

# Market update



**For professionals only**

**Iain Clark, Chairman of the Henderson Horizon Board gives his views on the current macro economic situation in Europe.**

Stock markets have fallen nearly 20% from their highs this year. So what do we think that that's telling us? It's very clear at the moment that the main fear for stock markets is that the developed world, both in the US and Europe, fall back into recession, and that's what's really worrying stock markets.

So what are the chances of this happening, and what are the possibilities and the levers that people can use to try and avoid that?

There are two principle aspects that people can use. Firstly, on the monetary side, clearly we've already got very low interest rates, so there's not much more that can be done there, however, there is what is called sometimes unconventional policy, or, in American terms probably a QE3 or in British terms a QE2, and I think it's probable that both the US and the UK monetary authorities will come up with something over the next few weeks. How that works, of course, is very much an open question, and I think people will be a little bit sceptical from previous occasions, but nonetheless I think we will see some action on that side.

The other side, where the authorities can change things and help to move economies along is on the fiscal front, and here, again, the stock markets are pretty sceptical at the moment. We've had the now 18-month saga of the European debt crisis, where politicians have generally been pretty slow to act, and people are concerned about that. And then in the US of course, we also had the ongoing saga of the budget deficit and trying to raise that ceiling on that, which again hasn't given people a lot of hope that politicians are going to be able to solve the problems.

Nonetheless, I think they will get there eventually. The slightly bad news, perhaps, in Europe, is that we may yet need another little European debt crisis before politicians really get their act together, but I do think there are definitely some issues, some levers that they can use to help on the fiscal side. It's all very well, all of this austerity, but not every single country can be doing it, because then we have what is called the Paradox of Thrift, and if everybody is doing it, then it becomes very difficult to see where the growth might come, and I think we have to find some other way. But at the moment stock markets are in this uncertain period, when they don't really know what's going to happen, either on the monetary front or on the fiscal front, so I think it will remain quite a difficult market.

One of the things too, that has notably happened over the last two or three months is that correlations between stocks have gone a lot higher, and that's meant that the top down factors are probably driving the stock markets a little bit more.

This is a pity, for example, because we are seeing still quite a lot of very good value. We can certainly find plenty of stocks in Europe, and indeed elsewhere in the world, where we see quite low valuations in terms of PE, with quite supportive yields, but the stock markets are really not paying very much attention to that at the moment.

So I'm afraid that I think the likely course of events is that stock markets remain quite volatile over the next month or two. I think we have to see some reactions, both from the monetary authorities, and the fiscal authorities, but I do believe that stock valuations look reasonable value, so looking out into the new year, I'm

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reasonably optimistic that we will see stock markets rise from here, but I think it'll be quite a hairy ride in between.

**Iain Clark, September 2011**

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