



Alan Aardvark MEP?

 Following Eurovision it has been European's chance to vote again but this time for MEPs, all 751 of them. Following this we now have the bizarre situation where about 1 in 3 MEP's are in the 'anti-European' union. Does this represent an earthquake or a minor tremor in the history of the EU? Only time will tell.



European voting can be a pretty confusing affair as we highlighted last week with Eurovision and perhaps in future they should follow English local elections? According to the journal Parliamentary Affairs, which has analysed local elections for many years, it appears that in the 2011 elections across the English shire districts and metropolitan boroughs that **161 candidates were apparently elected purely because their names were high in the alphabet and so appeared at the top of the ballot paper**. Which got us thinking. We chose Alpha Portfolio Management but should we perhaps have chosen Aardvark?

What are we watching this week?



Since late February there has been a major rotation out of growth stocks with stretched valuations. This first manifested itself in a sharp sell-off in very highly valued US bio-technology and internet businesses but has gradually spread to other cyclical and interest rate sensitive sectors. This in turn has been reflected in lower valuations for many new issues. In retail, the Fat Face float has been pulled while Card Factory went to a discount. Saga was priced at the bottom of the valuation range and has today slipped below the issue price. Both FTSE 250 and small cap stocks were very hard hit about a week ago. Increased risk aversion possibly due to concerns about China but also the Ukraine has seen US and UK 10 year Government bond yields drop to 2.5% and 2.6% from 3% at the beginning of 2014. This seems to have driven a rally in defensive bond proxy equities, those with seemingly more secure high yields. Some fund managers had written off tobacco stocks at the start of the year due to the increasing regulatory hurdles but also the development of e-cigarettes yet some tobacco stocks have seen 20% price appreciation since February. Certain high yielders such as Astra Zeneca were pushed up by a bid approach or in the case of Vodafone by bid hopes from AT&T.

Is this rotation ongoing? Astra has dropped sharply having rejected Pfizer's advances and it seems as if there will be no further developments for 3-6 months. Vodafone dropped on some fairly dull European numbers and slightly lower forecast guidance. In addition AT&T has instead bid \$48.5bn for DirecTV. Food retailers which had attracted income buyers and also been the subject of bid rumours with US private equity buyers believed to be looking at Morrison's property assets have started to retreat again as price war fears mount. Elsewhere, Royal Mail, another high yielder, has fallen on competition fears.

The FTSE 250 also includes a greater number of exporters and Sterling's appreciation particularly against the US Dollar and Euro has also contributed to this rotation with a series of gradual profit forecast downgrades by analysts -not helpful when share rating demands earnings upgrades! Painful as the evaporation of the froth in certain parts of the market has been it should prove to be a healthy development as it should tempt in the dip-buyers.



Last week we highlighted the unbalanced UK economy and the BOE concerns about the UK housing market. This week Lloyds, Britain's biggest mortgage lender said it intends to impose a maximum household earnings multiple of 4x to all loans over £500K. More worrying was the report by the Resolution Foundation which calculated that if interest rates were to move up to 3% from 0.5% by 2018 that some 2million of Britain's 8.4million mortgage holders would be forced to spend more than a third of their post-tax income on mortgage re-payments. This would

not be particularly good news for UK consumer spending and shows why some veteran fund managers like Neil Woodford believe interest rates will not be able to rise significantly for some time. To add to political uncertainty, as if there wasn't enough already David Miliband raised the **issue of the minimum wage if Labour returned to government** – potentially **not good news for a number of domestic sectors** such as retail, catering, hotels, support services.



In Europe, Italian and Spanish 10 year bond yields rose back up to levels not seen since April on **short term European election uncertainty**. National PMIs for the regions two largest economies showed the gulf widening with Germany expanding but France in contraction. The **Euro continued to weaken against Sterling** in anticipation of major action in June by Draghi and the ECB.



In the USA the AT&T/DirecTV deal only had a moderate impact on the market while there was disappointing news from the retail sector (Staples, Urban Outfitters). **Two Fed speakers said little to change market perception of the QE exit strategy plans** although one of the hawks re-affirmed that an interest rate hike should come sooner rather than later.



In Asia, the BOJ left policy unchanged as expected and re-iterated its assessment that the **Japanese economy is recovering moderately**. Investors however fretted about the implications of **a further slowing in China's housing market** which followed the April data that showed house inflation at an 11 month low. While the Chinese authorities have the policy levers and resources to bail out their banking system should things deteriorate there is no doubt that macro **China will continue to be a source of uncertainty and financial market volatility**. The HSBC flash manufacturing PMI however provided relief improving to a 5 month high.

Trading volumes remain low. We continue to see special dividends with **Booker** announcing another for 2015 as well as for 2014. Despite market uncertainty and volatility the mega bids have not gone away (AT&T/DirecTV) and UK companies are starting to make acquisitions. **These appeal to shareholders even more than special dividends** as the return on cash is so low **acquisitions generally tend to be nicely earnings enhancing**.



Now where did I put that dictionary? Aardvark... medium sized insectivore with protruding nasal implement.

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