



# Market Review



APRIL 2009

## Is Spring really in the air?

When the Bank of England lowered its base rate to 0.5%, the lowest level in its 315 year history, it probably concluded the monetary easing process started last October, but it was not enough to stabilise markets. That was only achieved by the introduction of a new policy of 'Quantitative Easing' (printing money), which allowed the Bank of England to buy gilts and corporate bonds – at the same time as the US authorities instigated a new plan to buy up to \$1 trillion of troublesome assets.

The measures put in place should gradually encourage banks to start lending again but this does not guarantee that demand for new borrowings will increase. Equity markets, however, have taken a more positive view. US banks led a very strong recovery with prices rapidly rising by 20% - 30%. This affected European markets, where financials led a recovery, the positive effect of which quickly rippled out to all sectors. Part of the reason for greater optimism is that certain leading economic indicators are starting to bottom out. In the US (the first economy into recession, so expected to be the first to come out), new and existing home sales, durable goods orders, and consumer confidence, are some of the measures improving. In the UK the rate of decline in house prices seems to be slowing and mortgage approvals have risen from their very depressed low levels. Hopefully these are the 'green shoots' we have been waiting for.

Equities weakened further during the first quarter until 9th March, when the FTSE 100 touched 3460, its lowest point for six years. The rally since then has been led by the banks, despite HSBC launching a £12.5bn rights issue. The issue was a success, and Barclays passed an efficacy stress test which suggested it would not need to go to the Government for funding. Gilt prices also rose, helped by Government buying as part of its quantitative easing programme. The yield on 10 year gilts fell to a multi-decade low of just over 3%.

The majority of market analysts doubt the longevity of this current recovery in equity prices. Admittedly it is difficult to see any real improvement in corporate earnings before 2010 at the earliest so the fundamentals for sustained improvement in share prices are unlikely

to be present this year. We accept these arguments, but note that historically, equity markets usually pre-empt economic recovery. Prices normally turn up twelve to eighteen months ahead of any confirmed improvement in corporate earnings – hence our cautious optimism. At the very least the severity of the bear market is such that the fall in share prices seems to have fully discounted the current recession. If one takes the longer-term view, with the benefit of hindsight, we feel that current prices may look increasingly attractive.

### 3 month performance

	31/03/09	31/12/08	Change
FTSE 100	3926.14	4434.1	-11.4%
FT All Share	1984.17	2209.29	-10.2%
US Dow Jones	7608.92	8776.39	-13.3%
Nasdaq Comp	1528.59	1577.03	-3.1%
FTSE Eurotop 300	700.95	831.97	-15.7%
Japan Nikkei	8109.53	8659.56	-6.4%
APCIMS Growth	2424.26	2658.56	-8.8%
APCIMS Balanced	2230.48	2416.48	-7.7%
APCIMS Income	1823.69	1954.25	-6.7%
£/\$	\$1.4299	\$1.4575	-1.9%
Euro/£	€1.0808	€1.0442	3.5%
Gold (per ounce)	\$919.9	\$875.32	5.1%
Brent Oil	\$47.74	\$45.59	4.7%

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# Stock Selections (prices as at 9th April 2009)

## HSBC

**Price 446p Yield 7.4% PE 15.5**

**Mkt.Cap. £76,862m High/Low 817p/270p**

Had it not bought US sub-prime bank Household in 2006, HSBC would probably not have needed the recent £12.5bn rights issue. The group reported a loss of \$15.5bn (£10.6bn) for its North American operations last year, whilst elsewhere it performed well. Operating profit was \$23bn excluding the US. The bank's strength is its presence in emerging markets, particularly Asia, where its operating profits totalled over \$10bn. Growth has slowed in these areas but relative to the West, remains strong. Following the rights issue and a reduction in the level of its dividend, HSBC's Tier 1 capital ratio is estimated to have risen to 9.8% from 8.3%. This means the bank is well capitalised going forward and may even look at opportune acquisitions in developing markets such as the Middle East and South America. Recently the bank announced that it had made a strong start to the year, ahead of its expectations.

## Land Securities

**Price 534p Yield 6.3% PE n/a**

**Mkt.Cap. £4,097m High/Low 1627p/323p**

The group is one of the UK's largest property companies with investments in offices, shops, shopping centres, and out of town retail parks. It is just completing a successful £756m rights issue, the funds from which will be used to bolster its balance sheet, hurt by falling real estate values. Since the peak in mid-2007, UK commercial real estate values have fallen about 40%. Expectations are that values may fall another 10% to 20%, based on previous recessions. Land Securities share price has fallen by 75% over the same period and stands at a 40% discount to its estimated post-rights Net Asset Value per share of 803p. We believe the fall in the share price has been overdone, even allowing for a further fall in real estate values, and that there is medium to longer term value on offer.

## Smith & Nephew

**Price 466p Yield 1.8% PE 16.1**

**Mkt.Cap. £4,119m High/Low 681p/401p**

Smith & Nephew is a global healthcare business with 3 main strengths:- orthopaedics (hip replacements etc.); endoscopy (devices for keyhole surgery); and advanced wound care products.

Scientific advancements in the areas in which S&N operate are creating new markets and demand where it did not exist before. Fourth quarter results provided reassurance that core business areas remained relatively immune to economic pressure and that steps are already in place to control costs in those divisions more exposed to the economy, particularly endoscopy. Sales for 2008 were said to have been 13% higher at \$3.8bn, while adjusted earnings per share rose 6.9% to 55.6 cents, better than consensus expectations.

S&N's shares have historically traded on a growth rating. This is no longer the case, despite expectations that earnings will continue to grow by 10% to 15%.

## Rexam

**Price 285p Yield 7.4% PE 10.6**

**Mkt.Cap. £1,832m High/Low 485p/212p**

Rexam is the world's second largest consumer packaging group and the world's leading beverage can maker.

The share price has fallen steadily over the last 18 months on concerns about the slowing global economy, and the group's high debt level. The fall appears to be overdone. In February Rexam reported a 28% increase in sales to £4.62bn, and underlying pre-tax profits up 34%, after it raised prices while aluminium costs fell. Group borrowings, which are about 80% dollar-denominated, were swelled by about £600m due to the appreciation of the dollar. It did take exceptional costs to close some capacity in the US, but management said it is operating within its debt covenants and has a "strong" financial position.

## Mid-cap selections

### Wincanton

**Price 163p Yield 9.2% PE 12.5**

**Mkt.Cap. £198m High/Low 371p/107p**

Wincanton manage supply chain contracts on an international, national, regional and local basis, transporting goods by air, land and sea. Clients include Glaxo, Unilever and BMW.

The group has suffered because of the economic downturn. In February it said full year profit will be at the low end of the range of analysts' estimates (£42m-£46m). Since this announcement the group has continued to report new contract wins, which should offset the effects of the recession. Its strength is its specialist approach, providing the full logistics solution. A profit of £42m would equate to earnings per share of about 25p, putting the shares on a forward PE of 6.5x. – an attractive recovery proposition.

### Debenhams

**Price 56p Yield 5.3% PE 6.3**

**Mkt.Cap. £498m High/Low 67p/20.5p**

Debenhams is one of the major department store groups in the UK.

Retailers are all suffering presently, but Debenhams is performing above average, and better than expected. In its update for the 26 weeks to end-February, it said that like-for-like sales were down 3.6%, but thanks to margin improvements, it indicated pre-tax profit for the period was higher. As if to emphasise its relative strength, the group said it had plans to create 1200 jobs over the next 18 months, and to open 6 large department stores, taking its total to 161. There is still speculation about a rights issue and possible dividend cut, but this is probably discounted by a share price currently only a quarter of its 2006 flotation level.

# Chart based recommendations

## Mercantile Trust

Price 692p Yield 5.2% PE n/a  
Mkt.Cap. £708m High/Low 1037p/515p

The Mercantile Trust is a closed-ended fund whose aim is to achieve capital growth from a portfolio of medium-sized and smaller UK companies. It also aims to achieve long-term dividend growth at least in line with inflation.

Mercantile mainly represents the Mid-Cap area of the market, which is dominated by companies that have more of a UK focus than those in the FTSE 100. It tends to underperform 'blue-chips' during bear markets in equities caused by recession, but as the economy bottoms-out, it tends to move to the fore. From the 2003 bear market low Mercantile's share price rose by 283%, far outstripping the 106% rise in the FTSE 100 over the same period.

Chart patterns suggest we have just passed an inflection point – and the Mercantile's share price is set to rise strongly.



## Xstrata

Price 572p Yield 0.0% PE 3.99  
Mkt.Cap. £16,894m High/Low 2510p/288p

Xstrata is a diversified mining group with operations in Australia, Africa, Europe and South America. It is the world's fourth largest producer of copper and nickel, and the world's largest exporter of thermal coal.

Last month Xstrata successfully completed a rights issue to raise £4.1bn, allowing it to pay down debt and purchase assets from its largest shareholder. Post the rights it is financially strong and has said it will look at copper acquisitions after the collapse in share prices in the mining sector. Unlike other producers, it has not cut back on copper production during this downturn, believing the long term demand outlook for the metal, to be robust.

In less than 12 months Xstrata's share price fell more than 80% as sentiment swung from one extreme to another. The fall in price was overdone and reflected an unwarranted level of pessimism regarding demand for metals and minerals. The share price has now bottomed-out and gave a buy signal on the move through 500p.



## Easyjet

Price 308p Yield 0.0% PE 15.5  
Mkt.Cap. £1,305m High/Low 423p/206p

Buying an airline stock during a recession, seems to defy logic, but the bullish pattern developing on the chart suggests the market is starting to look ahead to better times.

Like most carriers, Easyjet has seen passenger numbers drop recently, compared to this time last year. In March the total was down 6.3%, but this is better than the UK total for the month, -8.9%. There is also evidence that it is picking up market share at some of the overseas hubs it operates from, due to the precarious financial position of local providers. The inference is that when the economic position improves, Easyjet could outperform others in the sector.

The decline in the share price from the high in April 2007, to the low in November last year, was 72%. Since then there has been a period of consolidation, with the latest break above 300p signalling a buy.



# USING CAPITAL LOSSES

The tax year just ended has been a difficult one for investors and it is probably an appropriate time to consider some of the rules about the use of capital losses. The rules discussed here relate primarily to individuals and trusts; there are some differences for companies.

## The basic calculation

You work out the capital gains or losses for a year by:

- **calculating separately the gain or loss for each asset you dispose of, and**
- **taking away your total allowable losses from your total gains**

If you have made a net loss in the year it is carried forward for use in future years.

If you have made a net gain in the year tax is payable at 18% on the gains in excess of the annual exemption (£9,600 for an individual for 2008/09). You can deduct allowable losses brought forward from an earlier year to reduce your capital gains to the level of your annual exemption; anything left is carried forward to the next year.

You must claim an allowable loss in order to be able to use it. You can do this on your Self Assessment tax return or by writing to your Tax Office.

## Negligible value claims

If you own an asset that has become worthless it may be difficult to sell, but you might be able to crystallise a loss by making a claim that the asset is of negligible value.

If all conditions are met you are treated as if you sold the asset and bought it back again at negligible value on the earlier of the following dates:

- **when you make the claim**
- **the date specified in the claim - this may be in the previous two tax years**

The loss arising is claimed in the usual way.

HM Revenue & Customs maintains a list of quoted shares that they accept have become of negligible value. Claims may be made in respect of other shares but the owner will need to prove that the value has become negligible.

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