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ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

The quarter divides into two distinct phases. January and February were very poor months for equity investors as shares fell sharply but March showed a sharp rebound as some signs of investor confidence returned. The catalyst for a stock market recovery will be signs of change in trend in economic news, initially just signs of the rate of economic decline slowing. There is tentative evidence that we have entered this phase, hence the response of stock markets.

The tables below detail relevant movements in markets :

International Equities 31.12.08 - 31.03.09

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-1.5	-1.5	-1.8	+2.8
Finland	-18.3	-21.7	-22.0	-18.3
France	-12.5	-16.1	-16.4	-12.5
Germany	-15.4	-19.0	-19.2	-15.4
Hong Kong, China	-1.3	-1.0	-1.3	+3.3
Italy	-18.0	-21.4	-21.7	-18.0
Japan	-8.9	-16.1	-16.4	-12.4
Netherlands	-12.5	-16.1	-16.4	-12.5
Spain	-14.5	-18.1	-18.4	-14.5
Switzerland	-9.0	-14.5	-14.8	-10.8
UK	-10.3	-10.3	-10.6	-6.4
USA	-10.5	-10.3	-10.5	-6.3
Europe ex UK	-12.1	-16.0	-16.3	-12.4
Asia Pacific ex Japan	+2.6	N/C	-0.4	+4.3
Asia Pacific	-4.1	-9.2	-9.5	-19.7
Latin America	-4.3	+5.3	+5.0	+9.9
All World All Emerging	-4.6	+1.6	+1.3	+6.1
The World	-8.9	-10.7	-10.9	-6.7

Source FTSE World Indices

FT Government Securities Index All Stocks (total return) : -0.8%

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

Currency	31.12.08	31.03.09
Sterling	3.02	3.13
US Dollar	2.22	2.70
Yen	1.18	1.36
Germany (Euro)	2.95	2.99

Sterling's performance during the quarter ending 31.03.09 (%)

Currency	Quarter Ending 31.03.09
US Dollar	-1.7
Canadian Dollar	+1.6
Yen	+7.0
Euro	+3.2
Swiss Franc	+4.6

Other currency movements during the quarter ending 31.03.09 (%)

Other Currency	Quarter Ending 31.03.09
US Dollar/Canadian Dollar	+3.4
US Dollar/Yen	+8.8
US Dollar/Euro	+5.1
Swiss Franc/Euro	-1.2
Euro/Yen	+3.6

Significant Commodities (US dollar terms) 31.12.08 – 31.03.09 (%)

Significant Commodities	31.12.08 – 31.03.09
Oil	+8.0
Gold	+6.3

Markets

Unlike the previous quarter, currency movements did not play a large part in the performance of the FTSE World Index in different base currencies. Although the differences would normally be considered large (4.2% between the US dollar and euro adjusted returns), in the context of what had gone before this was not the case. In local currency total return terms, the FTSE World Index returned -8.9%, whilst, in sterling terms it was -10.7%, in US dollar terms -10.9% and in euro terms -6.7%. Looking at local currency returns in different areas, we see one positive area, Asia Pacific ex Japan, where the relevant FTSE index returned 2.6%. Elsewhere, there was not a huge variation between the major markets, with the FTSE USA Index returning -10.5%, Japan -8.9%, Europe ex UK -12.1% and the UK -10.3%. Besides a positive absolute performance from the FTSE Asia Pacific ex Japan Index, there were relatively good, but negative, returns from the FTSE Latin America Index, -4.3%, the FTSE All World All Emerging Markets Index, -4.6%, and the FTSE Australia Index, -1.5%. If we look at sterling adjusted returns, the US return comes in slightly less negative at -10.3% as the US dollar strengthened slightly against sterling, whilst Europe ex UK returned a more negative figure, -16.0%, as the euro weakened against sterling. The biggest difference was in the return on the FTSE Japanese Index where the return in sterling terms came in at -16.1% as the yen gave up some of the previous year's astonishing gains. Whilst the positive local currency return on the FTSE Asia Pacific ex Japan Index was eliminated to nil in sterling terms, the Latin American and emerging market indices moved into positive territory in sterling terms, +5.3% and +1.6% respectively.

An eventful quarter in international bond markets saw redemption yields on ten year government bonds rising. In the UK, they rose by 11 basis points to 3.13%, in the USA by 48 basis points to 2.70%, in Japan by 18 basis points to 1.36% and, in Germany, by 4 basis points to 2.99%.

In the currency markets, sterling declined by 1.7% against the US dollar, but rose by 7.0% against the yen, 4.6% against the Swiss franc, 3.2% against the euro and 1.6% against the Canadian dollar.

In the commodity markets, oil rose by 8.0% and gold by 6.3%

Economics

Although it has been a poor quarter for investors as a result of bad returns for January and February, March has seen a more optimistic tone in markets as indices have pulled back some of the decline in the first two months of the year. Whether or not this finally marks a turning point remains to be seen but, at some stage, either now or later, the economic news will improve. By definition, every economic cycle ends. At first, this is marked by evidence that the rate of decline of an economy or, for international markets, the world economy, is slowing down. Then there will be stability at the lower level and, finally, an improvement, at first a slow one and then a gathering of the pace of improving news. In times of the deepest economic and investor gloom, it is worth keeping this in mind.

Markets are also discounting mechanisms. On all available information, they should be looking ahead to developing trends, usually economic, but not always. The suddenness and extent of market falls last year reflected developments which were largely unforeseen. As each new setback occurred, it still had the power to shock, and markets reacted accordingly. If a reduction or even elimination of the power to shock is evident now, it should represent one step on the path to recovery and there is tentative evidence that we may be there now. If there is evidence of "green shoots" appearing, that is even better. "Green shoots" would represent a position when the economic data stopped being 100% bad, perhaps only 95%, but representing the start of a change in trend. This is perhaps where we are now, certainly as far as the USA is concerned and, because it is the world's largest economy, this would be a crucial indicator. We will look at this later.

Since we moved into this extraordinary world economic and financial situation our reviews have concentrated on the general issues and lessons from what has happened and how the world economy might move on from the current very serious position. We have not, as we have always done in the past, concentrated on the latest economic data because, as events moved so quickly, they became out of date and of little value. As we now look for "green shoots", the data will become more relevant again.

The G20 meeting has come and gone. Whilst it was an impressive spectacle, and well choreographed, its achievements could only be limited and the fact that it did not end in disagreement was helpful. At the end of the day, the twenty countries could not have agreed on joint action because each is in a different economic position. What one could do, say provide a further fiscal stimulus, another could not. Each of the G20 leaders has different constituencies to address at home and they will put those interests first. Perhaps the biggest achievements were not to advance the cause of protectionism, a certain way of leading to global depression, and an allocation of US$250 billion in Special Drawing Rights to help countries by boosting their foreign exchange reserves.

It might be helpful to start by looking at the relative economic positions of the world's major economies. Of course, it is bad for every country in absolute terms but, relatively, it is less bad for some and relatively worse for others. In terms of G20 countries which are relatively well placed in terms of expected growth rates this year, according to the IMF's figures in its paper "Global Economic Policies and Prospects" in the run up to the G20 meeting, are Brazil, China, India, Indonesia, Saudi Arabia and South Africa. Our very simple definition of being "relatively well placed" is just that, meaning, according to the latest IMF forecasts, that the economies are expected to grow this year. It does not mean that, in any sense, those countries will be satisfied with their projected growth figures. So, for example, China's projected growth rate of 6.7% this year can only leave other countries green with envy but, for China, it would be a disappointment compared to the performance in recent years. China needs to grow rapidly to provide employment opportunities for those coming into urban areas from rural areas. Relatively poor economic performance, as measured by the IMF's expectations of negative growth this year, are Australia, Canada, Japan, Mexico, Turkey, South Korea, the USA, France, the UK, Italy, Germany and Russia. This contrast vastly oversimplifies issues. For example, Australia is one of the best placed countries to ride out this recession but it is useful as a guide to relative performance and as a base for projecting the extent of what needs to be done.

However, it is far more complicated than just suggesting that countries expected to show a decline in real GDP this year should stimulate their economies more than those expected to show some growth, however modest. The financial situation of governments can act as a constraint on the size of its stimulus or, if it is relatively good, reasons for an additional stimulus. So, for example, the UK economy, expected by the IMF to contract by 3.8% this year and, therefore, prima facie, in need of a further stimulus, is in no position to do so because its overall international balance (government expenditure/ government revenue) is expected to show a deficit of 9.5% of GDP this year and 11% next year. On the other hand, China, forecast by the IMF to grow by 6.7% this year, is expected to have a deficit of 3.6% this year and next and, coming off a small surplus in 2007 (0.7%) and an even smaller deficit in 2008 (0.3%), gives it some leeway. Australia is another excellent example. Having managed its domestic finances prudently for many years, a surplus of 1.6% in 2007 and 0.1% in 2008, the IMF's forecast of deficits of 2.2% this year and 2.8% next year against a GDP growth forecast of -0.2% this year would still seem to give it room for a further stimulus if it is felt necessary.

Although recent economic forecasts have regularly had to be downgraded, it is worth looking at selected figures from the IMF's latest work prior to the G20 meeting in terms of expected growth this year against the overall balance of public finances for this year and next.

	Expected growth %	Overall Balance %	
G7 Countries	**2009**	**2009**	**2010**
Canada	-2.0	-3.2	-3.7
France	-1.9	-6.0	-6.2
Germany	-2.5	-4.0	-5.2
Italy	-2.1	-4.8	-5.2
Japan	-5.8	-8.1	-8.3
UK	-3.8	-9.5	-11.0
USA	-2.6	-7.7	-8.9
Brazil	+1.8	-1.0	-0.8
China	+6.7	-3.6	-3.6
India	+5.1	-10.0	-8.6
South Korea	-4.0	-2.2	-3.2
Mexico	-0.3	-3.2	-2.9
Russia	-0.7	-5.2	-5.1

Source : IMF

Also, just published, is an interim report from the OECD. Its forecasts are as follows :

Changes in real GDP against previous year %

	2009	2010
USA	-4.0	0.0
Japan	-6.6	-0.5
Germany	-5.3	0.2
France	-3.3	-0.1
Italy	-4.3	-0.4
UK	-3.7	-0.2
Canada	-3.0	0.3
Euro area	-4.1	-0.3
Total OECD	-4.3	-0.1

Consumer prices - changes against previous year %

	2009	2010
USA	-0.4	0.5
Japan	-1.2	-1.3
Germany	0.6	0.5
France	0.4	0.6
Italy	0.7	0.7
UK	2.0	1.7
Canada	-0.6	0.5
Euro area	0.6	0.7

General government financial balance
(surplus / deficit as a % of nominal GDP)

	2009	2010
USA	-10.2	-11.9
Japan	-6.8	-8.4
Germany	-4.5	-6.8
France	-6.6	-8.3
Italy	-4.7	-5.9
UK	-9.3	-10.5
Canada	-4.4	-6.2
Euro area	-5.4	-7.0
Total OECD	-7.2	-8.7

As mentioned earlier, there is little point in dwelling on items of individual economic data, other than to try to identify possible "green shoots". But from the forecasts given above, it tells us what we already know which is that this will be a very unpleasant year with an extraordinary contraction occurring in most of the major economies (China and India will be exceptions). By historical standards, next year will be a bad one for the world economy but far less so than this one and, as 2010 progresses, the improvement should gather pace, albeit from a very low level.

At this stage, it is worth talking about how the economic cycle will turn. It is easy to be convinced that this will not happen given the depth of the gloom with worse to come, in terms of news but not necessarily the stock market, but, of course, it will. What might cause it to turn? Changes in the stock cycle are a factor in economic cycles. When times are bad, such as the present, businesses tend to run down stocks. This reduces the amount of money tied up in financing stocks as some demand is met by drawing on stock. But there is a minimum level of stocks which it is sensible to maintain and, when that has been reached, production will increase to stabilise or, if the manufacturer is feeling more confident, raise stock levels. Such a trend can help to restore growth. In one of its tables in its interim report, the OECD breaks down the contribution of various factors to this year's expected decline in GDP. In five of the seven G7 economies, the contribution of stockbuilding this year is expected to be negative, one unchanged and one a positive contributor. Next year, the OECD suggests that stockbuilding will be neutral but a recovery from a negative position is positive in itself. Consumer demand is weak for obvious reasons. People are worried about unemployment or becoming unemployed and, therefore, reluctant to spend, and others, particularly the elderly who might rely to some extent on interest from their bank deposits and now receive hardly anything because of the very low level of interest rates offered on deposits, have reduced spending power. On the other hand, the majority of people of working age who are in work are benefiting from the current disinflationary environment which could leave them with more purchasing power. A simple example is the price of petrol which has fallen considerably in price since its peak last year. Theoretically, what is saved from the fall in price is available to spend on something else. There are qualifications. People may be experiencing a pay freeze, or even a pay cut, apart from fearing redundancy, but, for those for whom this does not apply, higher disposable incomes caused by disinflationary forces could help to stimulate demand. Increased corporate activity is likely to occur and we are already seeing some evidence of this, particularly in the USA, where two large pharmaceutical takeovers have been announced. There are still many companies and individuals in a good financial position and a time like the present provides opportunities. Increased merger and acquisition activity is likely to stimulate the stock market and a rise in stock markets will gradually help to reverse the negative wealth effect caused by falling share prices.

At the macroeconomic level, attempts to increase the money supply by central banks and governments are aimed at bringing a little inflation into the economy to stimulate activity. In the form of quantitative easing, as carried out in the USA and UK, the object is that the cash created by purchasing bonds from the private sector will, via a money multiplier effect, create additional demand as it spreads around the economy as well as raise asset prices and prices in general to cause a modest amount of inflation. The success of this tactic depends on the cash not being hoarded for defensive purposes but, rather, being spent and circulating round the economy. Given that, at times in the past, inflation has been the problem, it may seem strange to try to induce a little inflation but the reasoning lies in the dangers of deflation. At present, deflation could make a bad situation worse for three reasons. Firstly, it would raise the real value of debt for both the private and public sector. For the private sector, whether it be individuals or business, this could push them into bankruptcy. For businesses, it is not easy to reduce costs quickly, particularly in the case of payroll costs. If prices of the goods sold fell, yet costs remain constant, that combination could break a company. Thirdly, if consumers felt that falling prices were more than a temporary phenomenon, they would hold off discretionary purchases thus helping to create a vicious spiral of economic contraction. The prospect of modest inflation is therefore a more attractive proposition if it can be fine tuned accurately. It can help to chip away at the real value of debt, offers companies a better chance of surviving the recession and may encourage consumers and businesses to release some of their spending power.

On the surface, this all sounds wonderfully simple but, of course, it is not, and such a policy is fraught with danger. Creating money, such as the USA and UK have done, is an extreme measure to cope with extreme circumstances. Because conventional monetary policy in the form of lower interest rates has exhausted its potential with official interest rates at near zero, quantitative easing has become the next step. The creation of money has the potential to cause unacceptable levels of inflation. To show an extreme current day example with no political parallels at all, we can cite Zimbabwe. There the printing presses have literally been working overtime with money becoming virtually worthless in the face of hyper inflation. In the totally different political situation we are talking about in the west, money is created in a different way; by the stroke of the keyboard the central bank creates a deposit for the seller of the bonds, but, nevertheless, the genie has been let out of the bottle and it has to be put back in. That is more easily said than done. The central bank will have to withdraw from circulation the money which it has created by selling bonds. If it is totally free from political interference, it may do that. However, it is quite easy to see politicians, whose time horizons are much shorter, resisting such a move if it threatened their position. Inflation could be seen as a problem for someone else. However, inflation is not something which can be finely calibrated. Once it gains hold, it is very difficult to suppress and the longer it is left, the harder it becomes to contain it and the more unpopular the measures required to be undertaken to control it.

The other part of economic policy is the fiscal side and, as both the IMF and OECD figures show, the recession has paid havoc with government finances all over the world. Some countries are much better able to handle the situation than others which is why a uniform approach to fiscal expansion to counter the effects of the recession is not possible. There are two issues related to the level of public debt. The first is the size of the deficit in a particular year in relation to GDP and the second is the overall level of public debt in relation to GDP. Tied in with this is the cost of servicing the debt. If interest rates are low, as at present, then the cost of servicing it may be manageable but, if the cost of servicing it rises, then the effects can be very serious. We will talk about the eurozone later, but an excellent example is the case of Greece and Ireland which, as measured by ten year bonds, have to pay, at the time of writing, approximately 2.68% and 2.38% respectively more for their money than the best eurozone credit, Germany. As debt increases through a large annual government borrowing requirement, servicing costs rise and the higher the cost of borrowing (through higher interest rates and/or higher borrowing levels) the more the economy slows down and the ability to service the debt can be called into question. A country with a high level of public debt but with a low annual borrowing requirement may be able to get by but one with a high level of public debt and a high current borrowing requirement will be in difficulty. If interest rates return to more normal levels, then servicing the debt becomes more of a problem. Also a country with a low level of debt but a very large borrowing requirement may be able to satisfy markets for a while but the former figure will move up quite rapidly, leading to a less favourable view by markets. Best placed are those with low relative current borrowing requirements like Australia, China, Brazil and Canada, and the lower the level of public debt the better. The time bomb ticking for many countries is interest rates. When they return to more normal levels, the problem will intensify.

For this reason, the emphasis on reducing governments' current borrowing will have to resume when economic conditions improve. Markets will ensure that this happens. Last year, the foreign investors gave a big thumbs down to the UK as the pound fell heavily. Within the eurozone, as we have noted above, the markets can pass judgement through relative interest rates even if the currency remains unaffected because of monetary union.

What happens in the eurozone will be an interesting issue this year. There will be many issues competing for attention but the problem of monetary union is likely to feature highly. We have talked in recent reviews about the wide disparity in eurozone bond yields between those of the country deemed to be most creditworthy, Germany, and the remaining members of the eurozone. Even the country deemed to be the second most creditworthy, France, sees its ten year government bond yields starting on a yield 62 basis points higher than those of the German government. For the eurozone, the issue is credibility. The long term success or otherwise of the euro project depends upon discipline within its members, hence the Stability and Growth pact which dictates the parameters of the budget deficits. If budget deficit levels were ignored and fiscal policy became a free for all, the currency would lose credibility. But, as the relevant table shows, there are some pretty ugly levels of borrowing around for even the leading members of the eurozone and the 3% budget deficit limit will be well exceeded. The euro could not have a more exacting test of its durability than at present. For the perception of the ultimate creditworthiness of borrowers within the eurozone, observing the terms of the Stability and Growth Pact is essential. Obviously, time needs to be given to do this in the current circumstances and this is what the EU is doing but it is going to be a real test. There are two issues here. Firstly, to move back to within the pact's terms, even the first stop, the 3% deficit limit, is going to imply significant fiscal tightening. That is going to prove politically very tough because very unpopular decisions are going to have to be made which are likely to be politically expensive. But, independently of the current recession, some of the southern European members of the eurozone have steadily been losing competitiveness. So, for them, the exchange rate of the euro is overvalued. Being part of a monetary union, they cannot devalue their way out of the problem. To restore their competitiveness, say against the benchmark, Germany, would involve a significant cut in real wages. The theoretical ways of doing this are a massive deflationary package or some actual way of cutting wages and are really impossible to contemplate. Social unrest is rarely far from the surface in a number of European countries and such measures, even if they were practicable economically, would not be politically. It is quite possible that the eurozone will fragment at the edges. It always was a politically driven project and there would be huge political embarrassment if it did unravel but it is almost impossible to see how the status quo can be maintained for some countries. Low, nil or negative growth caused by, for them, an overvalued currency would exacerbate the debt problem and raise the question, in some people's minds, of default. Some in the EU say it has a plan to help countries in difficulties although, at present, there is no mechanism for bailing out a member of the eurozone which gets into trouble. But providing a temporary fix for a member in financial difficulty does not address the fundamental problem of lack of competitiveness. A good example is Italy, which has lost significant competitiveness against Germany since the start of the euro. The country has a high level of debt and, although a G7 member, sees its ten year government bond selling on a gross redemption yield about 133 basis points higher than Germany's. One wonders how it is going to extricate itself from its steady loss of competitiveness with all that entails for its future economic outlook. There is no easy mechanism for leaving EMU and the cost of doing so would be enormous - debts denominated in euros but the new currency being effectively devalued against it. But, as one well respected economic commentator asked recently in his weekly newspaper article, how Italy could remain in the eurozone?

It is difficult to articulate what this strain within the eurozone, as measured, for example, by the wide spread in bond yields, might mean for the euro as a currency. Should one concentrate on the basic strength of the Germany economy, notwithstanding its present travails, or be influenced by the cracks in the facade of monetary union evidenced by the strains in the bond market and the downgrading of the credit ratings of Greece, Spain, Portugal and Ireland? After all, the emphasis on the disciplines of being eligible for acceptance in the eurozone in the first place and the continuing disciplines of the Stability and Growth pact thereafter are all based on the concept of economic convergence. What is happening at present and has been happening before the financial crisis is that eurozone economies have been diverging. If the eurozone did fragment, probably the biggest damage, apart from the obvious one for holders of debt of countries which left the eurozone, would be the severe disruption to trade, especially within the eurozone. Intra EU trade is obviously very important and it would be hugely disruptive. It would slow economic growth and perhaps cause a recession independently of what was happening in the wider economy. How the situation develops will be one of the issues this year. We flag it now although we do not think investors are taking the eurozone's structural problems seriously into consideration at the moment.

An issue which we flagged well before the economic and financial crisis blew up was latent protectionism now coming out more into the open. We were concerned about it in the USA in the run up to the Presidential election last November and in Europe, too. Attacks on China for alleged currency manipulation looked particularly unwise given that it has the world's largest foreign currency reserves. The situation has become worse as a result of the economic and financial crisis, with each country fighting its corner to a greater or lesser extent. It will take some time to see whether the G20 can deliver some promise on this score but nobody should doubt that protectionism, whilst it may play well to voters at home, would slow down economic growth and reduce living standards. Translating this into the equity market would mean lower corporate earnings than would be the case at a greater growth rate. This is certainly one issue to look out for.

How is future economic growth going to be affected by the present international economic situation? As we can see from the extent of countries' international deficits, it is imperative that these are reduced as soon as is practicable. Why? There is a limit to investors' appetite for bonds. Because of the fear induced by the financial crisis, high quality government bonds were regarded as a haven of safety and, with short term interest rates falling rapidly, higher yields further out the curve appealed. Corporate bonds, of course, were a different matter, experiencing a dreadful time as investors fled the sector in favour of top rated government bonds. To put supply and demand more into balance, medium and long term government bond yields are likely to rise. Creating money to buy government bonds off the private sector threatens to unleash inflation. The process would have to be reversed. In the UK, there was recently an uncovered gilt auction which is an unusual event.

At the end of the day, it is the foreign exchange market and bond investors who will blow the whistle on governments perceived to be undertaking reckless policies. For example, in the UK, given the parlous state of the nation's finances, it appears to have been suggested in some quarters that a further reflationary package could be implemented. One look at the projected government balance for this year and next should have been enough to dissuade anyone from following such a course and it was left to the Governor of the Bank of England very discreetly to indicate to a Commons Select committee that this was not a good idea. Everyone took notice of this warning.

Indeed, the UK continues to concern us. The present economic problems do not fit well with the electoral cycle because unpleasant decisions have to be made. At the time the economic forecasts were made in last autumn's pre-budget report, it was generally accepted that they were unrealistic and now the Chancellor is preparing the ground for new and much more pessimistic economic forecasts to be given with the April 22 budget. With little over a year to go before the next election has to be held, political considerations would normally dictate that difficult economic decisions be put off until after the election. Given the state of public finances, delay will not be possible and a convincing plan will have to be articulated to show how the horrendous budget deficits and overall rising level of public borrowing are going to be addressed. If no convincing plans are put forward, it is likely that foreign exchange markets and bond investors will vote with their feet. Whichever method of starting to rectify the position is chosen, tax increases or public expenditure cuts or, realistically, a combination of the two, popularity is not going to ensue but it is better to do this than have the matter taken out of the government's hands by a financial crisis related to the UK's own situation. We remain particularly cautious about the UK with our usual considerable overseas exposure providing some kind of insurance policy.

Although we are not discussing individual countries' or regions' economic data in any detail because of the rate at which it has gone out of date, we should draw this review to a close by pointing out indicators which suggest a possible turning point in this economic cycle. As we said earlier, the first indication that a turn in the cycle may be on the horizon would be when data indicated that the rate of deterioration was decreasing, followed by stability at the low level of activity and then a recovery in the indicators. In certain cases, we are somewhere between the first and second position. The vast majority of the news remains bad. Markets, however, look ahead and can be expected to recover in front of the cycle which, as we have seen from the OECD table early in this review, is expected to be next year, albeit at a meagre rate and, in a number of cases, still at a negative rate. The point is that, in absolute terms, 2010 is still going to be a bad year but, relatively, a less bad year than 2009. Against this background, we detail below some data which may be the forerunner of some "green shoots".

In the USA, there was a slight increase in consumer confidence in March. The Reuters / University of Michigan preliminary index of confidence for March rose to 56.6 from 56.3 in February. Durable goods orders increased by 3.4% in February. This follows six months of declines and was the strongest gain for fourteen months. In the housing market, new home sales showed a modest improvement in March, increasing from an annualised 322,000 in January to 337,000 in February. The Conference Board's index of sentiment was slightly higher in March at 26, compared with 25.3 in February. In the eurozone, against recent fears that the world might move into a deflationary environment, eurozone prices in February were shown to have risen at an annual rate of 1.2%, compared with 1.1% in January. The eurozone services sector purchasing managers index in March stood at 40.1, compared with 39.2 in February, whilst there was a slight increase in the index for the manufacturing sector from 33.5 in February to 34.0 in March. The Markit eurozone purchasing managers index for business activity rose from 36.2 in February to 38.3 in March. Within the eurozone, in Germany, the ZEW index of German investor confidence stood at -3.5 in March, which was its best level since July 2007. In the UK, Nationwide conducts a monthly survey of consumer confidence and that for consumers' expectations in the February reading stood at 43, compared with 41 in January, and the best level since October. The National Association of Estate Agents said that the average number of sales agreed by estate agents in February stood at 8, a recovery from the worst level of only 5 last August. Also touching on the housing market, there was an increase in mortgage approvals in February compared with January, up from 32,000 to 38,000, which is the best level since May last year. The GfK NOP index of confidence stood at -30 in March, compared with -35 in February. People were very slightly less pessimistic about their personal financial situation over the next year, with the reading at -6 compared with -8 in February. The CIPS/Markit manufacturing purchasing managers index rose in March to 39.1, compared with 34.9 in February, one of the best readings since October 2008. There were slight signs that the rate of contraction in the services sector in the UK was easing. The CIPS/Markit services PMI activity index stood at 45.5 in March, compared with 43.2 in February, the best reading since last September. In the credit market, the CBI reported that businesses found it slightly less difficult to access credit in the first quarter of this year compared with the last quarter of 2008.

Whilst we may yet be disappointed if these tentative signs of "green shoots" may disappear, in a stock market sense this small minority of less than bad indicators are more important if they point the way forward, as they probably do, to better times in 2010 and 2011. In these circumstances, equities are likely to recover whilst a lower risk aversion and appreciation of the inadequate yields on top grade bonds are likely to make their pressure felt in those markets. In the coming months, we will look for confirmation that the cycle is bottoming prior to its turning upwards which, if it happens should provide support for our view of the relative attractions of equities against bonds and cash.

March 2009