way as the copper price. However, the results at Alcoa, which always opens the US corporate earnings season did provide a boost to equities just about the time that the European Central Bank started making familiar noises about re-entering the business of buying Spanish debt during periods of extreme stress.

Given that we now have to wait until June for the next major summit (G20) to find out how much backing the IMF will give the EU, such rhetoric may be as good as it gets although we can expect plenty more with elections in France, Greece and an Irish referendum.

We recognise that these, and several other factors, are weighing heavily on investor's fears. However, we have already positioned client portfolios relatively cautiously with mildly underweight positions in equities but have, nevertheless, come through the first quarter of 2012 with some good outperformance overall. We do see the current weakness as a buying opportunity but this would, at most, only be moving to being closer to benchmarks. Despite our positive outlook for equity markets however, we took the opportunity last month, to begin rotating out of some higher-beta names, which performed so strongly in the first quarter, into more defensive opportunities complimented by seasoned stock-pickers that can unlock much of the value we believe still present in equity markets even if a broad market rally does not materialise.

Whilst "we are all in a crisis" may truly reflect the mood on the streets of Madrid, we actually think this is a time of great opportunity and stand ready to act.

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