Pegasus View – June 2009

Thanks to unprecedented government action the world banking system, as well as many of the high risk/illiquid assets held by them are now all effectively bankrolled and supported by state guarantees. This, combined with other positive economic data has created a change of sentiment which has been welcomed by many managers. We have seen a strong rally in equity markets, with China and India leading the way, while at the same time we have seen more rational pricing of corporate bonds, rewarding those managers holding higher quality debt.

The last quarters rally has been one of the largest and most dramatic in stock market history, and while some managers are still bearish over the coming months, a combination of reducing volatility, increasing monetary stimulus and a lack of competing returns from other asset classes may mean equities have further to go, although it is likely to be a period when we may well see short term setbacks in a general move upwards. Global equities have risen on average by more than 35% since their March lows. The Russian index rose by 75%, Indian index by 68% and the Hang Seng Enterprise index (H-shares) by 46%. Commodity markets only required a hint of reflation in order to take off, with oil rising 22% and wheat and corn by approximately 14%. It is this area that most managers see as a promising one for the next 6 months, with Gold and Oil providing a good hedge against inflation (a background consideration given the extent of quantative easing, not thought to be an issue in the coming twelve months) creating a very bullish outlook, some have predicted Gold to be as high as $1,300 an ounce by this time next year.

Whilst there has been great interest in corporate bonds in the last eight months, there has been a great deal of activity for both government and corporate in the last three, with Government issues being sold off steadily in the face of slightly less awful economic data. The corporate bond market saw vast improvements in liquidity, resulting in more realistic pricing. This was accompanied by a vast supply of new issues, with most offering substantial discounts to existing issues. Those managers purchasing at the right time will have an extremely well performing bond portfolio.

It is likely that the world economy will continue to recover and this will be lead by the US and UK due to the huge impact their respective fiscal and monetary responses have had, and will continue to have. In the bond market, Sovereign bond issuers may now be more at risk than high quality corporates as government ratings are challenged and yield spreads narrow.

All managers are showing a general preference for real assets to include companies with strong dividends, gold, and commodities, as equities become the asset class of choice. Emerging markets showing markedly superior government finances and superior growth prospects provide a strong argument for all managers to be overweight to regional equities.

Finally there should be a short-term weakening of the US Dollar against both Sterling and the Euro due to the unique challenge posed by the scale of US bond issuance and the reluctance of the central bank to offer higher interest rates until the recovery is certain given the mistakes made in the 1930's.

In conclusion, it would appear that managers are in a much more confident (bullish) place however I would like to conclude that alternative managers still feel that we are still in a bear market and what we have seen (and will continue to see for 12 months) are bear market rallies. This means that all "Value" style investing will not add any value until we enter a new bull market, and this is not on the immediate horizon. This is reiterated by all our managers highlighting their flexibility to deal with any further negative economic news.