SRS
Strategic Retirement Solutions

Market View

After the nervousness of June calm has returned to global markets during July. Japan, Gold and China all picked up and bond prices held steady. Much of this calm was due to Ben Bernanke explaining in greater detail the potential timing for the introduction of the taper. The market now believes it will start in September but that interest rates will stay low for some time yet. Much as ever depends on the unemployment statistics. We have also had the US corporate earnings season which helped support the markets. Global Equities were up 4%, FTSE100 up 6% and the Far East 2%. Bonds were flat and for the first time since 2008 Property has started to move up.

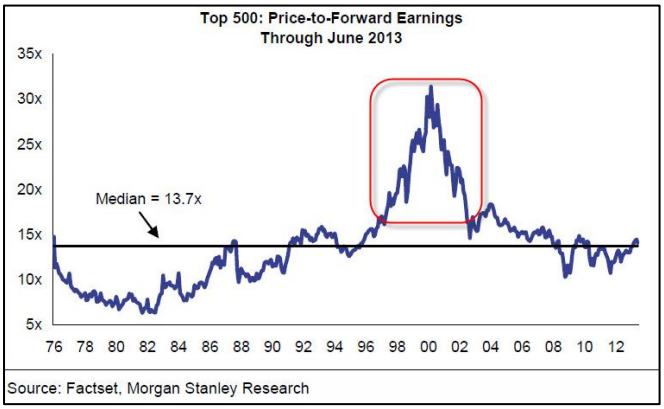
We still need growth to support equity markets; there are the classic green shoots in the UK as house prices and construction activity pick up, the US looks like growth may accelerate and markets are sitting waiting for the Chinese new grand plan. Japan is also just showing a few minor signs that Abenomics might be working. Fundamentally, there is not enough growth at the moment for markets to keep moving forwards without QE, but if things continue as they are, by the final quarter of this year, there might just be. Remember, markets are priced not on what is happening now but on what could happen in twelve months' time.

US Earnings Season

US companies report their profits quarterly and the results season which represents sales and profits for the period March to June 2013 is drawing to a close. This was a quarter where QE3 had only just begun to work and US unemployment was slowly moving down and house prices slowly moving up. So a sluggish economy still, and in general that is what US corporations reported. The average operating profit was up a minuscule 0.2% over Q2 2012 and on a rolling 12 month basis up by 2.9%. This is still way below what we should expect at this point of the cycle.

It explains why investors are so nervous about the tapering of QE3, if this is the best that can be achieved with QE3 what will happen without it? But Bernanke is looking for the inflection point, he will only taper QE3 when there is hard evidence that the economy can grow without it. But if we dig underneath the broad numbers what messages are we getting from the companies themselves? A surprising but encouraging one was about Europe. Companies such as General Electric, Johnson Controls, PPG, Honeywell, Ingersoll Rand all reported improvement in their European operations. Manpower, the recruitment agent, reported improvement in France, Spain and Italy, SAP the software company went even further stating that its Spanish business had bottomed and is now growing at double digit rates. Caterpillar reported improvement in China whilst Apple's Chinese iphone sales fell. Apple's results were not expected to be good but they did exceed pessimistic expectations. Apple appears to be gearing up for an across the range product revamp with colourful, cheaper iphones targeting China and India rumoured to be in production. Big tech from Google, Intel and Amazon were all flat indicating that the US consumer is not yet back spending.

This is the key "take" from all these results, this is not a booming (and thus inflationary) US economy, growth is sluggish, valuations still reasonable and yet the prospect of growth accelerating is now very real. If Europe is also picking up and providing Bernanke has not burst the growth bubble too early, then the equity cycle must remain intact and may just go on longer than normal.



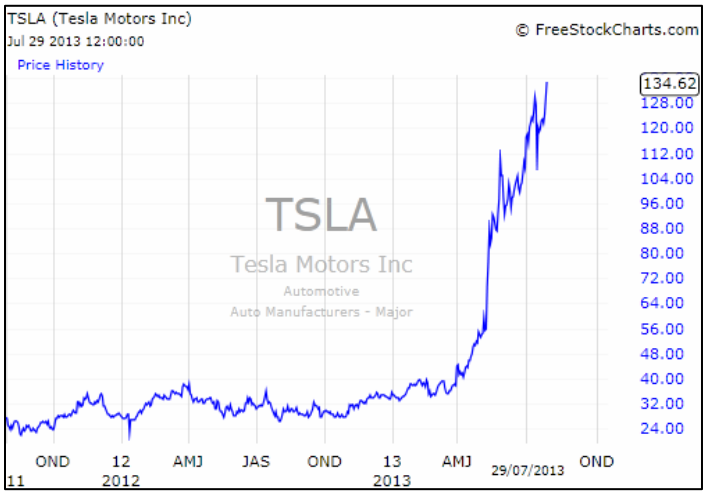
This chart shows the long term valuation of the S&P 500. The section highlighted was the "tech bubble" which can distort the average. Regardless of this period the market valuation remains fair. Furthermore, should economic growth accelerate from here then corporate earnings will do the same and valuations fall rapidly to the bottom end of the range, prices will then have to rise to compensate. If we do a similar calculation based on the S&P500 operating profits since 1988 the current valuation is 15.9 which is below the average of 18.8. All of which tell us that despite equity prices continuing to rise they remain good value.

SRS
Strategic Retirement Solutions

Market View

Electric Vehicles

Electric cars have been around in some form or another for many years but have yet either to become mainstream vehicles or a transformational technology. The cost (even after government subsidies) places them in the premium price bracket and buyers so far have not been willing to swap their Audi, Mercedes, Jaguars for something electric. That however is changing; in the USA the Tesla Model S has changed perceptions. Now, with the Tesla due to arrive in the UK shortly, BMW is launching its new i3.



Tesla was founded by South African Elon Musk who was one of the creators of PayPal. After years of developing expensive sports cars using proprietary technology Tesla launched a $70,000 four door car, the Model S, which astounded US motoring critics and as the chart shows the share price took off. Sales have risen to $562m in the first quarter and Tesla has moved into profit. This has shown the likes of BMW that an attractive premium electric car will sell and be profitable. Electric cars are fast and refined but the Achilles heel remains range and recharging. BMW is offering use of a backup vehicle if you wish to go on a long journey and also a range-extender version (a small engine to generate the batteries as you drive along). But just like when the internet first developed the real winners of this technology revolution may not be the car manufacturers.

Many of us drive around with half or quarter empty fuel tanks safe in the knowledge that a fuel pump is never that far away. With an electric car there is not the comfort of a fast charger being close. This undoubtedly will change and will be the transformational technology. The electric vehicle market is not yet big enough for the wholesale infrastructure expenditure needed to set up nationwide charging points but with BMW arriving into the market it may soon be. In the US, startup operations Ecotality, Chargepoint and Car Charging Group are aiming for "first mover advantage". Such "industrial revolutions" happen slowly over many years but with BMW entering the market charging points may become very common and quite soon. Just a question of who will make money out them? Could electric vehicles and their associated infrastructure, in investment terms, become the next mobile phone?

Markets

August is often the quietest month of the year as the investment trading world goes on holiday, but then so do most governments, news flow drops and so do market volumes. Thin markets can cause spikes in share prices both up and down. There is nothing we can do about this other than accept that this is part and parcel of investing. Ben Bernanke is still playing with fire and risks derailing the recovery just as it is about to get going properly and all eyes will be on the jobs and growth data. China remains an uncertainty for now, few know what the new leadership has in mind but the various speeches seem to suggest that they will be targeting steady (for them) growth of 7-8%, levels which the western economies can only dream about.

The dislocations of the end of the "Yen Carry Trade" are still being manifested in the Gold price, though traders have taken the opportunity to jump in as prices have risen from $1200 to $1300 in a month. Gold for now we believe will be the key "tell" for short term market direction. Nevertheless the July rally has taken some markets to new highs and it would be reasonable to expect that prices should come back before making further progress. With Europe starting to pick up, Japan growing again and China about to embark on its reflation all the stock market ducks may be lining up for the first time in many years? 31st July 2013