

Market update



David Jacob, Chief Investment Officer at Henderson Global Investors shares his views on the market turbulence experienced around the world in recent weeks.

This month equity markets are down anywhere between 10 and 20% and bond yields in a number of major markets are reaching historic lows. It is a difficult and nerve racking time for investors but I think it's important to understand some of the forces behind what's creating this volatility and how they're likely to play out in the near term.

I'll give you some thoughts on potential investment strategy in this environment and then also some of the things we'll be looking for over the near term to understand how to chart our way forward. What I won't be able to tell you is where equity markets are going to end up this week, or at the end of next. I think it's important to remember that the investment horizon needs to be longer than the short-termism that we often get in volatile markets like this, often dominated by fear in the marketplace.

So, what are some of the driving forces that have caused this volatility? If we go back to basics the four components that really drive economic growth: the Government, the consumer, corporates, and exports and imports. If we look at each individually you get some understanding of why volatility might in fact be here to stay for a while.

Starting first with the consumer, the consumer in most of the developed markets is going through a difficult time. It is faced with higher taxes, unemployment and, in many cases, inflation, all eroding disposable income which in turn makes spending power and confidence very low. Thus, market falls of the type we've just seen will further enhance fear in the eyes of the consumer.

Governments, since 2008 have played an increasingly dominant role in the markets that we're familiar with: whether they are expanding monetary policy, expanding fiscal policy, bailing out companies, regulating companies or buying companies. The Governments are now a fact of life in the markets and investment as we know it. So much so that I think they are a key to understanding the volatility we currently see. And, at the same time, will help us keep perspective on what we really want to do which is pick suitable investments to invest money in and make returns from.

The difference with having the Governments in the market relative to other investors is that you often know what the Government's agenda is. Moreover, the markets are very keen to test that agenda and we've seen Governments not only turn around in their views, waiver in their resolve, but also be confused in how they communicate with markets; because, in addition to their agendas, they also have political concerns back at home dominated by the need to think about the overall electorate.

Bring together all the Governments in the developed markets and try to find a coherent message from them and it is very difficult. Yet day-to-day we think about what is Obama or Bernanke going to say next, what's going to happen in the UK, what's the ECB going to do? We continuously look to the Governments to provide input into the markets. And, generally speaking, what Governments have been trying to do since 2008, is revive the economies in the developed world from what is a very difficult situation. And I think, as the market continues to test Governments and as Government policy continues to evolve, we are due for continued uncertainty and volatility in the marketplace.

However corporates on the other hand have been model citizens in this in terms of managing their costs and having good solid balance sheets with cash to avoid problems in downturns. That's not to say they're impervious to a recession, but, right now, they are the healthiest of the three domestic components towards economic growth.

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I believe that corporates and their management overall is strong. With equity markets down at these levels I think that there are some key buying opportunities that we need to be searching out and looking for. I favour solid balance sheets, companies that will pay dividends and companies that are well managed, in what is going to be a difficult environment for all corporates.

Lastly, the export sector in particular is driven by growth from the developing markets. Developing markets continue to grow and they provide an opportunity and a source of demand for healthy corporates that are in those markets. However, we have to be keenly aware of how their growth is doing. While generally speaking their growth has remained resilient through this, we need to keep watch and understand the impact it's going to have on exports in the developed markets.

So, what are the things we'll be looking out for? First, I think we have to be alert to the fact that economic evidence is starting to suggest that economies are in fact slowing. That will put pressure on those healthy corporate balance sheets and ultimately earnings as well. We expect earnings estimates to be revised downward from here, particularly given the uncertainty we've seen in the markets this month, and that will lead, possibly, to a difficult earnings season in Q3 and Q4, 2011.

Having the ability to spot good opportunities is going to be an important part of the investment platform going forward and we will be watching how company expectations, demand and earnings evolve over the remainder of the year. In summary, investors should not get overly concerned about the market volatility and certainly not panic. Rather, use this as an opportunity to take onboard good solid companies for long-term investing.

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