

# PLAYING A WAITING GAME



EQUITIES HAVE BEEN THROUGH ANOTHER TOUGH YEAR, SO WILL 2003 SEE INVESTORS CHANGE THEIR TUNE AND RETURN TO THE EQUITIES FOLD? **CHRIS TRACEY** OF JPMORGAN FLEMING ASSET MANAGEMENT LOOKS AHEAD

## ■ WHAT MAJOR PROBLEMS AND OPPORTUNITIES DO YOU EXPECT IN 2003?

The main problems will continue to be the low level of economic growth globally and the low level of inflation, which at least outside the UK and Europe will remain perilously close to deflation. Such is the level of overcapacity that prices of a wide range of traded goods will continue to fall. Therefore, even in the absence of recession, the outlook for corporate profits will remain tough – although, globally, we predict some growth, probably in single digits. The absence of an inflation problem, however, will keep interest rates low. Main opportunities for investors will be in taking advantage of continued fears of recession/deflation to pick up equities with good dividend yields, particularly those with yields in excess of the local government bonds. A key indicator of confidence returning to risk assets will be a narrowing of spreads of corporate bonds, a good sign that concerns about credit risk are lessening.

## ■ WHAT PRICING TRENDS DO YOU ANTICIPATE IN 2003?

The valuation of UK equities relative to gilts is currently at levels last seen in the early 1960s, suggesting little, if any, dividend growth over several years. This reflects the concerns by equity holders that a world of very low inflation leaves the corporate sector with little pricing power – and therefore with profits growth rates that, in turn, will be very low by historic standards. It is possible, though, to assemble a portfolio of UK shares in companies with good balance sheets, whose dividend yields exceed the redemption yield on long duration gilts. We believe this is a valuation anomaly that will be corrected in time and in the meantime income will exceed that on most alternative assets.

## ■ WHAT TRENDS IN CURRENCY, DEAL TYPE AND STRUCTURING DO YOU EXPECT?

The prospects for IPOs in 2003 is likely to remain subdued, and some quoted companies may continue to look to go private.

## ■ WHAT TRENDS DO YOU EXPECT IN INVESTOR APPETITE AND, IF 2003 IS GOING TO BE AN INVESTOR-DRIVEN MARKET, WHAT COMPROMISES WILL ISSUERS HAVE TO CONSIDER TO GET THEIR DEALS COMPLETED?

**‘THE PROSPECTS FOR IPOs IN 2003 IS LIKELY TO REMAIN SUBDUED, AND SOME QUOTED COMPANIES MAY CONTINUE TO LOOK TO GO PRIVATE.’**

It is quite possible that it is going to be an investor-driven market, but the trend through 2003 will be for investors to gravitate more towards instruments that behave like equities, rather than bonds. High-yield corporate bonds that have behaved like distressed equities are likely to outperform convertibles when investors perceive that credit risk (as evidenced in the default rate) is decreasing, reflecting more confidence that the world is not going to slip into recession, with debt deflation a possible consequence.

## ■ WHAT DEVELOPMENTS DO YOU FORSEE IN ASSET-BACKED, COLLATERALISED AND SECURITISED ISSUANCE?

A trend by pension funds towards fixed income has already been in place for some years as the maturity profile has increased, albeit that the trend accelerated as a result of the bear market. If equities start to stabilise and recover in 2003 then, given the huge outperformance of bonds over equities since the peak of the bull market, it is possible that the flows from equities into bonds may reverse.

## ■ WHAT ARE THE PROSPECTS FOR HIGH-YIELD ISSUANCE?

The new corporate initiatives are more likely to have a more positive than negative effect on equities, particularly in the US. But we do not see these as having anything like the impact as an improved economic environment.

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