



MARKET ANALYSIS

December 2008

If the start of November was dominated by the election of Barack Obama and the sharp reduction in UK interest rates then the end of the month had its own events of note, with the dominant piece of news being the rescue of Citigroup.

During the month major markets found new five year lows before a rally in the final week, no doubt boosted by the Citigroup news, but with employment, housing and retail sales figures looking weak across much of the developed world there is still a feeling that the rally may be short lived.

Despite spending much of 2008 being concerned about the effects of inflation, central bankers focus has now shifted dramatically and deflation is now the enemy, with the concern being that falling prices will further discourage consumers from spending as they believe that lower prices will result. This in turn damages businesses, raises unemployment and leads to further weaknesses in demand and even more savage price cuts. This is very much the scenario which befell Japan in the early 1990's, however this time it is unlikely to persist for any appreciable time, although short run deflation cannot be discounted.

With interest rates slashed in virtually every region worldwide, and massive amounts of liquidity being pumped into the global financial system at some point the flow of liquidity will resume, and some progress is being seen, with cuts in Inter Bank rates. We may not see a sustained recovery until the latter half of 2009, however with governments showing the willingness to act swiftly and aggressively we do feel that the long term investor will be rewarded in time.

President elect Obama seems to be putting together a talented and experienced team, which seems to be finding favour with the US media. The anticipated economic stimulus package shortly after Obama takes office should also help the US economy and our view is unchanged in that we feel that the US looks an attractive investment proposition. We also feel that any sustained rally will persuade capital to flow out of cash deposits, especially as the returns from deposit accounts are now below the official inflation rate in much of the Western world.

UK – The major news for November was the 1.5% cut in the Bank of England Base Rate, and Chancellor Darling's Pre Budget Statement which ushered in a £20bn fiscal package, with the

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Key Data

	28/11	31/10	+/(-)%
FTSE 100	4288.01	4343.2	(1.3)
Dow Jones	8829.04	9325.0	(5.3)
CAC	3262.68	3445.9	(5.3)
DAX	4669.44	4994.5	(6.5)
Nikkei 225	8512.27	8577.00	(0.7)
Hang Seng	13888.24	13968.7	(0.5)
£ = \$	1.53		
Euro = \$	1.27		
£ = Euro	1.21		

Interest Rates

Bank of England	2.0%
European Central Bank	2.5%
US Treasury Reserve	1%



headline action being the 2.5% cut in VAT until the end of 2009. Other economic data confirmed the continuing weakness of the UK economy, with unemployment nudging towards 2 million. The weak data has continued to have a negative impact upon Sterling, with £1 only being worth \$1.53 at the end of the month, a significant fall from the \$2.06 seen at the end of 2007.

Europe – The majority of key Eurozone economies now appear to be in recession and although the European Central Bank (ECB) cut interest rates by 0.5%, there was an element of disappointment from the weaker members, who were looking for a cut along the lines of that seen in the UK, however the ECB does have the difficulty of setting rates across a broad range of economies, with each operating at a different speed, therefore M Trichet's options are always likely to be more limited.

US – Now that the election dust is settled eyes have turned to cast opinion over the make up of President elect Obamas team. So far he seems to have received approval for his choices, including handing the key role of Secretary of State to Hillary Clinton. Obamas priority for the US economy is to create 2.5 million jobs, it is expected that this will involve a \$700bn stimulus package, which will focus on infrastructure renewal. This is not surprising, given that US unemployment reached a 14 year high in November. In the short term however the current Treasury team has to deal with the request for funding from the auto industry, the outcome of these talks will nervously anticipated by Wall Street.

The dollar continues to strengthen against both Sterling and the Euro and with oil prices hovering around \$50 a barrel the dollar is once again starting to look like a first reserve currency.

Asia Pacific – Although this region still feels the effect of the slowdown in the US especially, the Japanese and Hong Kong markets were actually amongst the better performers in November. The equity market was helped somewhat by speculation that China would take further steps to boost domestic demand.

Emerging market currencies in Asia came under renewed pressure, with the South Korean Won and the Indonesian Rupiah at one point falling to their lowest levels since the Asian financial crisis of 1998. However the announcement that the US Federal Reserve had established currency swap lines with four emerging market central banks, including South Korea, helped ease liquidity concerns and pulled emerging market currencies away from their lows.

STOP PRESS – as this article goes to press the Bank of England has announced a 1% cut in UK Interest rates to 2%, the lowest level since 1951. The European Central Bank has also lowered rates by 0.75% to 2.5%.

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