ALPHA BITES.....bite sized pieces of information

ALPHA

PORTFOLIO MANAGEMENT

It all looks a bit Messi

 Argentinian World Cup captain Lionel Messi has been living up to pre-tournament expectations. A brilliant individual goal against Bosnia and then double his tally in an otherwise lacklustre display against Iran. However things look somewhat messy for **Argentina** in other ways as it is facing the prospect of **sovereign debt default** after the US Supreme Court refused to overturn a ruling that ordered Buenos Aires to pay its 'holdout' creditors. Agreement will need to be reached by the 30th June, two weeks before the World Cup final, in order to avoid a technical default. Significantly the amounts due to all such 'holdout' funds could amount to a sizeable $15bn - this compares to the country's reserves estimated at $28bn. This may have ramifications for other emerging market countries looking to service their debts and could reduce fixed interest investor's appetite in future for debt restructuring.

Nearer to home we previously touched on the performance of UK new issues relative to The FTSE 100 and FTSE 250 indices. This week we focus on UK smaller companies or rather the **marked difference in performance over the last three months between those fully listed companies in the FTSE small cap and those quoted on AIM**. Over the last three months the small cap index is down by about 5% yet the AIM index has fallen over the comparable period by 15%. Besides the obvious difference in sector weightings, with about 20% of AIM focused in mining, oil and exploration this underperformance also reflects the significant drop in the share price of some of the largest value companies on AIM.

 **Two of the top five companies on AIM previously by market value** at about 20% of the index, **ASOS and Quindell have seen share price falls of over 55% and 70%** respectfully. Being the largest fish in a small pond is not always necessarily the best thing and is a reminder that when looking at smaller company investing **make sure you take AIM carefully.** This is why we tend to spend lots of our time carefully screening the report & accounts and particularly the cash flow profiles of many of our smaller company investments. In any business there can be challenging periods but robust cash flow provides support to get through any difficulties or volatile market conditions.

What are we watching this week?

 Market volumes remain subdued as hard working city types headed off to Ascot or stayed up late to watch the World Cup and now it's Wimbledon!

At a global level, developments in the Ukraine and Iraq continue to overshadow things with investors continuing to favour safe haven assets. The Brent **oil price has continued to nudge** upwards to $115. **Iraq appears to be sliding towards civil war**. The Kurds have seized Kirkuk to protect oil installations while a siege by Islamist forces has forced the closure of a major oil refinery in Northern Iraq. In the South the oil majors have started to evacuate staff from key oil fields.

In the **UK** the equity market continues to follow a similar pattern, **running into resistance at the higher end of its forward price earnings ratio range while the downside is limited by the support of favourable relative valuation comparisons against other asset classes**. Tax driven US mega pharma bids were back on the agenda with Shire receiving a $46bn offer from AbbeVie Inc, although, as with the Pfizer/AstraZeneca bid, this approach was rejected by Shire's management team. A possible reflection of market fatigue came with results from US/UK plant hire business **Ashtead**. The shares had moved up ahead of the results and although results exceeded expectations and more cautious analysts raised their forecasts for 2015 and 2016 because the overall consensus forecast did not appear to have moved the shares dropped 6%. In the current market it's all about managing expectations and shows how short term the market has become. **Currency headwinds are still impacting on forecast expectations** with the £/$ over 1.70. Company specific profit warnings in the FTSE 250 have continued. Inkjet print head supplier **Xaar** is the latest with declining sales to the ceramic tile market and the shares have now fallen over 50% this year.

New issue activity shows no sign of slowing with the AA and SSP the latest offerings as venture capital firms continue to offload shareholdings onto new investors. We remain very selective on new issues generally on valuation grounds. One exception has been **TSB** where there appeared to be a clear valuation anomaly against parent Lloyds with a book value of 0.9x against 1.5x in a sector **which should benefit from the turn in the UK interest rate cycle**. By comparison, those **interest rate sensitive sectors linked to consumer spending continued to remain out of favour** following Mark Carney's recent comments. However May's **CPI data seemed to be in stark contrast to the BoE's hawkish comments**. While retail prices appear under control, the housing market must be firmly in focus with UK average house prices up almost 10% Y-o-Y albeit with London and the South East providing the bulk of the increase.

Elsewhere, according to the FT, the US Fed has been discussing imposing exit fees on bond funds to avert a run on them by investors as they believe these have the essence of shadow banking giving people a liquid claim on illiquid assets. In the UK, retail bonds have been very attractive for many private investors but these may also prove illiquid in a period of rising interest rates and as if to highlight the potential risks Moody's, the credit rating agency, downgraded Tesco.

In **Europe**, data for May confirmed inflation of 0.5%. The ECB is likely to continue its 'dovish' comments over the summer although with regards to full blown QE but we still think some dissenting voices are bound to be heard particularly from Germany given their bitter memories of hyper-inflation in the Weimar Republic.

The IMF delivered a cautious assessment of the US economy and trimmed its forecast for 2014 from 2.8% to 2% as well as the medium term outlook. The IMF said it could see no argument for moving key policy interest rates upwards until well into next year. **US inflation** data showed CPI up 0.4% **MoM driven by food prices and medical care costs**. Markets had therefore been expecting a potentially more hawkish Fed statement as a result. However, the Fed made no mention of signs of higher inflation keeping its forecast almost unchanged at 1.6% and predicted below target inflation until the end of 2016. It did cut its US growth forecast to 2.2% which came as no surprise after the weak Q1 and World Bank and IMF downgrades but left 2015 and 2016 estimates unchanged.

Tapering continues as a result with the monthly pace of bond buying reduced by a further $10bn to $35bn. The US S&P index hit a fresh all-rime intra-day high. **US companies remain in good health** with strong cash flow **reflected in a record first quarter for share buy backs and dividends** at $241bn. This partly reflects low interest rate returns on cash and activist shareholder pressure to return money **but also suggests that companies remain cautious about spending cash on expansion**.

In China new home prices fell by 0.2%, tiny but significantly the first decline in two years. While on his UK tour, Chinese leader Li Said China would not have a hard landing and growth would be 7.5%. The HSBC flash manufacturing index for June improved from 49.7 to 50.8 **suggesting the authorities' policy of selective support is working**.

And finally…, Iraq, Ukraine, oil, UK interest rates, stretched equity valuations, currency headwinds…. it all sounds a bit messy!

If you wish to discuss any aspect of this newsletter, please do not hesitate to contact us.

Further information about Alpha Portfolio Management, our products and services, please visit www.alpha-pm.co.uk or email info@alpha-pm.co.uk. Alternatively, you can call us on 0117 203 3460.