NEW MINERVA REPORT

Is It All Over?

Most of the major stockmarkets saw a bottom in the middle of July. These lows coincided with a peak in the oil price and many other commodities. This was indicative of a recent phenomenon, where share prices and the oil price have become negatively correlated. For nearly five years prior to May, the oil price was highly correlated with share prices. This demonstrates how inflation, with upward pressure from the rising oil price, has become a major concern to markets. Another interesting point noted in the movement of shares from the lows in July, is how quickly bank shares and other financials have risen. A couple of examples are Barclay's Bank, which went from 260p to 356p, a rise of 36% and RBS which went from 167p to 221p a rise of 32%. These dramatic changes have prompted many commentators to question whether we have now seen the bottoms in the markets.

If you look at the economic statistics currently being released, they are all pointing to worsening conditions. In the UK, GDP slowed to 0.2% in the second quarter. The first quarter's was just 0.3%, which when annualised shows growth of just 1%. Retail sales in June were down 3.9%. Property prices, according to Nationwide, were down 1.7% (or £15,000 per house) in June. Mortgage approvals in June fell to 36,000, down from 41,000 in May. This is the lowest figure since the data was first published in 1993. On the other hand, consumer price inflation rose 3.8% in July, and that's 1.8% above the Bank of England's target. The Retail price index is now at 4.6%. Energy prices are still rising, despite the oil price moving lower, demonstrated by the announcement that British Gas are raising prices by 35%.

In our view there are four reasons why the UK and the US economies will continue to slow, and may even go into a recession. The consumer, which represents 70% of the economy, is being squeezed from all directions. The jump in food and fuel prices means they have less to spend on other items. The fall in property prices means they are not only feeling less well-off, but also no longer able to withdraw equity from their properties, and spend it. In the US we have already seen unemployment rising, and we are just seeing the first signs of it rising in the UK. In the past few years consumers have been able to overcome some of these problems by borrowing money. The 'credit crunch' has closed this avenue. In any case, due to the excessive borrowing in the last few years, many are now looking to reduce their borrowing and are starting to save where they are able to.

Markets always look forwards. The question is whether all this bad news is in the price. At the moment we don't believe it is, and we are currently experiencing a rally in a bear market.

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