meridian

ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

A strong performance by international equity markets in January has led to a significant return over the quarter as our table below shows. Although the economic news has been slightly less bad, there has been no fundamental breakthrough in tackling the problems which exist. In our view, the rise is due to the continuation of very loose monetary policy and an improvement in sentiment which can occur without a positive catalyst. High quality government bond yields have risen but they still look very low in relation to what we consider to be good value. Currency markets have moved significantly with the weakness of the yen being a particular feature.

The tables below detail relevant movements in markets:

International Equities 31.10.12 - 31.01.13

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+9.3	+11.7	+10.0	+5.0
Finland	+12.2	+19.4	+17.5	+12.2
France	+9.1	+16.1	+14.3	+9.1
Germany	+7.3	+14.2	+12.4	+7.3
Hong Kong, China	+10.3	+12.0	+10.2	+5.2
Italy	+9.9	+16.9	+15.1	+9.9
Japan	+27.6	+13.6	+11.8	+6.7
Netherlands	+9.0	+16.1	+14.2	+9.0
Spain	+8.9	+15.9	+14.1	+8.9
Switzerland	+11.8	+16.2	+14.4	+9.2
UK	+9.4	+9.4	+7.7	+2.8
USA	+7.0	+8.7	+7.0	+2.1
Europe ex UK	+9.3	+15.7	+13.8	+8.7
Asia Pacific ex Japan	+7.7	+9.4	+7.7	+2.8
Asia Pacific	+15.2	+11.0	+9.3	+4.3
Latin America	+6.1	+10.3	+8.5	+3.6
All World All Emerging	+8.2	+10.2	+8.5	+3.6
The World	+8.8	+10.2	+8.5	+3.5

Source FTSE World Indices

FT Government Securities Index All Stocks (total return): -1.6%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	31.10.12	31.01.13
Sterling	1.84	2.14
US Dollar	1.70	2.01
Yen	0.78	0.78
Germany (Euro)	1.47	1.71

Sterling's performance during the quarter ending 31.01.13 (%)

Currency	Quarter Ending 31.01.13
US Dollar	-1.6
Canadian Dollar	-1.9
Yen	+12.5
Euro	-6.1
Swiss Franc	-3.9
Australian dollar	-2.1

Other currency movements during the quarter ending 31.01.13 (%)

Currency	Quarter Ending 31.01.13
US Dollar/Canadian Dollar	-0.3
US Dollar/Yen	+14.4
US Dollar/Euro	-4.5
Swiss Franc/Euro	-2.2
Euro/Yen	+19.8

Significant Commodities (US dollar terms) 31.10.12 - 31.01.13 (%)

Currency	Quarter Ending 31.01.13
Oil	+6.3
Gold	-1.9

Markets

International equity markets showed a significant rise over the last quarter. In local currency terms, the total return on the FTSE World Index was 8.8%, in sterling terms 10.2%, in US dollar terms 8.5% and in euro terms 3.5%. Looking at local currency returns first, the outstanding performer was Japan which returned 27.6% as measured by the FTSE Japan Index. The action plan from the new government and the Bank of Japan caused a significant depreciation in the yen which resulted in a strong rally in stocks perceived to benefit from a weaker yen. Elsewhere, in local currency terms, returns were closely bunched around the performance of the FTSE World Index. However, when we adjust for currency movements, the picture changes dramatically. The yen, in particular, as alluded to above, was very weak, whilst sterling also declined. For sterling investors, and, as reflected in the relevant FTSE country or regional index, returns from overseas markets were usually significantly higher. The exception was Japan, where the index return came down to 13.6%, still well above the return on the FTSE World Index. The best performing area in sterling terms came from the FTSE Europe ex UK Index, where the local currency return of 9.3% increased to 15.7%. The USA, although producing an excellent sterling adjusted return of 8.7%, was below average, as was the UK, although only very slightly. Australia produced a slightly above average performance of 11.7%.

High quality sovereign bond markets experienced a weaker quarter. Given how overvalued this market is, it was always going to happen and we believe that there is much further to go. Right at the end of the quarter, gross redemption yields on US and UK ten year government bonds broke above 2%. Over the quarter, the gross redemption yield on the ten year UK government bond rose by 30 basis points to 2.14%, on US Treasuries, by 31 basis points to 2.01% and, on German Bunds, by 24 basis points to 1.71%. Japanese government bonds, always a special case, remained unchanged at 0.78%.

As we have indicated above, the feature of the current market was a policy induced fall in the yen against which sterling rose by 12.5% during the quarter. But, elsewhere, sterling was weak, falling by 6.1% against the euro, 3.9% against the Swiss Franc, 2.1% against the Australian dollar, 1.9% against the Canadian dollar and by 1.6% against the US dollar. Interestingly, looking at other cross rates, we note that the Swiss Franc fell back by 2.2% against the euro, something which Swiss policymakers will welcome.

In commodity markets oil rose by 6.3% whilst gold fell by 1.9%.

Economics

2013 begins with a slight improvement in sentiment about prospects for the world economy this year. International equity markets have enjoyed a good start to the year and it may be that this has influenced sentiment. Equally, the rise may be telling us that the economic outlook may be improving. Whatever the reason, stronger stock markets may induce what Lord Keynes described as "animal spirits" amongst businesses and individuals, as a result of which they may feel inclined to invest or spend more and thereby create a positive economic multiplier effect cascading down through economies. Our view of the likely course of stock markets has, for a long time, been influenced by the very loose standard and non-standard monetary policy being followed by many countries, firstly, as a way of trying to mitigate the effects of the 2007/8 financial and economic crisis and, more recently, as an offset to tightening fiscal policy. These standard and non-standard (quantitative easing) policies are driving investors to look for yield. Firstly, they fled to high quality bonds and, as confidence slowly returned, to lower quality bonds and conventional equities. This has left bonds, in our opinion, looking very expensive, whilst equities, notwithstanding their rise, still offer value. As we have noted before in these reviews, ultra loose monetary policy is fraught with danger and is certainly not the best reason for the stock market's rise. In an upward trend in the international equity market, we expect setbacks on bad economic news, of which there will be plenty, and that should be an opportunity for those investors who are minded to commit more cash to the equity market to raise their holdings.

There is no doubt that the rise in international equity markets has caught some investors by surprise. It is easy to think of the stock market moving in the same cycle as the economy, but it does not necessarily do so. Therefore, in bad economic times, stock markets can perform well as they may look ahead to better economic times and vice versa.

The IMF has just published its latest economic forecasts which indicate an increase in global growth to 3.5% (down from last October's forecast of 3.6%) in 2013 from 3.2% in 2012. Of course, it is very early in the year and many things can happen to affect this forecast but it does point to slightly better conditions overall despite the slight downgrade and this may be reflected in the movement of stock markets at this very early stage of the year. If we look at individual components of the IMF's forecast, we note that the projection for advanced economies shows only a marginal increase on the outcome for 2012, 1.4% against 1.3%. This is a reduction of 0.2% on its October forecast and, essentially, this reflects a sharp downgrade in the forecast for the eurozone which has been reduced by 0.3% for 2013 to -0.2%, the outcome for 2012 being -0.4%. Although most of the forecasts for the eurozone countries have been downgraded, the big reduction in the 2013 forecast for German growth, -0.3% to 0.6%, weighs heavily on the eurozone. So, if we look at the four biggest eurozone economies, the 2013 forecasts are 0.6% growth for Germany, 0.3% for France, -1.0% for Italy and -1.5% for Spain. Elsewhere amongst the G7 countries, the USA is forecast to grow at 2.0%, just 0.1% below last October's forecast, Japan at 1.2%, an unchanged forecast, the UK at 1.0%, a 0.1% downgrade, and Canada at 1.8%, a 0.2% downgrade. Although the forecast for the Newly Industrialised Asian Economies has been downgraded by 0.4% from last October to 3.2%, it still represents a useful rise from the depressed level of 1.8% in 2012.

As ever, the very subdued forecasts for advanced economies compare with those for Emerging and Developing Economies, where the IMF forecasts growth of 5.5% in 2013 compared with 5.1% in 2012, a downgrade on October of just 0.1%. Within these forecasts, eyes focus particularly on China and, here, the IMF maintains its growth forecast of 8.2% for 2013, up from 7.8% in 2012. The forecast for India has been trimmed by just 0.1% to 5.9%, up from 4.5% in 2012. Elsewhere, Brazil, which had a disappointing economic performance in 2012 with growth of just 1%, is forecast to grow by 3.5% this year, 0.4% less than was forecast in October. So the disparity between advanced economies and emerging and developing economies looks likely to widen again in 2013. This need not be bad news for companies based in the USA, Europe or Japan which conduct significant business in these faster growing areas of the world economy. As we see from many companies' results, they are benefiting from their exposure to these regions and countries and represent a low risk way of doing so. So, as investors or investment managers, we should not be too concerned about investing in companies headquartered in low growth or recessionary economies if they have these diversification attractions and, notwithstanding our negative view on the eurozone and concerns about the UK economy, that still remains the case. So, for example, after a poor 2011, eurozone markets overall showed a strong rebound.

The economic and financial problems which existed in 2012 are not likely to go away in 2013, although they may be of different intensity. Notwithstanding the calmer background to eurozone bond markets as a result of the speech of Mario Draghi, the ECB President, in the summer when he effectively said that the ECB will do what it takes to save the euro, the underlying problems of the eurozone remain as severe as ever and could cause a shock to markets at any time. In the USA, although revenue measures were agreed at the turn of the year, the debt ceiling issue has been pushed back only temporarily and spending issues have to be addressed, something on which the Republicans in the House of Representatives may dig in their heels. In the UK, the problems of the public finances seem as intractable as ever. The aggressively expansionist economic policy instituted by the new government in Japan carries with it big risks, given the very serious state of Japan's public finances. One more positive note, however, is being struck in China where the rate of growth seems to be accelerating again.

If we take the eurozone first, the fact that, if the IMF's latest forecasts are correct, it will contract this year shows how difficult it will be to control the debt situation. If economies are contracting, it makes the servicing of debt more difficult because it generally worsens a country's budget deficit. If a country takes measures to try to improve the budget deficit by raising taxes and/or cutting public spending, it risks a self fulfilling contraction in the economy with its malign effect on public finances. So, if we take the third and fourth largest eurozone countries, Italy and Spain, both of which have significant debt issues, and note that the IMF forecasts a contraction this year of 1.0% and 1.5% respectively, we note the size of the problem both countries are facing. To be eligible for the ECB's international bond purchases under its proposed Outright Monetary Transactions ("OMT") programme, a country will have to request aid and subject its economic policy to eurozone control. Spain, perhaps the most obvious large candidate, has so far avoided meeting the much expected request but it has a very large financing programme this year to tackle. Really only the symptoms of the eurozone's problems have been tackled and these in a piecemeal way. Although countries like Spain have achieved a reduction in relative costs compared to Germany, the cost of the internal devaluations (i.e. pay and pension cuts) is exacting a high price and the horrendous level of unemployment in Spain, around 26%, with youth unemployment over 50%, threatens social unrest. The normal policy of devaluation is denied to countries like Spain because it is a member of the eurozone.

France remains a possible problem for the eurozone. It has steadily been losing competitiveness to Germany and has moved into a significant current account deficit. Its public finances are in a poor state and it seems reluctant to embrace change in its labour and product markets, which could help its competitiveness. With the French state accounting for 56% of GDP, the private sector risks being "crowded out" and the country's well known aversion to wealth and business is sending out exactly the wrong signals if it is to attract investment. The divergence in economic performance between the number one and two sized eurozone economies is a concern. Although it lost its AAA rated sovereign credit from Moody's, France has been able to borrow cheaply, but its economic problems are a looming concern, not only for it, but the rest of the eurozone. It remains to be seen whether France can tackle the level of public spending which it needs to do. It is self evidently true that a number of eurozone countries need to tackle their unsustainable debt problems but, austerity, in the absence of a flexible exchange rate to provide a competitive boost to an economy, makes a bad situation worse, and this is where we are now and a major reason for the depressing eurozone growth forecast from the IMF.

News that, in the USA, agreement had been reached on the revenue side of the equation started a rally in stocks at the beginning of the year. Whilst most of the headlines surrounded the increase in taxes on the wealthy, individuals earning over US$400,000 per annum, the ending of the temporary payroll tax holiday will cut into after tax earnings and have the same effect as a tax increase. It is estimated that these two measures will exert a drag on economic growth of over 1%. The second issue of the debt ceiling has been deferred after the House of Representatives voted temporarily to suspend the USA's borrowing limit. This leaves the Republicans to fight on the spending programme and, having given ground on tax increases, they are likely to back spending cuts. From an earlier deal, spending cuts are due to come in on 1st March in defence and non defence areas amounting to US$109 billion for 2013, if agreement cannot be reached before then. So the battle is not over in the USA, and the very poor relations between the two political parties means that there is little centre ground around from which to fashion an agreement. The USA has to address its future spending programmes on entitlements and social security because they will become unaffordable but it is, of course, very difficult politics. Whilst markets are calm, as this is written, this is another issue which could turn ugly for investors.

The state of the UK economy, in particular the seemingly intractable debt problem and the absence of growth, makes big economic headlines in the UK but are unlikely to move world markets in the way that the eurozone and the USA might do if things go wrong. Part of the UK's problems arise from the eurozone's woes, the eurozone being an important trading partner. Falls in real incomes as inflation has stayed above target have also depressed consumers' purchasing power. It would undoubtedly have been much worse had the UK joined the euro because the flexibility afforded by having one's own currency and the ability to follow an independent monetary policy, including administering quantitative easing, would not have been there. In 2012, sterling was a strong currency, perhaps because the government's plans to tackle the deficit carried respect in international markets, perhaps because it looked less bad than other counties' currencies (after all, currencies cannot all go down together, some have to show relative strength) and perhaps because the UK, unlike, say, the USA and France, retained its AAA rating with all three leading credit rating agencies. But the new year has seen, at least temporarily, a change in sentiment towards sterling as its trade weighted average has declined. There is a reason why every major currency could be weak, but it is a zero sum game, and, in the case of sterling, there are a number of reasons which could be valid. One is the current account deficit running at about 3.6% of GDP. With the UK economy depressed, one would have expected a much better position than this. Sometimes it influences opinions on currency movements, sometimes it does not. If people are feeling in a negative frame of mind, they could cite the current account deficit as being a reason for a negative view towards a currency. Secondly, the UK's relatively high inflation rate could be a reason for currency weakness. Thirdly, the extensive use of a quantitative easing in the UK threatens to debase the currency. The UK has been particularly aggressive in its use of quantitative easing and it may come back to haunt it. Fourthly, it seems likely that the UK will lose its prized AAA sovereign debt rating this year. It will not necessarily cause sterling to weaken because it may already have been discounted, but it may. Fifthly, the very serious state of the UK's public finances and the difficulty in turning them round may cause confidence in sterling to weaken. Sixthly, because it is a relative state, other countries or regions might look less bad than the UK. It must be emphasised that one could draw up a list of negatives for all major countries and regions but, as this is written, it looks as if the UK, like the eurozone last year, could feel the effect of a change in sentiment. This need not be bad for investors in the UK equity market as UK companies with international exposure could be a good hedge against a depreciating currency as their overseas earnings are worth more in sterling, and, depending on what pricing policy they follow, their exports could be worth more. Higher overseas earnings could positively affect the level of dividends declared and offset the negative effect for sterling based investors of the higher level of inflation which results from a lower pound.

We referred earlier to "animal spirits". Something happens to effect a change in sentiment. That is what we have seen so far this year. Investors have become more positive towards equities, but it is difficult to attribute this to anything really tangible. It is true that there is some evidence of slightly better economic conditions, for example in China, but the move is largely sentiment. As we know, bonds of various qualities have proved popular with investors in search of yield, or perceived safety, but it has very often come at the expense of taking a major risk in accepting bond yields which, in normal circumstances, are significantly out of line with their intrinsic worth. We all know why bond yields have been driven down. This is a combination of very loose standard and non-standard monetary policy (quantitative easing), a flight to perceived quality and lower risk and official hints and reassurances that monetary policy will remain loose for a long time in many of the major economies. However, that does not alter the fact that, on a value basis, many bonds look very expensive. This is recognised by many investors and the tipping point for some has been the rise in equity markets which has made some investors nervous of missing out on further rises. This follows a traditional pattern of market movements, up or down, dictating some investors' decisions. Hence, we have seen big inflows into equity funds during January, called by some "the great rotation" out of bonds into equities. Very loose monetary policy cannot indefinitely sustain low bond yields as fundamental issues must catch up with that market, the main one being currency debasement (in some markets) and the inevitable resurgence of inflation if quantitative easing is not reversed. We would normally expect to see a real interest rate on ten year government bonds but, despite the recent rise in bond yields, that is not generally the position now. One has to ask oneself if one can see any reasonable investment case for buying ten year UK government bonds on a gross redemption yield of 2.14%, US Treasuries offering 2.01% and German Bunds offering 1.71%. One would have to be very pessimistic to settle for these returns. In all cases, the dividend yields on the representative indices for those three markets are higher than on the relevant government's bonds.

Whilst equity markets may react positively to a gradual normalisation of yields on bonds (we have mentioned government bonds but this could apply to high quality corporate or high yielding corporates) as a sign of a gradual return to normality, the danger always is of a rout in the bond market. Bonds are often thought of has being held to moderate portfolio risk because they are less volatile. With such an overbought market, price falls could be very substantial. The irony of the situation is that many banks are heavily invested in supposedly safe government bonds, so a major fall in bond prices could raise the banking risk again and, through links with sovereigns, raise concerns about defaults. Investors should be aware of this danger as the market distortions, caused by very loose monetary policy, build up.

If we now turn to look at different areas of the world economy, starting with the USA, we note, right at the end of the month, a surprisingly week US GDP number, with GDP sliding by 0.1% on a quarter on quarter annualised growth rate. In fact, it was distorted by special factors, business inventories and a fall in defence spending which exerted a sharply negative influence on growth, 1.3% in each case. Movements in business inventories are likely to be reversed in the following quarters. On the other hand, there were positive areas of growth in the form of consumption, business investment and construction which were responsible for a 2.7% contribution to growth. For this last quarter, headline figures are not likely to have given a representative picture of the US economy. Other data shows a more positive picture, although of an economy moving forward only modestly. The latest purchasing managers indices paint a mildly encouraging picture. That for manufacturing rose from 50.2 in December to 53.1 in January, whilst that for the services sector rose from 54.8 in November to 55.7 in December. In the employment market, figures suggest a stable but not a much improving situation. In January, 157,000 new jobs were created and the unemployment rate rose slightly from 7.8% to 7.9%. December's figure was revised upwards to 196,000 and November's to 247,000 The Federal Reserve's Beige Book provides useful anecdotal evidence of the state of the US economy. All twelve Federal Reserve districts reported moderate or modest growth in its latest report. The one consistent observation was of strength in the housing market, which will be very welcome to policy makers, since that is where the crisis started. The Beige Book reported a mixed picture in manufacturing. As the Beige Book indicates, there have been a number of encouraging items of news from the housing market. Stocks of homes for sale hit an eleven year low in December. The housing inventory fell by 8.5% and the inventory to sales ratio fell to 4.4, which was the lowest level since May 2005. On the house price front, the latest S & P/Case Shiller index of house prices was 5.5% higher than a year ago. This was the most rapid increase since August 2006 and it enabled 1.3 million households to emerge from negative equity. 10.7 million households remain in negative equity. Finally, the day before the GDP figures were announced, there was some encouraging durable goods orders data. The headline figure was for an increase of 4.6% in December compared with 0.7% in November. They were boosted by the volatile transport element, up 11.9%, but, excluding these, orders rose by 1.3%. As a proxy for investment, non defence capital goods orders, excluding aircraft, rose by 0.2%.

In summary, the US economy looks in a healthier situation than the eurozone, UK and Japanese economies and the best estimate, at this stage, is for the growth rate in the USA this year, as the latest IMF forecast shows, to be modest but far better than the three areas mentioned above. The headwinds which the USA will face this year include the tax increases and an end to the payroll holiday already in effect, possible sequestrations coming into effect on the 1st March and the uncertain outcome of the wrangles between the two political parties over the debt ceiling and spending. However, the unsustainable path of the USA's public finances is not something which can be ignored and, at some stage, the markets will signal this and the optimistic view would be that this wrangling will ultimately result in a situation which puts the USA's public finances on a more sustainable path. That may be an optimistic hope given that politicians rarely look beyond the next election but, if it could be achieved, markets would probably accept the drag on growth caused by the fiscal tightening. Because the US dollar is the world's major reserve currency and has to be held in countries' foreign exchange reserves, the USA can get away for a long period without addressing its serious deficit and debt issues, but this state of affairs cannot last indefinitely and markets will show their concern at some stage.

It is difficult to add anything meaningful to what we have said about the eurozone. We are in a state of limbo waiting to see if Spain seeks a bailout and thereby triggers the ECB's OMT programme. The Italian election is unpredictable and nobody wants to rock the boat in front of the German election later this year. In particular, the near certainty that there will be official losses on Greek debt is a taboo subject in front of that election. The big fall in peripheral eurozone bond yields suggests a partial return to normality but this is as a result of the successful shaping of expectations by Mr Draghi. This can only last for so long and fundamentals will catch up with the eurozone. The latest eurozone unemployment rate is 11.8%, a record, and the situation will deteriorate. There is a possibility that social unrest will spread in these circumstances. Even Germany, the eurozone's powerhouse economy, contracted by an estimated 0.5% in the final quarter, suggesting that the eurozone core is being affected by events in the troubled eurozone countries. So, whilst there is certainly more confidence around in the eurozone's financial markets, it is more of the "animal spirits" kind, rather than because of any fundamental improvement in the area's position.

Events have moved quickly in Japan following Mr Abe's victory in December's election. With the economy stagnating, he has moved to try to stimulate the economy, unveiling a JPY10.3 trillion (US$112 billion) stimulus pledge and has pressurised the Bank of Japan into following a more stimulative policy. The Bank of Japan has agreed to double its target for inflation to 2% and it has agreed to buy government bonds in a big way. These are desperate measures. Japan's gross public debt is around 230% of GDP and, whilst most public debt is domestically held, the government cannot rely totally on domestic investors soaking up government debt indefinitely. As our table at the beginning of this review shows, the effect on the yen has been dramatic. Whilst the yen is thought of as a strong currency, there are deteriorating fundamentals in the form of a trade deficit which nearly tripled in 2012 to the equivalent of US$77 billion as a result of energy imports necessary as a result of the closure of most of Japan's nuclear power stations. So, things are changing in Japan and policy moves and a deteriorating trade deficit which impacts on the current account surplus could see currency vulnerability, apart from the recently induced one. Japan's public finances are in a dreadful state with the budget deficit almost 10% of GDP and the high level of outstanding debt as a percentage of GDP as mentioned above. There are already murmurings about Japan seeking to gain a competitive advantage through currency depreciation and, in this time of economic difficulty, protectionism is never far away. Most countries would like to do what Japan is doing, namely to gain a competitive advantage. The new government's moves have galvanised the Japanese stock market with exporting stocks gaining strongly, but the challenge posed by the economy for both the Bank of Japan and the government is enormous, given how out of balance it is.

In China, there is evidence of an acceleration in economic growth and the stock market has been buoyant, reversing a dull trend. The latest purchasing managers indices give some room for encouragement and the fourth quarter growth showed an accelerated annualised growth rate of 7.9%, with the quarter on quarter annualised growth rate at 8.2%. December's exports were buoyant, rising by 14.1% from a year earlier, whilst imports were up 6% from a year earlier. The state of the Chinese economy is closely watched by economists and investors and, just at the moment, there is room for tentative optimism.

In the UK, the Chancellor is having to grapple with very challenging economic conditions and a very difficult deficit reduction plan. The lack of economic growth has compromised badly the original borrowing forecasts which were predicated on a much better position than the one in which the UK finds itself at present. The latest figure for the budget deficit in December was £15.4 billion compared with £14.8 billion a year ago, giving a flavour of just how intractable the problem is. With the first estimate of fourth quarter 2012 GDP showing a 0.3% annualised decline on the previous quarter, the Chancellor is receiving no help from GDP growth originally expected. Counter intuitively, the employment figures have been encouraging. In the quarter to November, there was a fall of 37,000 in the numbers unemployed. The figure of 2.49 million was the lowest for eighteen months. Over the quarter, the number of those in employment rose by 90,000. This took the number in work up to 29.68 million, which represented an increase of 552,000 over the year and was the highest level since records began in 1971. What is one to make of this apparent paradox? Opinions are divided. The pessimists will say that this state of affairs is a result of poor productivity. For example, the Conference Board estimated that UK productivity declined by 1.3% in 2012. There is the view that this state of affairs is a function of companies hoarding labour ready for an upturn, or that "zombie" companies, which would normally have gone out of business, are being kept alive by the banks and that this is reflected in employment levels higher than one would expect, given the state of the economy as represented by the GDP figures. The optimistic view is that there is something wrong with the GDP figures. Only time will tell.

What is true, and will limit UK growth, is that the public and private sectors are heavily overleveraged. Deleveraging by the government and individuals has and will continue to involve cutting back on spending, which will exert a negative impact on the economy. What can be done? There is a great deal of speculation about what the next Governor of the Bank of England, Mark Carney, currently Governor of Canada's central bank, might do if he can persuade sufficient members of the MPC and the Chancellor. Although the Bank of England is independent, its mandate is laid down by the Chancellor, currently a target inflation rate of 2% but regularly exceeded. There is some speculation that the new Governor might favour targeting nominal GDP growth, although that would have to be authorised by the Chancellor. Nominal GDP growth would combine inflation plus real growth (which could also be negative). At a time when an economy might be flat on its back and needs reviving, this may look tempting but it also invites inflation. Given that the UK is regularly exceeding its inflation target and seems more prone to inflation that most major economies, this poses a risk to the currency. It cannot be emphasised too much that the UK's monetary policy is extreme and risks currency debasement, although it is not alone in this. One is also doubtful, with official interest rates where they are at present, about the effectiveness of further monetary easing. Notwithstanding the difficulties facing the UK economy, we consider UK shares to offer reasonable value, both from the point of view of the earnings multiple on which they are selling, estimated to be just under twelve times for the current year for the FTSE 100 Fund, and the dividend yield, estimated to be around 3.8% for the current year. The spread of geographical interests of FTSE 100 companies is an appealing defensive characteristic.

The year has started strongly and, realistically, cannot go on at this pace. Nor is it desirable because a very sharp rise can be followed by a significant setback. In an upward trend, we believe that there will be setbacks occasioned by negative items of economic news which should offer an opportunity to enter the equity markets for those with surplus liquidity. Our view remains the same. Shares offer the best value, bonds the worst. There is no room for complacency, given the background economic news, and aggressive monetary easing does not provide the soundest of bases for stronger stock markets but it is likely to be the main influence for the time being.