

MARKET ANALYSIS

July 2010

Overall, July was a positive month for the majority of stock markets, with investors relieved to see some positive growth in equity markets following two turbulent months. However, the announcement that economic growth in the US had slowed to 2.4% for the 2nd quarter of 2010, down from 3.7% in the 1st quarter, tempered the momentum gained from the largely positive corporate earnings data.

Across the Atlantic in Europe and the UK, the economic outlook has been decidedly more positive, fuelled partly by better than expected economic growth in the UK and the lack of any further crisis in the Eurozone. Both the Euro and Sterling gained significantly against the Dollar, with Sterling at its highest level against the US currency since February 2010.

Investors were encouraged by the results of the bank stress tests in Europe, which revealed that only 7 out of the 91 banks tested would need additional funds in the event of further economic shocks. Question marks remain over just how stressful the tests were, but overall the impact was positive.

Stock markets in Asia were held back following news that economic growth in China slowed to 10.3% in the 2nd quarter of 2010. Although this is only a relatively small reduction from the 11.9% growth recorded for the 1st quarter, analysts are concerned that even a small drop in growth could signal a drop in demand in the burgeoning domestic Chinese market.

In the UK, house prices become a subject of conversation again as the average price of a house fell by 0.5% to just under £169,500. However, when compared to the year on year prices recorded in July 2009, the average price was up over 6.5%.

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Key Data

	30 July	30 June	+/(-)%
FTSE 100	5258.02	4916.87	6.5
Dow Jones	10465.94	9774.02	6.6
EuroStoxx50	2742.14	2573.32	6.2
Nikkei 225	9537.30	9382.64	1.6
Hang Seng	21029.81	20128.99	4.3
MSCI EM	991.41	917.99	7.4
Crude Oil	\$78.99	\$75.37	4.6
£ = \$	1.569	1.496	4.7
Euro = \$	1.306	1.224	6.3
£ = Euro	1.203	1.222	(1.6)

Interest Rates

Bank of England	0.50%
European Central Bank	1.00%
US Treasury Reserve	0.25%

Throughout August, investors will remain focused on corporate earnings, with many of the banks in the UK, including those bailed out by the UK Government, expected to announce a return to strong profits. In the US, campaigning for the mid-term Senate and House of Representative elections to be held in November will begin in earnest, with the key battle ground likely to be the level of unemployment.

UK

Macro-economic data released in the UK in July was universally positive; unemployment fell to its lowest level since January 2010, retail sales were up over 1% and inflation was down 0.2% to 3.2%. Undoubtedly the major boost came from the GDP growth figures, which revealed that the economy had expanded by 1.1% in the 2nd quarter, significantly higher than most analysts' estimates for growth of 0.6%. The Bank of England, whilst acknowledging the short term benefits of these results, was keen to point out that the long term outlook remains volatile, with the UK set for rising inflation, low growth and higher unemployment in the next few years.

EUROPE

A closer look at the bank stress test results reveals that the 7 banks which failed were all relatively small and would need an additional £3 billion between them to satisfy the test criteria. Of those that failed, five were provincial Spanish banks, one Greek and one German and all had previously been tipped as potential problem banks. Some analysts have queried the relevance of the tests given that they were very generous when assuming losses following a potential sovereign debt default, a scenario which still remains relevant for most Southern European economies. However, it is our belief that whilst not a panacea, the stress tests do take a step towards more clarity and transparency in the industry, and hence increased confidence for investors and depositors.

US

In the US, Governor Schwarzenegger was forced to call a fiscal emergency in California as the State struggled to balance its multi-billion dollar budget deficit. Analysts are concerned that the Federal Government in Washington DC may be forced to underwrite the State's debt, an undertaking that would dwarf the similar guarantees given to the mortgage companies Freddie Mac and Fannie Mae. North of the border in Canada, their experience of the global crisis has been somewhat better, with the Bank of Canada joining the list of those raising interest rates.

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ASIA/PACIFIC

Following a disastrous election night for the ruling Democratic Party in Japan, the new Prime Minister must now rule without a majority in the upper house of his country's parliament. Prime Minister Kan had been planning significant fiscal reform, aimed primarily at reducing the country's massive debt to GDP ratio, calculated at 217%. Also of concern was the Government's reaction to news that the Yen continued to strengthen as investors continued to lose confidence in the global economic recovery. Prime Minister Kan had previously indicated that he would be prepared to intervene to weaken the Yen and boost Japanese exports but, as yet has not resorted to currency manipulation.

EMERGING MARKETS

India and Turkey were much in the news in July as David Cameron led a British business mission to both countries in an attempt to strengthen ties with two of the fastest growing Emerging Market nations. Markets in Turkey responded positively to Mr Cameron's support for the country's EU application, whilst markets in India posted modest gains as attention turned towards the heavens, as they await the monsoon rains to provide nourishment for the crops and help keep food prices low. With most of the stock markets in Asia limited to small gains, the best performing stocks amongst Emerging Markets were to be found in Brazil (up nearly 10%) and Russia (up 6%).

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