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The recession is over... time to be cautious

History shows that an economic recovery could be a signal to tread carefully. We look at defensive areas to shelter your savings



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Britain may be limping its way out of recession, but this does not mean an easy ride for your investments.

The economy grew by 0.1% in the final three months of last year — the first positive change for six consecutive quarters— marking the end of its longest continuous slide in the post-war period.

However, the rise was far less than the 0.4% analysts had expected, leading some to say that the economy could suffer a double dip, with growth falling back again this year. Others expect the figures to be revised up in the near future.

Reflecting the uncertainty, star fund manager Anthony Bolton, president of Fidelity International, has warned we could be in the midst of this bull market's first serious setback: the FTSE 100 has fallen 3% to 5,189 since the start of the year.

"Markets are worrying less about the recovery and more about what happens after that," Bolton said at a seminar last week organised by Saunderson House, the wealth manager. "What we are seeing now could be the first major consolidation phase [price falls] for this bull market."

Meanwhile, research from Morgan Stanley, the investment bank, found that shares declined by an average 23% in the 12 months following a peak in economic indicators — the smallest fall was 12% in 1999 and the largest was 36% in 1987.

It thinks the OECD's economic indicators for the UK, currently at their highest level since 1987, are likely to peak soon — bad news for share prices.

Graham Secker, analyst at the bank, said: "The FTSE All-Share has risen only once in the 12 months after a peak in economic indicators and that was from October 1999 to October 2000, when markets were in the grip of the tech bubble."

So for the time being, how you select sectors and shares for investment is crucial.

Mark Barnett, who manages the Invesco Perpetual UK Strategic Income fund, said: "We are already seeing a stock market correction. Following strong rises last year, we are now anticipating quite a setback. It was not a normal recession and, therefore, we will not get normal recovery."

We look at defensive areas to shelter your savings while you ride out the turbulence.

RISING DIVIDENDS

Most of the big cuts to dividends from UK shares have already taken place, said Ted Scott at F&C, the fund manager, so it ought now to be safe to get back in and start investing for income.

The added benefit here is that some firms will have good scope to increase dividends as the economy gradually recovers, whereas income from gilts and corporate bonds is fixed.

Furthermore, defensive stocks in sectors such as utilities, tobacco, pharmaceuticals, telecoms and support services, which traditionally show strong dividend growth, are still cheap.

"These are the steady growth areas where company shares usually trade at a premium to the rest of the market but they are now at a discount," said Barnett. "This is a very good opportunity."

Ben Yearsley at Hargreaves Lansdown, the adviser, said: "In tough times, defensives give you a predictable income as people can't stop using gas, electricity and water."

For investors who do not wish to select stocks themselves, an equity income fund can be a good way to tap into these stocks. Most investment funds levy an annual management charge of about 1.5% and an initial charge of about 5%. However, many advisers and fund brokers will refund initial charges to investors.

Yearsley and Martin Bamford at Informed Choice, another adviser, recommend Invesco's Income and High Income funds, managed by Neil Woodford, which have produced consistent longer term returns.

PHARMACEUTICALS AND HEALTHCARE

These sectors are good examples of defensive areas that were left behind by last year's rally: the sector is up only 1% in the past 12 months, against nearly 30% for the All-Share. Glaxo Smith Kline, for example, is trading on an all-time low price-to-earnings (p/e) ratio of just under 10. This means its share price is just 10 times earnings. It has a dividend yield of 5.2% and this is expected to grow at 7% or 8% a year. "It is about as cheap as it has ever been," said Barnett.

Scott added that if the US dollar rallied against the pound this year, as expected, this would translate into higher earnings for companies in the pharmaceuticals arena that make a high proportion of their earnings in America.

For those who prefer to use a pooled fund to invest in shares, Rob Burgeman at Brewin Dolphin, the broker, recommends the Finsbury Worldwide Pharmaceuticals or Biotech Growth trusts. Yearsley likes the Framlington Health fund.

UTILITIES

This is another area where consumers have no choice but to continue spending, but it has not yet benefited from last year's stock market bounce: it is up only 5.7% over the past 12 months compared with 28.4% for the FTSE All-Share.

"The dividend yields in this sector are, frankly, too good to resist, and these are the companies that have grown dividends the most over the past 10 years," said Barnett.

United Utilities and National Grid, for example, yield more than 6%, and Scottish & Southern 6.2%. National Grid, in particular, has a strong exposure to huge infrastructure developments in Britain and America, where ageing pipes are being replaced.

Burgeman recommends HSBC's Infrastructure fund or 3i Infrastructure for investors looking to tap into these sorts of opportunities.

Oil companies also have good dividend yields, said Scott, with BP and Shell yielding about 6%. "These levels are very attractive in this environment, particularly as savers are looking for more income and the more defensive stocks are still quite cheap," he said.

TECHNOLOGY AND TELECOMS

The tech sector has always outperformed the market in the 12 months after a peak in the economy, with an average gain of 14.7%, according to the research by Morgan Stanley.

As we approach the 10th anniversary of the collapse in technology stocks, some advisers are again recommending the sector.

Yearsley said: "A lot of companies are trying to make themselves more efficient and technology is a good way to do that. If you are a software provider, you also tend to have low overheads." He recommends the GLG Technology fund.

However, Bamford said some tech firms might continue to struggle in the credit crunch. "If they find it hard to get hold of the cash they need to grow, that could hold them back," he said. "I would say this sector should be regarded as quite adventurous and risky."

Telecoms companies, on the other hand, are performing well, with BT and Vodafone yielding 6% to 7%, said Scott.

SELECTIVE ON CONSUMER STOCKS

Retailers are among the worst performers in the 12 months following a peak in the economy, falling by an average 10.8%, according to Morgan Stanley. Construction stocks and insurers also do badly, with falls of 11.8% and 7.4% respectively.

However, Secker at Morgan Stanley would not abandon consumer stocks entirely. "We would caution against getting too bearish on the UK and would not necessarily exclude all stocks sensitive to the economy from a portfolio," he said.

For investors who may want to increase their holdings in the UK, he would recommend Barratt Developments, the housebuilder; ITV; and JD Wetherspoon and Whitbread, the leisure companies.

TAKING A BALANCED VIEW



James Neale, 37, a property developer from south London, said uncertainty about the economic climate and the stock market have made him naturally more defensive when it comes to his investments. Neale, pictured with wife Vanessa, 35, and son, Jake, 2, is considering where to invest his Isa allowance before the end of the tax year. "I think I will just stick with my Schroder Income fund because it is the safest bet at the moment."

A NEW LOOK FOR MY ISA



Kate Cotta, 43, has overhauled her Isa savings with Investors Planning Associates, her adviser, to take a more cautious stance.

Cotta, a teaching assistant who lives with daughters Caroline, 14, and Christina, 12, in Cheltenham, said: "I am concerned to make sure my investments are as secure as possible."

In her Vantage Isa she has investment funds that take a particularly defensive slant, such as Invesco Perpetual Income and First State Emerging Markets.

FINANCE CHECK

Consumers are being urged to take stock of their household finances amid a sluggish return to growth.

Fix your mortgage

Lenders including Santander, Cheltenham & Gloucester and Yorkshire building society cut fixed and tracker mortgages by up to 0.4 percentage points last week.

The best two-year fix fell to 3.29% after Yorkshire cut rates for those with a 40% deposit. The deal has a £1,195 fee, replacing Principality's at 3.44% with a fee of £999.

The best five-year deal is unchanged — HSBC at 4.73% with a fee of £999. The best lifetime tracker is also from HSBC at 2.49% with a £999 fee.

Last week's economic data supported the view that interest rates could remain on hold until the autumn, but even then borrowers with all but the biggest deposits would be better off fixing, according to Aaron Strutt of Trinity Financial Group, a broker.

Find a holiday money window

Following Tuesday's data, sterling fell against the euro and the dollar but soon rebounded to €1.15. It closed unchanged against the dollar over the week at \$1.61.

Sterling has risen steadily against the euro and is back at levels not seen since August 2009.

Holidaymakers hoping to pick the right time to convert their pounds to euros should do so ahead of the election, which could hit sterling again.

Pay down your debts

Credit card and loan providers are making their offers more attractive to lure consumers, but be careful of taking on more debt. Business groups say pay freezes are likely for another year, while unemployment is widely expected to rise.

Don't bank on property

House prices rose 1.2% in January, according to Nationwide, but experts do not expect the rally to continue, with some predicting that values could fall another 10%.