DELMORE
ASSET MANAGEMENT

Globetrot 28th February 2012

Greek Tragedy Part 21

Since the Greek crisis first started in the summer of 2010, the European Union has held 21 meetings in its attempts to square the circle. The latest meeting proved once again, that the approach adopted which relies heavily on punishing the Greeks by imposing unparalleled austerity, still has little chance of success due to seething popular discontent. As we all know most turkeys would not vote for Xmas! The enormous waste of resources now occurring in Greece, symptomised by the high unemployment, precipitous fall in growth and the clear signs of enormous social stress, all point to the eventual failure for this draconian experiment.

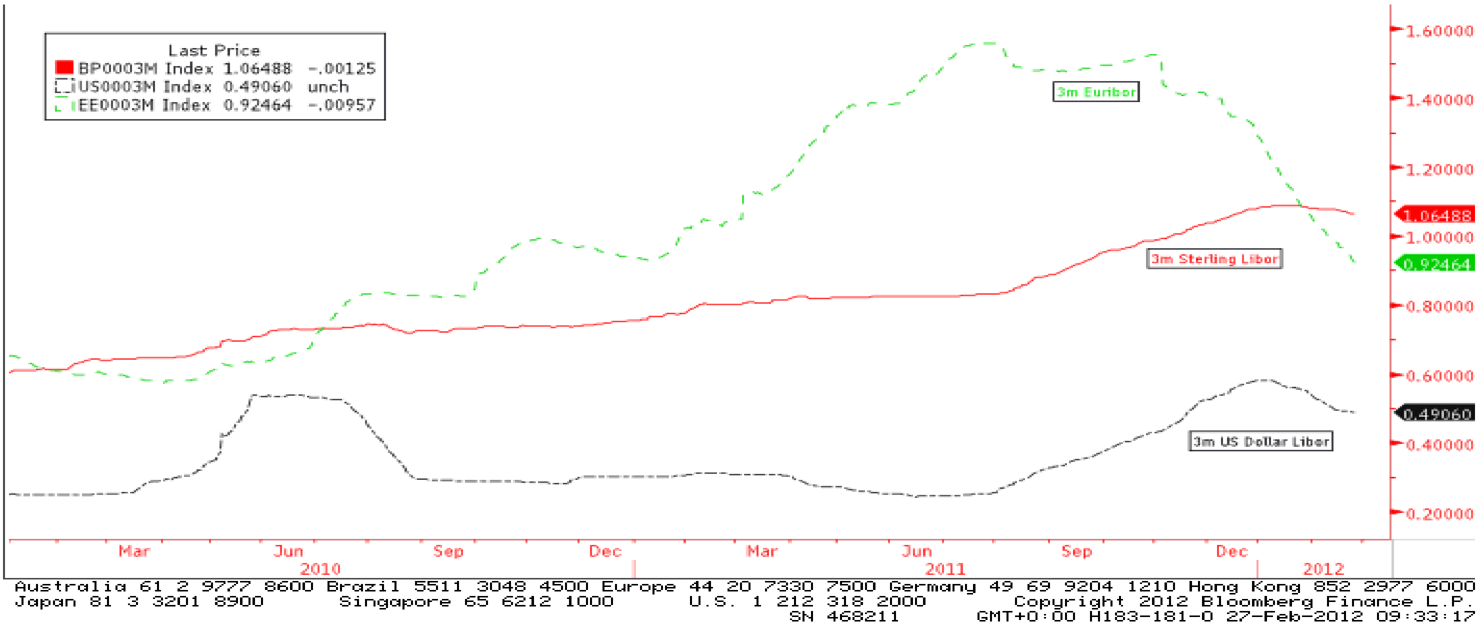
Greece really needs a modern day Marshall Plan which would promote growth and lead to a large rise in tax revenues thus reducing the deficit. The extreme sensitivity of these vaunted sacred forecasts by the European Commission and the IMF has been given very little prominence. Apparently any change in either direction of 0.5-1.0% a year would have made a considerable difference to the forecast. Unfortunately all efforts to translate this simple common sense approach into every day German have failed. Angela Merkel is running scared of her electorate and as a consequence has put her brain into cold storage!

This latest enormous piece of sticking plaster could last for three months, six months or even nine months. Basically, the only way that Greece and the Greeks will recover is through economic growth. They need some encouragement to dig themselves out of the pit. This can occur either as a result of leaving the Euro and devaluing the new successor currency against other trading currencies or by receiving some acknowledgement from the EU that the present course of action being imposed is doomed to failure. For now the message remains the same; don't hold your breath!

Greece has impacted the whole European continent due to the contagion caused by the continued drop in the value of their sovereign debt. Unfortunately, this problem will have to be addressed over a long time and it is for this reason that the European Central Bank has flooded the interbank markets with Long Term Refinancing Operations for three years at 1%. We fully expect a further dose of liquidity to be issued imminently.

So far this year most capital markets have performed quite well and there seems to be a general reluctance to acknowledge the difficulties which we still face. The Chinese economy is finally reacting to the monetary squeeze and the bubble in their residential property prices has truly burst. This will impose a strain on the banking system and already central government has sent out clear instructions that the banks should not write down their property loans and that they should not be over zealous in collecting capital or interest. One can almost hear the system creaking. Nevertheless, China is a large country and it is quite likely that consumer price inflation will resume its downward path now that the lunar New Year holidays are behind us. This will allow the authorities to continue easing monetary policy.

Here in the UK, it seems probable that the nadir of this secondary downturn within this long recession was reached during the fourth quarter of 2011 and that the overall economy will climb painfully out of the pit during 2012. More QE could actually prolong the pain as the UK money markets are still suffering from a severe liquidity squeeze exemplified by the continued elevation of Libor. Unfortunately this big problem has been ignored by the Bank, which should be providing more medium liquidity directly to the banking system by renewing some of the facilities provided in 2009.



This could be achieved by buying residential mortgage backed securities and also buying up corporate debt with this next dose of QE rather than continuing to support the gilt market!

The greatest cause for optimism remains the USA where the employment numbers continue to improve, bank lending is on the increase and the residential property market seems to be stabilising finally; after almost six years of severe decline. We expect that the American recovery will gain traction as the higher employment numbers feed into increased consumer spending which will in turn reinforce the recovery in the housing market. Provided US employment growth continues to strengthen the American locomotive will play a vital role in leading the world economy.

Outlook

Central banks from the Federal Reserve to the European Central Bank, the Bank of England and the Bank of Japan have all stated their intention to keep interest rates low and to provide liquidity by being lenders of last resort. This reflects a growing determination by Governments and international institutions to tackle the European malaise and this should prove to have a positive impact on global capital markets.

This gigantic expansion in world money is currently fuelling the rally in capital markets. The biggest difficulty in the majority of countries relates to the fact that the monetary transmission system has broken down and the liquidity which has been supplied so copiously by the central banks is currently trapped in the capital markets and the commercial banking system. Recently, it has finally begun to leak into the American economy as lending standards are relaxed and we expect that US banks will lend more during the year particularly in the second half.

The major caveat about this view relates to the fact that the capital adequacy standards required of the banks continue to be tightened. The European, deadline of June 30th when banks will need to show slimmer balance sheets is fast approaching. This has crimped lending even though many banks have substituted money market deposits with funds from the ECB LTRO facility.

In the USA, many capital market participants are complaining about the severe restrictions being placed on normal trading activities by the proposed Volcker Rules. Meanwhile, here in the UK, the Governor of the Bank of England and the Treasury continue to exhort the banks to lend more freely to the small business sector, but the Bank of England continues to penalise the banks for conducting this borrowing by requiring much heavier provisions in this sector than many other areas of their loan books. Whilst this dichotomy remains lending to small and medium sized businesses will continue to be restrained. Where does this leave the Investment Management Industry? Not on the beach!

<u>Current Investment Strategy</u>

a) Maintain a good spread of assets across all asset classes including government bonds. We aren't out of the woods yet; we are into the fourth year of a period of elevated market volatility and could well have another few years before it's over. One can play the global market rebound, but remember that the Iranian situation and the oil price, the financial (in)stability of Europe, the ongoing Arab Spring activity, not to mention a globally aligned 2012 election cycle in China, Russia and the US are all events that carry potential risks that could rear up at a moments notice and derail the nascent recovery.

b) Stay long inflation hedges (real assets) given the huge amount of liquidity pumped around the world. After all the best way to get rid of a debt is to inflate it away.

c) Stay long quality assets, income yield and yield cover. A barbell approach with some mid cap/higher beta equities is fine but be prepared to remove that beta at short notice or hold it for the long term; much easier if your assets are high quality.

d) Keep some liquidity and don't panic if we see further troughs. Global central banks have proved that they are willing and able to pump money if need be which is very supportive for equity markets, and good quality assets may be bought on the cheap when sharp dips occur.

Tel: 020 7224 2889 Fax: 020 7224 3631 Email: enquiries@delmore.co.uk Website: www.delmore.co.uk

DELMORE
ASSET MANAGEMENT

Regulatory Statement

The comments and views expressed in this publication are solely those of Delmore Asset Management Ltd and are provided for information purposes only and should not be used as the basis for taking any investment decisions. Delmore Asset Management Ltd shall not be liable for any actions taken in reliance on the content of this publication. Professional advice must be sought before investing. The information has been compiled using sources of data believed to be accurate at the time of publication; however, no responsibility is accepted or assumed by Delmore Asset Management Ltd for any inaccuracies contained herein. The Financial Services Authority does not regulate all forms of investment mentioned in this publication which may not be suitable for all investors. Please ask for details of those investments which are not regulated by the Financial Services Authority. The price and value of investments and the income derived there from can decrease as well as increase. You may get back less than the amount you invested. Past performance should not be seen as an indication of future performance. E&OE

 28th February 2012