



Brussels sprouted

It is terribly tempting to chunter on about the death of European democracy. In the past week we have witnessed two democratically elected prime ministers hounded from office because it has been demanded by 'the markets'. Some will argue that what we are seeing is the disenfranchisement of large chunks of the population of Europe in the name of alleged good economic management. Any country that has signed up to the euro has clearly foregone the right to mismanage its economy into bankruptcy, or at least the right to be able to try to rescue itself after it has spent its way into oblivion. In the UK we may have betented swampies at St Paul's, but they are protesting about cuts cultivated in Whitehall rather than Brussels or Berlin. Even the naturally reserved English might feel the upper lip twitching at the prospect of job cuts grown in Europe.

This week however we are also discussing inflation. On Wednesday the Bank of England publishes its last Inflation Report for the year in which it will give its last pre-2012 forecasts. The gist of this is already well known: growth is lousy and inflation will fall quickly. The inflation side of this is important. The latest calculations of the indices will be published on Tuesday, which should show that CPI has already passed its peak with a small fall from last month's 5.2%.

Last week the British Retail Consortium reported that its measure of shop price inflation has fallen to a mere 2.1%. The producer price index, which is commonly referred to as 'factory gate prices', has dropped back to an annualized 5.7% from September's 6.3%, the lowest level since May. On the other side of the world the rate of increase in the Chinese CPI has fallen from 6.1% to 5.5%. This morning though there has been a small disappointment from India, where inflation has been reported unchanged at 9.72%.

All the efforts currently being made to reflate and restimulate the global economy cannot disguise that we are coming to the end of an inflation cycle. Wage pressures across the developed world are next to zero, while energy, commodity and agricultural prices are no longer the damaging force that they were. All of which means that the chances of interest rates rising anywhere across the mature world in the foreseeable future are pretty much zero. So life as a central banker ought to become a great deal easier. The monthly (or near monthly meetings) should now be about whether more stimulus is needed, to which the answers will be no. Lower inflation will help corporate profits, the economies will grow (slowly, but with the exception of the Eurozone they will grow) and strangely everything in 2012 ought to be rather uninteresting.

Which brings us back to Europe. The world should in theory be dull for the majority next year, but in practice that really is terribly unlikely. Our confidence in anything material and permanent happening to Europe is minimal. Berlusconi's long career warns us that this is most unlikely to be the last we shall see of him and it is surely only a matter of time until Greece has to return to the EFSF with its begging bowl. Lucas Papademos and Mario Monti can be no more than temporary stop gaps until elections are held, and these will be votes that will test the willingness of the Greek and Italian electorates to stay in an organization that will be blamed for leading them into misery and to which they are now required to hand over significant parts of their sovereignty. Let us just say that this will keep markets on their toes.

And this is without even mentioning the alleged option of the 'two speed Eurozone'. The idea of pushing the fringe countries out into a 'eurolite' is reported to be gaining favour, especially with Mr Sarkozy. The French President is showing every sign of wanting to enter wedlock with Germany and let everyone else go and look after themselves. Which leaves us wondering who he thinks is going to pay for the recapitalization of his banks that will be needed as a consequence and also how he thinks the Merkozy empire will escape the inevitable recession-cum-depression across Greater Europe? And very interestingly, Chancellor Merkel appears to be taking a rather different view and has reconfirmed her commitment to a very large Eurozone. Cracks are appearing at the core.

Finally, the elephant is the only land mammal that can't jump. Today, where did Salvador Dali live?

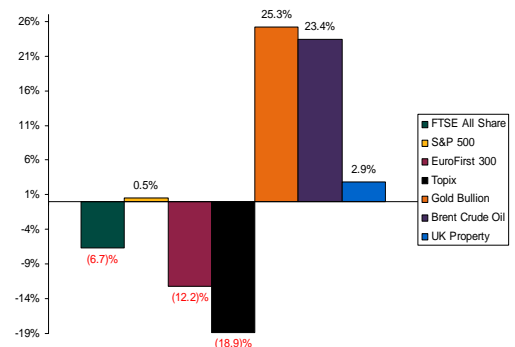
FTSE 100 Weekly Winners

Man Group	6.6%
ICAP	5.7%
Anglo American	5.5%
Vodafone	4.1%
Experian	3.8%
AMEC	3.7%
Severn Trent	3.6%

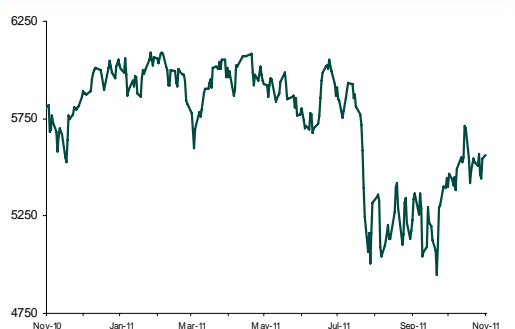
FTSE 100 Weekly Losers

Admiral	-29.2%
Vedanta	-7.6%
Essar	-7.5%
HSBC	-6.8%
Capita	-6.6%
International Airlines Group	-5.2%
Tullow Oil	-4.3%

Year To Date Market Performance



FTSE 100 Index, Past 12 Months



source: Thomson Reuters



Selected stock comments

Vodafone – BUY 173p (TP 200p) Vodafone's interim results were in line with expectations. Operating profit guidance for the full year has been edged up to the upper half of the previous range and free cash flow guidance maintained. There will be a 4p special dividend representing the pledged payout in respect of the Verizon Wireless dividend, which we expect to be a continuing feature. Vodafone remains our clear preference in telecoms for its exposure to emerging markets and mobile data and improving cash flow story; we retain our BUY recommendation and 200p price target.

Balfour Beatty – BUY 238p (TP 365p) A third quarter update confirmed that trading was in line with expectations. Its order book is strong at £15.5bn and the company had an average net cash balance of £240m at the end of September. Short term, trading is challenging but Balfour is a diversified company and longer term it is well positioned to benefit from the need for infrastructure spending across the world. We view the company's valuation on a 2011 p/e of 6.8x with a prospective yield of 5.5% as attractive.

BP – ADD 447p (TP 500p) Nobody was surprised to hear that the disposal of 60% of Pan American Energy had collapsed given rumours of acrimony between the parties. The \$7.1bn proceeds were a large part of BP's \$45bn disposal programme but given the stronger financial position that BP is now in, courtesy of a strong oil price and some agreements with key partners in Macondo, it is not a major problem and we keep our target price unchanged at 500p, where the prospective yield is 3.5%. ADD.

Rentokil – Downgrade to REDUCE 67p (TP 60p) Rentokil has released its third quarter trading statement. The turnaround plan is said to be progressing well. However, with year to date adjusted operating profits down 11% and equivalent operating cash flow down 40%, there is little evidence. The announcement is full of positive language backed up by dreadful financials such as with City Link where the 4th quarter is expected to improve significantly – one would hope so given that losses here have more than quadrupled in the first 9 months.

This Week's Forthcoming Events

UK	Oct CPI (m/m & y/y)
UK	BoE quarterly inflation report
UK	Oct retail sales (m/m & y/y)
US	Oct PPI (m/m)
US	Oct retail sales (m/m)
US	Nov Empire State survey
US	Oct CPI (m/m)
US	Oct housing starts
US	Nov Philadelphia Fed survey
US	Oct leading indicators
Emu	Sep industrial production

Last Week's Highlights

Yule Catto & Co - Downgrade to HOLD

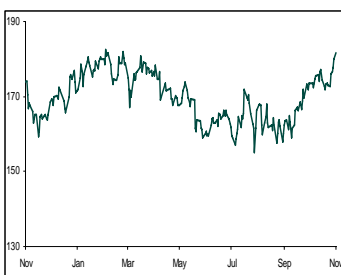
Tullow Oil - Downgrade to HOLD

Launch of the HSBC FTSE 8% Range note

Bank of England maintained UK interest rate at 0.5% for 32nd month

China's CPI for October was reported at 5.5%

Vodafone



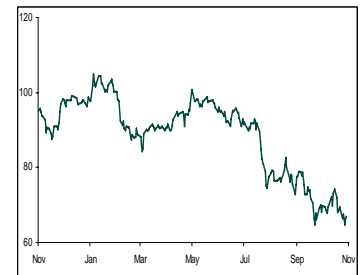
Balfour Beatty



BP



Rentokil Initial



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