

MARKET STRATEGY

INVESTMENT RESEARCH

18 July 2008

Mike Lenhoff – Chief Strategist

Tel: 0845 213 3360; e-mail: mike.lenhoff@brewin.co.uk

A catalyst that could boost equity markets.



Source: DATASTREAM

As a colleague likes to put it, the cascading sequence of lower highs and lower lows shown in the chart of the FTSE 100 ex resources is as good a way as any of visualizing what it means to be in a bear market. Not only does it convey a sense of failure in the market's energy to sustain a rally - there is the constant dashing of hope - but it also illustrates the sense in which that failure encourages a drive to new lows with a vengeance. And so it goes until that pattern of lower highs and lower lows is finally broken on the upside.

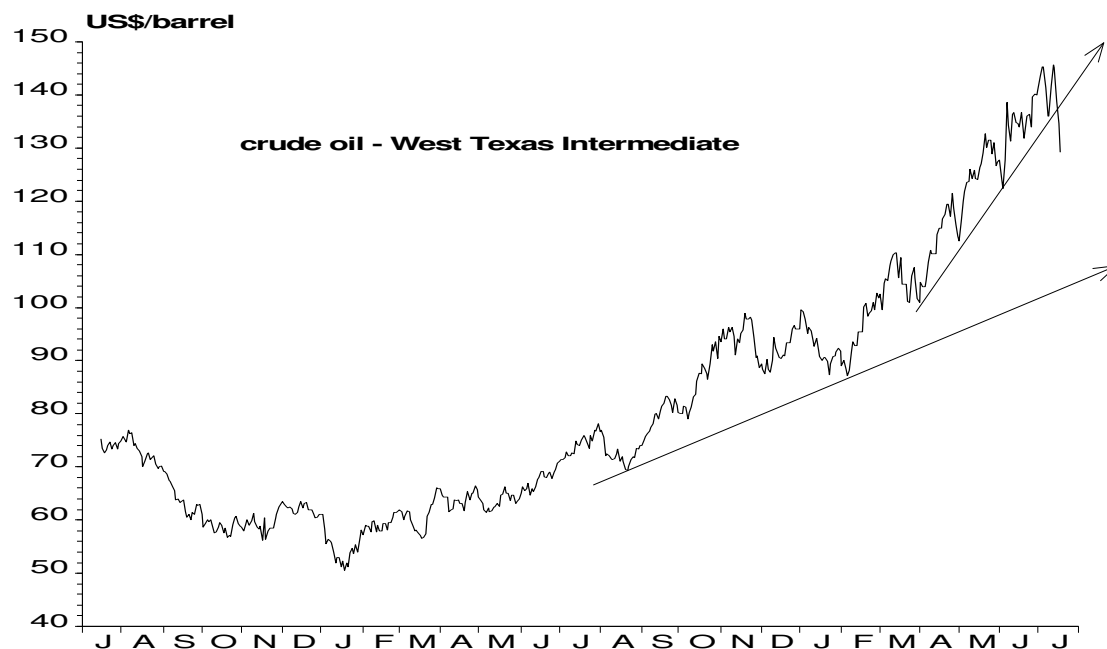
Quite aside from the underlying fundamentals, a bear market is not just about falling share prices. There is a time dimension to it. There is diminishing liquidity in some areas of the market. Rallies turn quickly into damp squibs. Oversold conditions become more extreme. Expectations disappoint time and again. The barrier to making money becomes ever more formidable. Indeed, there is wealth destruction. There is the tedium of it all, the test of wills and ultimately there is capitulation.

Then suddenly things change. A new leadership emerges and away we go. Ah yes, but when? When??

If only this could be unconditionally or unequivocally answered but it can't. On the other hand, if the oil price, which has dropped in recent days, gives way further and heads down towards \$100 per barrel, I think three things would happen. First, the drop in inflation, which would come through reasonably quickly, would be accompanied by a downward revision in inflation expectations which would help to lift the pressure that the central banks feel under to raise interest rates. Second, and because of this, yields at the both the short and the long end of the government bond markets would fall. Third, this downward shift in the yield curve would lead to an immediate improvement in the valuation for equity markets.

Actually, the influence on inflation expectations is not so easy to articulate because the stimulus to economic growth provided by a sizable drop in oil prices could influence expectations of core inflation and that could keep yields up at the long end of the bond markets. However, the stimulus to growth would help to lift expectations for corporate earnings too, which would help the corporate bond markets and reduce yield spreads, thus helping to put the appetite for risk back onto the table. All that would give equity markets a big boost.

Of course that is jumping the gun over the latest developments in the oil price. The oil market is as volatile as any market and we could find the oil price back up to its previous highs in no time on the slightest of provocations. However, the point is that sentiment could turn rapidly for the better on good news flow and, given the value which we think exists in equity markets, the kind of rebound that followed the rescue of Bear Stearns in mid-March could be easily repeated. We just need the catalyst and a further drop in the oil price could provide it.



Source: DATASTREAM

☆

☆ The information contained in this report has been taken from sources disclosed in this presentation and is believed to be reliable and accurate, but without further investigation cannot be warranted as to accuracy or completeness. The opinions expressed in this document are not the views held throughout Brewin Dolphin Ltd. No Director, representative or employee of Brewin Dolphin Ltd. accepts liability for any direct or consequential loss arising from the use of this document or its contents. We or a connected person may have positions in or options on the securities mentioned herein or may buy, sell or offer to make a purchase or sale of such securities from time to time. In addition we reserve the right to act as principal or agent with regard to the sale or purchase of any security mentioned in this document. For further information, please refer to our conflicts policy which is available on request or can be accessed via our website at www.brewindolphin.co.uk. The value of your investment or any income from it may fall and you may get back less than you invested. Past performance is not a guide to future performance. If you are in any doubt concerning the suitability of these investments for your portfolio you should seek the advice of a qualified investment adviser. Brewin Dolphin Ltd, a member of the London Stock Exchange, authorised and regulated by the Financial Services Authority. Registered office: 12 Smithfield Street London EC1A 9BD. Registered in England and Wales no 2135876.