

Market update



For professionals only

In light of the continued market volatility, David Jacob, Chief Investment Officer at Henderson Global Investors shares his views and explains the reasons behind current sentiment.

Given markets are highly volatile and down significantly from their recent levels I thought I would share with you the brief substance of some of the discussions we are having across our investment desks.

Many previous dramatic falls in equity markets can be explained by overvaluation of either the equity market, a sector, or the amount of leverage being used in the markets themselves. Arguably, this decline does not have those characteristics. It is our shared view that the one economic participant that is in good health is the corporate sector. Strong balance sheets, deleveraged after the crisis, combined with solid cost control and good cash levels characterise many of the developed market companies. The issue this time is the market's faith in the governments that underpin our economies.

Since 2008, we have lived with governments being an ever increasing participant in capital markets. Emergency monetary policy, quantitative easing, and bailing out of distressed banks have left the government sector intertwined with markets. The objective of the government intervention has been to avoid depression and deflation brought about by the massive deleveraging of the banking sector. The current turmoil is being brought about because markets no longer feel those government participants have the tools or balance sheets to further stimulate economies and impact markets sufficiently to prevent a slow down.

The US downgrade, while not providing any new information and being largely backward looking, showed the US fiscal toolbox to be empty and the political infighting in the run up to another election would prevent sensible policy from being carried out effectively. That combined with slowing economic information in the US created an environment where the fear of a likely recession (double-dip) increased with the government being limited in its ability to prevent it.

Similarly, fiscal concerns in Europe and the disharmony with the euro have created an environment of heightened uncertainty. The ECB is pursuing, in my opinion, a sensible agenda, but too late for it to have the desired impact. The ECB would like to see the reforms put in place in each Euro country that would improve their flexibility as an economy as well as provide for increased fiscal responsibility. This agenda itself is not pro-growth. The poor health of the periphery countries is well known, and markets feel we are moving towards a key point in the European experiment.

Combine all these things, and the flight to safety becomes understood.

However, going back to my first point, we continue to believe that corporates are generally in good health. Additionally, developing markets are contributing an increasing amount to global growth and may provide some much needed fuel for global economies. While we do not take a single house view, I think it is fair to say that most of the investment teams on the equity side feel that at these levels there are some attractive buying opportunities and that we may be nearing a low for the near term. On the debt side, credits remain strong, and levels are again beginning to look appealing given the health of balance sheets. On the interest rate side, of course the sovereign credit risk is clearly increasing, and it is difficult to feel that government bonds offer good value at these levels.

Finally, liquidity remains very thin, but chiefly because of the summer period and absence of many market participants. Counterparties are reluctant to take on risks at present mainly due to uncertainty, but we are

Market update



not seeing the market dysfunction that we observed during the Lehman crisis. This is much more about confidence and outlook than creditworthiness.

I hope this brief update puts the turmoil in perspective and also gives some indication of the fact that we feel things are currently overdone at these levels.

David Jacob, 9 August 2011

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