

‘Volatility likely to get worse in coming weeks’, warns Tigue



This week's turbulent market events have shown that the effects of the credit crunch are far from being over at the same time as inflationary concerns intensify, according to Jeremy Tigue, manager of the Foreign & Colonial Investment Trust.

"Yesterday Fed chairman Ben Bernanke painted a very uncertain outlook for the economy and investors agreed with him as share prices, particularly in banks, moved up and down with ever increasing gyrations," he said.

In the US concerns that Fannie Mae and Freddie Mac would become insolvent under the weight of non performing mortgages and falling house prices led to unprecedented government support and an explicit acknowledgment that the US government would stand behind them.

"This is like Northern Rock but on a far greater scale and with far greater potential consequences," he commented. "If their debts are added to the US national debt, overseas investors may take fright and put pressure on the dollar." According to Tigue, this potential outflow of foreign investors' money would put upward pressure on inflation, making interest rate cuts impossible and rate rises highly likely, with the consequent negative impact on the economy. Regarding the UK, he commented: "The housing market in the UK is several months behind the US and everyone is nervous that the banking sector over here will experience similar pressures. Inflation news this week was disappointing and interest rate cuts by the Bank of England look a long way off." However, amidst the general gloom and turmoil there were two positive signs. First of all, the oil price has fallen over the last few

days as US demand slowed down and inventories increased. Secondly, the US bank Wells Fargo announced better than expected results leading to a huge rally in US banking stocks.

"A lower oil price would be unambiguously good news for markets," Tigue said. "The rally in bank shares shows how easily share prices can move in both direction and also just how much bad news is factored into current valuations."

He concluded: "The summer holiday season is now well under way so this volatility is likely to get worse in the next few weeks."

Time to shop for cheap assets

Equity markets came down substantially in June, with the SPX down around -9%, the Eurostoxx down -11.5%, and the FTSE All share down -7.5%. According to Francois Barthelemy of F&C Partners, the fund of hedge funds manager, this renewed bout of anxiety is very different from the credit-related fears that took place earlier in the year. "This time it is about a global earning slow down and a recession induced by high energy prices. A noticeable feature was the absence of panic selling: markets were mostly orderly, and it helped hedged funds to weather the storm somewhat."

The current sharp and somehow irrational price movements are a source of volatility but provide opportunities to gain exposure at low levels.

"Ultimately we see this crisis as the source of strong future returns, once things stabilise. The price we pay for our positioning is increased short term volatility, but the hedged nature of our investments mean that we have still managed to outperform pretty much all other risk assets, while we have preserved exposure to outsized gains in future," he explained.

Barthelemy does not subscribe to the view that now is the time to be short or in cash and he describes his current set of exposure as "moderate net long". Going forward there are three key themes where he thinks there is money to be made.

"First of all, and as the world is

becoming hysterically bearish our proposition is: buy now. This might be the most volatile of all propositions, but in my opinion it will be the most profitable, eventually. Since we do it with hedges, our net long exposure remains low."

A second theme he focuses on is traditional distressed investing that, according to Barthelemy, will be strong going forward, as the economy softens and financing becomes harder to get.

"A wave of bankruptcies has started and will intensify, and will provide rich picking for our funds," he explains. "At the moment most of the work is dedicated to the unwinding of structured credit positions, which is a new but equally promising opportunity set."

Finally, he believes that the underlying source of the crisis is about the rise of a number of large emerging economies, with the accompanying competition for resources.

"In fact, take away the oil price and we reckon inflation would be contained," he pointed. "US rates would be nearer zero than they are now; and share prices in the banking sector would have gone up a lot." Although slower global growth will probably help in shaping the recovery, the underlying source of inflation remains.

"We are starting to see a number of hedge fund launches dedicated to extracting value from the beneficiaries of the inflation surge, such as emerging countries, resource based companies or collateral recipients such as consumers based in those countries. Hedging is also becoming possible, hence making it a more attractive proposition for us. So we will be looking at that part of the world closely," he added.

Investors' guide

F&C has put together a "Guide to Investing in Uncertain times", outlining the various options available for those living in the UK to save and invest. The guide explains why equities and investment trusts will remain an important part of a diversified investment portfolio. It also highlights different ways to minimise any potential negative impact a volatile market can have on investors' portfolios. To request a copy of the guide or obtain further information call 0800 136 4207 or email

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