



LLOYD GEORGE MANAGEMENT

Investment Outlook for the Second Quarter 2012

We try not to attach too much importance to short term moves in the stock market: as Warren Buffett remarks, “Mr. Market is either neurotically depressed, or else euphoric”. In the first quarter of 2012, we have seen a remarkable rebound in investor confidence, with the S&P500 rising 12%, the Nikkei up nearly 20%, China up only 5% and India up 13%. The markets have anticipated stronger US economic data and stronger earnings figures.

At the same time, there have been some signs of recovery in the US economy: in employment, exports, and even home prices (and of course, the consumer accounts for around 70% of GDP). The super bears remain unconvinced by this improvement saying that it is a dead cat bounce in the long deleveraging and deflationary cycle which we have to undergo for at least seven years (according to the theory of Kenneth Rogoff); and that recessions following a debt crisis take longer.

There is an old Chinese proverb: “There is no feast that lasts forever”. The big question for us is whether the Hong Kong and China growth model, heavily dependent on property development, has reached its limits. The recent election of CY Leung to be Chief Executive of Hong Kong has caused tremors in the business community, which expects him to increase land sales to bring down property prices. Wages in China are rising at almost 15% annually, and Shanghai in 2012 is at least the price level (and urban sophistication) of Tokyo in 1982. Property prices in China continue to correct, and the recent power struggle in Beijing has not encouraged confidence among investors in China.

The major question is whether China’s demand for raw materials will slow down. Premier Wen Jiabao reduced the growth target for 2012 to 7.5%, (although most observers expect this to be exceeded). However, this growth is assuming a different composition, with more consumption and imports, compared to infrastructure and property construction, and exports. China’s monthly trade deficit of over \$30 billion in February underlined this underlying economic change. The commodity outlook is more nuanced: the president of BHP Billiton’s iron ore division has predicted for instance that China’s slowdown will reduce iron-ore demand to single digit growth. But China’s economy is expected to double by 2020: and only 39% of the population in China and India is urbanized (vs. around 57% for the world), so steel demand will remain strong.

In India, the economy has slowed, along with inflation (and the Rupee has weakened again). The Indian budget was moderately well-received, although the Delhi government has announced that they are changing their tax policy retrospectively, potentially going back 50 years. This has certainly shaken the confidence of foreign investors, both industrial investors, (like Vodafone), and portfolio investors who no longer have any assurance of their capital gains tax position.

Meanwhile, the Rupee price of oil has hit an all time high, due to the weakness in the Indian currency.

The Greek bail out has reduced the risk of another global banking crisis starting in Europe, and the health of US banks has also improved. The US Dollar is strengthening, especially against the Yen. China's energy demand continues to be strong, and local gasoline prices have been raised. Meanwhile, the Saudis have announced increased oil production, and chartered eleven more supertankers to deliver crude oil to the US market (perhaps in time to reduce pump prices before the November election).

The agricultural and soft commodities prices are still rising (soybean prices are up 13% ytd) and may bring higher inflation in the second half of 2012 in many developing countries. Indeed, many of the same patterns of 2011 are being repeated: so it seems likely that markets could weaken from May onwards. ('Sell in May and go away...') In a normal environment, we can expect interest rates to rise with an improving economy but Bernanke says they should stay low for two years and we may have just seen the top of the bond market, after 30 years of falling yields.

In Latin America, the outlook for economic growth across the region is set to moderate in 2012 to about 3.5% but is still at a premium to developed markets. Mexico and Brazil will grow 3-3.5%, while the Andean nations of Peru, Colombia and Chile will lead growth with rates in the range of 4.5-6%. Inflation is under control in most markets, (except for Venezuela and Argentina where rates exceed 20%) but we continue to monitor risks in Brazil where rate cuts may be excessive given low unemployment rates and strong internal consumption trends.

In EMEA, we have taken a fresh look at Turkey, where the currency appears to have stabilized (despite 10% inflation, and 50% of exports going to the EU). Our South African consumer shares are still outperforming despite a lack of credibility of the Pretoria government. We see Russia as a trading market dependent on the oil price. So the elephant in the room remains Iran, and whether the good mood in the market may be spoiled by spiking energy costs.

We remain cautiously positive, and believe 2012 is a market for stock pickers rather than 'risk on and risk off'.

A handwritten signature in dark ink, reading "R. Lloyd George". The signature is written in a cursive, slightly slanted style.

Robert Lloyd George

2nd April 2012