

The Middle East and North Africa (MENA)

Markets had a brief setback on the MENA tensions and higher oil prices. However, rallied thereafter as positive economic numbers and reports from companies proved irresistible to the bulls. Oil prices have been very volatile, escalating with the rise of unrest and subsiding as Saudi Arabia suggests that they can make up for any shortfall in supply.

OUR OPINION: We believe that this situation bears close monitoring and will return to the forefront when we have more clarity on the Japanese nuclear situation. However, if tensions remain locally contained, the effect on the global economy will remain moderate even though oil prices will probably stay over USD 90 till tensions subside.

Japan

After the earthquake and the Tsunami which have had devastating effects on the lives of the people of Japan, they now face the invisible treat of radiation which would have much longer lasting effects. The situation in Japan is very fragile at the moment and it is impossible to gauge the likelihood of the military getting the nuclear power plants under control.

OUR OPINION: If the nuclear situation in Japan is contained and there are no further after shocks similar to the magnitude of the one that caused all of this devastation, we believe that the medium term future of Japan looks positive. The economy is expected to grow 2% due to investment in reconstruction. This is twice the growth of the recent past and would help the country move away from the deflationary cycle it has been stuck in for decades. As most Japanese and especially corporations are well insured, re-construction should move forward at a brisk pace. Steel production has been affected in the world's second largest producer which will help steel producers in other countries increase their revenues. Demand for copper, cement and construction equipment should rise and this will be very positive for the raw material and construction machinery sectors. All of this should start to happen three months from now and show clearly six months from now. The largest Japanese automobile manufacturers are shifting as much production to the US as possible. This will be beneficial to US employment figures and hours worked.

Many investors are making comparisons to Kobe 1995 when the equity market fell 22% over six months. However, there are two key differences. Markets in Japan were 40% higher in 1995 than they were when the earthquake struck this time. Also, the trailing EPS (earnings per share) in Japan is three times the best level of the 1990s. Therefore fundamentally the market is much more attractive. We have not been invested in Japan for our private clients but believe that it is worth taking a more in depth look at individual stocks at current levels.

General Thoughts

We believe that 2011 is the year when cheap credit and excess cash is put to use by companies in a way that will improve return on equity. From 2007-2009 companies were working for the bondholders and equities suffered. Since 2009 companies are working for equity holders again. From 2010 onward the skew will be more towards equity holders. Therefore strategically we believe investors should be more exposed to equities and less to bonds than they have been over the past decade.

Tactically, we were expecting a market setback even before the devastation in Japan. Sentiment was too euphoric and valuations were getting stretched. We had therefore cut back on our client's equity holdings and moved the remaining equity exposure to more defensive, high dividend yield stocks and away from the more cyclical sectors. This change in position in the month of February has benefited our clients in the recent market setback and opened up opportunities for us to buy back some of the more cyclical stocks which have now corrected substantially and which we believe have good potential for the medium term. We will proceed with caution but will keep an eye out for the opportunities that arise due to all of this turmoil.

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