AEGON Asset Management

Monthly Outlook – October

March's "all-you-can-eat" buffet

What should we put on our plate while we've still got the chance?

As an old Buddhist saying goes: "The best way of preparing for the future is to take good care of the present, because we know that if the present is made up of the past, then the future will be made up of the present. All we need to be responsible for is the present moment. Only the present is within our reach. To care for the present is to care for the future".

If the above quote strikes a familiar chord with those holders of shares, who, in principle, invest over the long term, then this is probably because most investors are only prepared to weigh up the circumstances of the given moment, disregarding the forecasts, which can be worth their weight in gold at times such as these. Let's face it: most investors suffer from a form of selective deafness: in a bull market they close their ears to anyone who warns of an impending bear market, or even just a correction; but in a bear market, interestingly enough, everybody suddenly starts paying far more attention to predictions, regardless of what they foretell.

Well, since March, investor sentiment has certainly been rather bullish (but does all this really signal the beginning of a new bull market?) and our previous scepticism has subsided, as for a good while now we are no longer referring to the spectacular growth that's been under way for more than seven months now as a bear rally. And the growth certainly has been spectacular. Let's look at a few examples, by running through the most commonly tracked indexes from each region. From 9 March to the present day, in the North/Latin American region the S&P Index has risen by 57.04%, the Nasdaq Composite by 65.39%, the Mexican Bolsa by 79.61% and the Brazilian Bovespa by 74.22%, in their local currencies. Europe also made a good showing, with the DJ Euro Stoxx 50 Index up by 60.62%, and the DAX, the FTSE 100 and the CAC 40 indexes by 57.76%, 47.85% and 51.79% respectively. In the Asia-Pacific region, the most commonly monitored indexes are the Nikkei 225, the Hang Seng and the S&P/ASX 200, which rose by 40.25%, 83.59% and 53.59% respectively over the same period. But after these standard-fare dishes, let's take a look at some of the real delicacies on the menu, the absolute record-holders in their own currencies: the Ukrainian Equities Index achieved a 257.95% rise, the Kazakhstan KASE Stock Ex a 169.10% growth, the Russian RTS Index a 150.18% and the Vietnamese Ho Chi Minh Stock Index a 146.50% increase, while the fifth best performer was the M.AR Merval Argentina IX, which rose by 138.71%. However, not even those Hungarian investors who bought when prices were at their lowest have any reason to be despondent, since the BUX has also risen by 114.88% over the same period.

In the thrall of the wonderful figures above, one could easily jump to the conclusion that this really is a "V-shaped" recovery. Many already seem to have forgotten that there is still the possibility of a correction, to say nothing of the fact that the "alphabet soup" still contains plenty of other letters, to which a high statistical probability can also be attributed. I am still not 100% convinced that all the above factors signal the start of a new bull market. Perhaps it would be wiser to focus not on the present, but on the very near future.

For example, an important factor could be whether, in the case of the individual indices, the key points of resistance become supports, or simply send the indexes rebounding, resulting in a correction. There is a chance of this happening within the next two-four weeks. The extent of such a correction would be hard to predict, but it could be around 5-10%, and this may be worth exploiting in order to make further purchases, although there's also a possibility of the correction escalating into a relatively severe decline.

A defining threshold for the S&P500 index, and one that is worth keeping a close eye on, could be the 1120-point mark. Up to that level it remains sensible to maintain neutral equities exposure, spiced up with a light sprinkling of overweight. Following the correction (assuming that it does occur), it may be advisable to increase the weight of shares in your portfolio. However, just how long this unmitigated joy will last is also mainly dependent on the central bank's monetary policy – namely, at which point monetary restrictions will be imposed and the liquidity taps that have been pouring for months will be closed, bringing the sudden realisation that what we had thought was an "all-you-can-eat" buffet will no longer be replenished over and over again.

Only a few days ago, at the Fed's conference in Washington, Fed Chairman Ben Bernanke spoke of how the institution that fulfils the role of central bank in the US is ready to impose monetary restrictions immediately, if necessary. In my interpretation this means that they definitely won't make any changes to the benchmark rate before the end of the year, since in his opinion the economic outlook first needs to "improve sufficiently". This could justify, for example, a rise in the benchmark rate or the lifting of accommodative monetary-policy measures. I can, however, envisage the latter being put into practice far earlier than the former. This gives rise to a number of important questions: will the economy really be able to stand on its own feet after the money pumps have been shut off? Or, rather than a "V", will the recovery be "W"-shaped or possibly another letter altogether? Due to the future inflationary impact, is the central bank already far too late in halting the money presses? Will it be possible to deal with the extremely high level of unemployment? Will the population be willing to begin consuming again?

Of course, the question arises of what types of investment we should be focusing on at the moment, in the light of the above. Among the equities markets, Turkey, Russia, Brazil and China may continue to be attractive, and among the "Visegrád" group of nations Poland and (albeit to a lesser extent) the Czech Republic are also deserving of attention. It might be prudent to reduce exposure in the hitherto excellently-performing Hungarian market. For anyone agonising over whether to invest in the US or European region, American securities could prove a more attractive proposition. Hungarian government securities also show considerable appreciation potential, although the scope for this begins to narrow below seven percent. In the currency markets, the dollar has come under strong pressure, but is technically heavily oversold, so a 2-3% correction may ensue, despite the fact that in the long term the euro is expected to strengthen further against the US currency, possibly even back to a level of 1.6 USD/EUR.

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