

Cyclicals more attractive as investors move to 'recovery stocks', says Aldridge



Hilary Aldridge, manager of F&C's Stewardship Growth and Stewardship Income funds, has been gently adding to more cyclical positions during the first quarter of 2009 as she believes the market's pessimism towards the prospects of such companies currently looks excessive.

"The quarter saw further concerted efforts by the authorities to kick-start the ailing UK economy" she commented. "As well as cutting interest rates to a 315 year low of 0.5%, the Bank of England announced a £75 billion programme of 'quantitative easing' designed to revive not merely the financial system but the broader economy. Despite this, the UK equity market suffered further losses as the tone of economic and corporate data remained depressed. Nevertheless, it would appear that investors are beginning to rotate out of traditional defensive stocks and into more cyclical recovery stocks in response to an improvement in some leading indicators".

The shift of investor sentiment at the end of the quarter towards more cyclical shares aided relative performance returns for both funds in terms of general retail position and stock selection within the oils sector. "We added to our exposure to general retailers before Christmas and holdings, such as Next within our Growth fund and Dunelm in our Income fund, yielded positive relative returns. Market expectations had

become so low for these companies that even with the difficult consumer environment, the valuations looked too low. There is also the possibility that some of the benefit from lower mortgage rates and utility bills finds its way into discretionary consumer spending" explained Aldridge.

Hopes of a much-needed upturn were reflected in the outperformance of smaller companies relative to the larger blue-chips during the quarter. Whilst the beleaguered financial sector remains mired in negative sentiment, the FTSE 100 Index of leading shares was unable to keep pace. Progress has been hindered further by a large number of rights issues as companies used the equity market to raise additional capital to restore their balance sheets; Aldridge's view remains that there are more rights issues to come and this will hold the UK equity market back overall.

In the current uncertain investment climate 'pragmatic caution' sums up Aldridge's approach. "With the Stewardship funds, we aim to maintain diverse portfolios with a focus on better quality companies and no strong thematic or factor bias" she concluded. "In the meantime, with dividends under threat as businesses seek to re-adjust to the new economic conditions, we remain vigilant to those companies that we think could disappoint investors and will continue to take advantage of the volatility in share prices to add to favoured positions".

Emerging Debt risk aversion back to normal levels

The extreme risk aversion seen in emerging debt markets since the third quarter of last year is now reverting to more normal levels, according to Helene Williamson, Head of Emerging Debt at F&C. She believes the second quarter of 2009 should offer

opportunities to add risk to emerging debt portfolios and taking advantage of the still distorted prices in some sovereign and corporate credits. Emerging markets' sovereign and quasi-sovereign issuance in excess of \$20bn in the first quarter of 2009 suggests that a significant part of this year's financing needs has already been met.

Williamson took the opportunity to gradually add risk to the F&C Emerging Market Bond fund during this period, primarily by reducing the Mexico and Russia positions and adding higher beta credits with an attractive risk/return profile (e.g. Venezuela, Gazprom).

She explained: "The concerted G-20 effort to mobilize additional resources in the form of IMF and EU loans is a positive development for emerging markets, particularly for Eastern Europe. Risk aversion has been at extreme levels since the third quarter in 2008, but this is now reverting to more normal levels. Oil and other commodity prices appear to have stabilized." In her opinion, these two factors should support emerging market spreads that tightened by 54 basis points to 636 basis points over US Treasuries during the first quarter of 2009.

"Spreads were quite volatile, ranging between 622 and 700 basis points. A return to extreme levels of risk aversion could put pressure on spreads, however technicals for emerging market sovereign are supportive and global liquidity conditions should improve on the back of the implementation of different "quantitative easing" programmes and the disbursements of recently approved IMF programs," she added. Williamson concluded "Future supply will depend on the balance between a possible increase in fiscal shortfalls and additional support from multilaterals".

Press Contact: +44 (0)20 7011 4600

Jason Hollands (Corporate)
Tel: +44 20 7011 4168
jason.hollands@fandc.com

Paula Garrido (Institutional)
Tel: +44 20 7011 4190
paula.garrido@fandc.com

Jennifer Donohoe (OEICs)
+44 20 7011 5017
jennifer.donohoe@fandc.com

Véronique Sant (SICAVs)
Tel: +44 20 7011 4278
veronique.sant@fandc.com

Sarah Godfrey (Investment Trusts)
Tel: +44 20 7011 4215
sarah.godfrey@fandc.com