

Inflation winds equity markets

The summer season is not unused to finding the equity markets in the doldrums, but this year the prospect of accelerating inflation has left little wind in the market's sails. The expectation of a counteractive rise in interest rates has sent markets to lower levels which, compounded by low volumes, has, among other things, resulted in an increase in the magnitude of daily market swings. This rise in volatility has meant that those seeking to guard against the toppiness of the market have been faced with higher costs for insuring equity positions by purchasing put options.

It is interesting to observe that while short-term volatility has risen, longer term volatility has remained stable and is in fact below its two-year mean level. If volatility is taken as a measure of future uncertainty, this phenomenon may be viewed as a demonstration of confidence in the health of the long-term economy. In other words, the short-term nervousness regarding the

course of the market does not extend to uncertainty about the longer term fundamentals. There are perhaps many explanations for this confidence, but an interesting angle may include the extent to which it is attributable to the wider acceptance of shareholder value principles throughout mainstream corporate Europe and the longer term market benefits that this will ultimately bring.

A new circumspection

Companies are increasingly analysing their balance sheets with a new circumspection. Whereas in the past, the connection between a company's share price and the composition of its balance sheet had received at best cursory attention, now the trend – particularly on the continent – is to judge the strategic value of every item in relation to its contribution to shareholder return. In the same way, companies are more alive to the efficiency of resource allocation and are less willing to allow excessive dilution of future earnings or equity.

This manifests itself in many areas. Perhaps most evident is the increase in share buyback activity. Companies are less inclined to invest surplus cash in low yielding assets if shareholders can obtain better returns elsewhere. By buying back its own shares, the company not only returns value to shareholders, but also enhances the value of its remaining shares.

The asset side of the balance sheet is being subjected to a similar scrutiny. In particular, the network of cross shareholdings that had traditionally weaved throughout much of the European corporate fabric is being gradually unravelled as the strategic importance of these alliances dwindles and more pragmatic concerns regarding the concentration of market risk prevail.

So perhaps it is not so surprising that long-term uncertainty as to the future performance of the equity markets does not appear to be an issue. If companies continue to get their balance sheets in order, then all other things being equal this will naturally be rewarded through share price growth.

However, experience tends to suggest that things seldom remain equal for long. ■

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INTERNATIONAL EQUITIES

These are a selection of issues announced recently. The details, updated to the middle of last month, were supplied by IFR Securities Data, London and other sources.

Issuer	Amount raised (m)	Type of issue	No shares (m)	Offer price	Pricing date	Exchange listing	Fees (%)	Bookrunner
Azurix	USD695	P, S	36.6	USD19	9 Jun/99	New York	6	Merrill Lynch
eXchange	GBP163.4	P, S	81.7	GBP2	6 Aug/99	London	4	Warburg Dillon Read
<i>Comment: On-line financial services provider. The company provides insurance related products on the internet.</i>								
Freeserve	GBP264	P, S	176	GBP1.5	26 Jul/99	London NASDAQ	4.5	Credit Suisse First Boston Cazenove
<i>Comment: Proceeds will be used for general corporate purposes.</i>								
Future Network	GBP173.25	P	45	GBP3.85	17 Jun/99	London		Morgan Stanley Dean Witter
<i>Comment: The proceeds of the sale will be used to repay debt incurred in the management buy-out and to develop the company's US and German operations, including its internet activities.</i>								
Ryanair	GBP155.9	S	28.9	GBP5.4	8 Jun/99	Dublin London NASDAQ		Morgan Stanley Dean Witter
<i>Comment: A leading European low-cost airline. Shares being sold by major shareholders.</i>								
Telecom Eireann	EUR4,216	P	108.2	EUR3.9	7 Jul/99	Dublin London New York		Merrill Lynch

P = primary; S = secondary; IPO = initial public offering; D = demerger.