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

It's going to be a game of two halves

A few weeks ago we featured an artist who was re-creating works by Banksy in Lego. Now we have discovered an artist, Terry Lee who has re-created iconic moments from world cup matches with Subbuteo figures. For the benefit of the younger generation brought up on FIFA computer games, Subbuteo was, in its day, the must have football game for 'us old timers'.

In footballing terms, last week saw the end of the 'first half'. **The performance of the various global equity indices reflected the differing monetary policies of central banks**. In the USA the S&P was up over 6% in the first half of 2014, the Dow broke through a new high of 17,000. While US Treasuries defied expectations of an end to the bond market rally. This reflected the US economy rebounding in Q2 from a much weaker than expected, weather impacted Q1 GDP outcome. In Europe, the DJ Euro Stoxx index increased by 3.8% while yields on Spanish 10 year bonds fell to a similar level to US and UK bonds. This reflected ECB support and the hope of QE later this year. UK equities have fallen behind and lag other markets. The FTSE All- Share marginally down with mid and small cap sectors losing further ground. This appears to have been a momentum shift towards large cap with profit warnings, a tightening or interest rate expectations and valuation levels combining with currency movements to create a formidable opposition.

The **other feature of the first half was global takeover activity** which was up 75% on the same period last year at $1.75trillion with a number of mega-bids. The US and the pharma/healthcare was the main driver and included Medtronic's $48bn acquisition of Coyidien and Valeant's $63bn acquisition of Allergen. Closer to home, Astra Zeneca rejected Pfizer's approach while Shire rejected AbbeVie. One of the drivers within the pharma industry for deals outside of the USA was tax. However, as we suggested in May, US companies are estimated to be sat on over $1.64trillion of cash overseas and looking to make this work harder.

So how will we fare in the second half? Well, for global equities the **oil price remains a key determinant** given its impact on both consumers and companies. The **US economic data appears to suggest the rebound in Q2 GDP should continue into Q3** and although inflation is edging higher, it is not yet enough to alter the Fed's current policy timetable. In **China, targeted policy support appears to be working so far while in Japan the improved outlook for capital investment is encouraging. In Europe, the ECB is waiting to assess the impact of its aggressive policy stimulus**. The recovery appears to be better established in peripheral economies **but France still looks troubled**.

In terms of the outlook for UK equities we do not see the currency headwinds abating and clearly these are restraining earnings growth. The currency situation may possibly begin to change later this year with the forthcoming Scottish independence vote and thoughts then turning to the UK general election and risk of a hung parliament. However, there are **some reasons to be cheerful. Strong cash flow is supporting inflation busting dividend growth and special dividends** while we are **starting to see some takeover activity** outside the FTSE 100 with **Kentz** a good example. **Companies with strong cash flow therefore seem to us to be a good place to be invested right now.**

What are we watching this week?

Global capital investment is forecast to decline by 0.5% this year according to Standard & Poor's. While cash rich companies are starting to make acquisitions they do not appear confident enough to step up capital investment. Again, as with the takeover activity, this may be sector driven as we already know that some of the leading mining (**Rio Tinto, BHP Billiton**) and oil companies (**Royal Dutch Shell**) are cutting back on capital projects to focus on raising cash flow.

One leading investment house warned that were the situation in Iraq to escalate and involve the major oil deposits in the South of the country that Iraqi production could be hit hard with a short term spike in the oil price to $150 a barrel. However, **oil eased slightly** to $110 as Libyan rebels said that they would re-open two oil terminals.

In the **UK** June's manufacturing PMI came in at a 7 month high although this in turn pushed Sterling up to a six year high against the US Dollar of $1.71. CIPS construction PMI logged a four month high reflecting greater housing activity while the Nationwide house price index showed an annual rise in house prices of 12% with a 26% increase for London.

In **Europe**, the flash inflation reading for June came in at 0.5% while corporate lending activity remained weak with private sector lending down by 2% in May. Clearly, the aggressive policy stimulus announced by the ECB in June is going to take some time to take effect.

In the **USA**, the housing market seems to be continuing to pick up from the weak weather affected first quarter. Pending home sales in May increased by over 6% MoM rising to an eight month high. The key ISM manufacturing survey for June was steady with new orders at a six month high. Janet Yellen mounted a forceful defence of the Fed's decision to keep its monetary policy loose in the face of soaring asset prices. While commenting that investors may be underappreciating the risks of higher volatility in future, particularly on corporate bonds she said that excessive risk taking would not play any role in decisions about interest rates. However the latest US jobs data didn't look just like a catch up from the bad Q1 weather but also some gathering strength in the economy. Bond market yields rose as fixed interest investors began to consider whether the Fed could be pushed into making an early move in 2015 to increase interest rates.

Japanese business sentiment dropped slightly in the second quarter with the Bank of Japan Tankan survey of large manufacturers showing the first dip in six quarters.

In **China**, the official manufacturing PMI for June improved to a six month high of 51 while the HSBC index was also in positive territory at 50.7, so it looks as if targeted policy support appears to be working so far.

The **second half has started on a bullish note with global macro data generally supportive of equities.** The re-assuring Chinese data has given a boost to the Mining sector and the main UK equity market and we sit within a whisker of an all-time index high. However we are mindful that summer trading volumes remain painfully thin while currency headwinds and Middle East tensions have not gone away. Investors will now be watching half year company trading updates to tell us what is happening out there in the real world although given Sterling's strength and BoE monetary uncertainty, UK management teams may be wary about guiding forecasts higher at this stage.

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.