

Conditions are tough despite recent good news, and more solid improvement is needed

The true meaning of signs of recovery

MARKET WATCH
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Both sterling and the price of oil are at seven-month highs, while house prices and high-street sales have fallen again. But mortgage approvals are stronger and factory output has improved. With a spring in the step of the FTSE, what are investors to make of it?

There are few people in public life who have enhanced their reputation as a result of this recession. In parliament, Vince Cable bucks the trend, while among the Bank of England's Monetary Policy Committee members, it was David Blanchflower's lone voice that called for interest rate cuts before it became fashionable.

Retiring from the MPC, Mr Blanchflower has opined recently that decline has slowed and there are tentative signs of recovery, but that conditions remain tough and we are "not out of it yet", with months of unemployment to come.

While stock markets have rebounded off the back of good news, there is very little underpinning recovery in the UK and Europe. And while all eyes are on the US to pull the world out of recession, China could be just as important.

From the US, perhaps the biggest

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industrial news to emerge has been the General Motors bankruptcy. Once the biggest company in the world, the decline of GM will affect jobs in the US and in Europe.

Though manufacturing continues to contract in the US – albeit at a slower pace – the sector actually expanded in China during May.

At \$770bn (£474bn), China remains the biggest foreign investor in US government bonds. But as one of only a handful of countries that will record positive growth in 2009, China has sought assurance from the US Treasury that Chinese investments in the US are 'very safe'.

The irony is, amid all this mixed news, shares have actually experienced a genuine bull market since March, having firmly broken through the 20 per cent gains.

While indicators such as earnings ratios suggest the market to be of reasonable value, there is perhaps too little value to expect much further progress in the short term, and some investors must be considering taking profits.

For the Bank of England, managing the incipient recovery will be even more precarious than handling the downturn.

While government and central banks threw money at the recession and dropped interest rates rapidly, if late, more difficult judgments lie ahead.

In the UK, quantitative easing has meant printing pounds and holding base rates close to zero. Such policy is ultimately inflationary, and public borrowing is skyrocketing.

At some point, monetary policy needs to be tightened to control price rises, as does fiscal policy to reduce the deficit.

Markets appear to be fair value and offer opportunities for those seeking quality or drip-feeding funds. But investors will want to see firmer economic indicators before they call a real equity-market recovery.

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