

What to expect of government fiscal stimuli, a weak pound and the direction of the FTSE

Keep a close eye on the medium term

MARKET WATCH
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Times are hard for policy-makers and investors alike. Readjusting portfolios to the rapidly changing economic conditions is a challenge. Confidence has felt the pressure. But there is a misconception about sterling. From most of the talk, anyone would think an exhausted pound had expired, damaging our economy and industries.

It is true that sterling has fallen sharply from recent highs to the current \$1.38. The cut in interest rates has only underlined the position. And, according to Société Générale, astute investors who bought their sterling/dollar put covered warrant back in the summer have seen them return a staggering 1,760 per cent in just a few months. But the exchange rate drop in itself is no reason to panic. The pound bobbed along at these levels during 2000-02 and helped maintain UK growth at a time when other western economies declined. Surely this is the point for investors.

The theme of chancellor Alistair Darling's recent pre-Budget report – ahead of a Budget arguably more important than any in a decade – was fiscal stimulus, with the measures pumping roughly £20bn into the

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British economy. While we might all be grumbling at the rising cost of margaritas and foreign holidays, we need not worry too much about the inflationary effects of the pound. The chancellor forecast UK inflation would fall to a low of 0.5 per cent in 2009 – the lowest in comparable history – with the danger now deflation, meaning lower long-term interest rates.

While there are concerns about the government's ability to repay debt if its projections for a V-shaped recovery do not hold, a weak pound is not all bad news. As such, a 25 per cent fall in sterling means a similar discount in the cost of British exports around the world. If ever there were a fiscal stimulus, this could be it.

The direction of the FTSE into 2009 remains uncertain. Every major world economy is now facing a downturn.

The chancellor's fiscal stimulus is dwarfed by banks' liquidity issues. After all, Royal Bank of Scotland shareholders alone accepted a government bailout in November of £20bn. Combined, these measures can only boost the markets' discounting mechanisms, even if they cannot themselves counteract recession.

Taking a view on medium-term market movements and underlying economic conditions means altered investment strategies. It is perhaps for this reason that Soc Gen has diversified its product range, launching structured products for these uncertain times. I was interested to see its new product, SG77, where capital is at risk only if the market should fall 50 per cent with an interest-rate-busting coupon of 10.5 per cent. Surely it's an instrument to match the times.

The level of sterling will have a more positive effect on the economy than the scaremongers would have us believe, but it has also shaped investment product choice. And with investment considerations increasingly taking a macro level, being able to take a measured view of the market is more important than ever.

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