



A stitch in time

If all the influences acting in a system cancel each other out it results in a stable environment, otherwise known as equilibrium. It sounds simple enough but can be very difficult to maintain. Take economies for example. They go through cycles of growth and contraction and then back to growth. Speedy action is often required to prevent a situation from straying too far from equilibrium, and without it serious problems can ensue. The Eurozone and US debt crises are cases in point.

However, it is possible to recover from a severe state of disequilibrium. Some of the economies that are now in good shape were once in the throes of debt crises. For example, in 1994 Canadian officials watched nervously as the clock ticked down with thirty minutes left before a bond auction closed and there were yet to be any bids. The country had been downgraded by Standard and Poor's from its AAA status. Bond yields were soaring. Market commentators were sceptical of its prospects. Debt had swelled up to 68% of gross domestic product. Sound familiar?

Roll forward a decade and Canada is a bastion of stability and a paragon of fiscal discipline. Her books are balanced and debt is under control. Bond rates are low and the currency is strong. It went through the 2008/9 crisis and bounced back quickly. Unemployment has been steadily decreasing from a peak of 8.7% in 2009 to 7.3% at the last reading. Maybe, just maybe, Canada's transformation from pariah to fiscal darling could provide valuable lessons for the nations currently groaning under the weight of debt.

The lessons learned from Canada's experience are by no means cut and paste. However, we would highlight three elements of the Canadian solution that the world's currently indebted nations might do well to emulate. First would be a slowing in the pace of government spending and a shrinking of the size of government. Reduced government spending would not only be positive for the budget but would also send a message to the voters that the government is serious about and also willing to take the pain of austerity. And that is why it should be a huge chunk of the whole programme. The current austerity programme in the UK is only restraining the rate of growth in the deficit and will make hardly any inroads into the relative size of the government sector.

Second would be an increase in tax revenues. This could be achieved through increasing tax collection efficiency, simplifying the tax code or increasing taxes. Again, different countries have different needs here. The emphasis of a tax regime should be on pragmatism rather than on ideology; an example would be making tax increases conditional upon meeting certain spending targets. However, the ongoing impasse in the US illustrates how difficult it can be for pragmatism to hold sway over dogma.

Finally, there needs to be a political will to act and to act quickly. Rising bond yields can trigger a vicious cycle that escalates a liquidity problem into a full-blown solvency crisis – and very quickly. It therefore makes us concerned to see cheap politicking taking centre stage in the US while fundamental differences and maybe self-interest stymies the political process in Europe.

Monetary policies should focus on money supply growth and boosting competitiveness while fiscal policies should be timely and cut any slack. 'Kicking the can down the road' is not a sustainable strategy. Bold and decisive action is required. The longer the problem is left to fester, the bigger it gets. And the proverb a stitch in time saves nine springs to mind.

Finally, England reached the 1,000-goal landmark when Jimmy Greaves scored in a 5-1 win against Wales at Wembley in 1960. Today, in November 2004, Canada experienced a sudden six-fold increase in immigration inquiries. What did they put this down to?

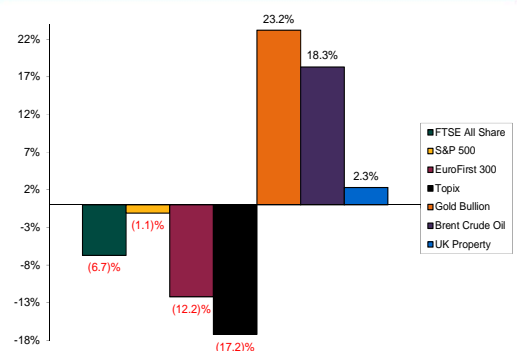
FTSE 100 Weekly Winners

Barclays	22.5%
Kazakymys	18.8%
Vedanta	17.0%
Weir	15.5%
Royal Bank of Scotland	15.4%
Antofagasta	14.8%
Schroder	14.8%

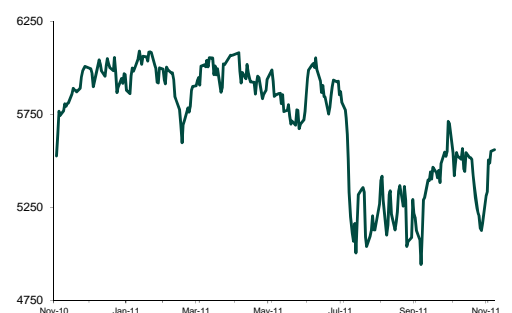
FTSE 100 Weekly Losers

National Grid	-3.8%
Randgold	-1.1%
Severn Trent	0.1%
Tate & Lyle	0.1%
Scottish & Southern	1.6%
Morrison Supermarkets	1.8%
Reckitt Benckiser	1.8%

Year To Date Market Performance



FTSE 100 Index, Past 12 Months



source: Thomson Reuters





Selected stock comments

SGE – Sage – BUY 274p (TP310p) Sage reported results for its full year that were in-line to slightly better than forecasts, apart from a surprise ‘re-basing’ of its dividend, up 25% giving a yield of 3.5%. The outlook statement contained the now customary note of caution about the eurozone but was positive in its overall tone. Sage remains our preferred pick in the technology sector. Although it is somewhat cyclical, it has high and stable margins, steadily growing free cash flow and a strong balance sheet. We retain our BUY recommendation, although note the upside is now 13%.

MARS – Marston’s – BUY 93.9p (TP 122p) Marston’s announced final results slightly ahead of expectations with a 4.8% increase in revenues and 12% increase in EPS, although the dividend of 5.8p was not increased and may not be for a year or two. Operating profits grew in all the divisions and the management expect to be able to manage cost pressures again by tight cost control and flexibility in menu management. The new pubs are performing well and the new agreements in the tenanted division are proving popular. The shares offer a good yield (4.8%) from a steady and well managed business.

BALF – Balfour Beatty – BUY 230p (TP 365p) The company announced that it has been awarded a programme management consultancy contract on a £5bn roads and drainage scheme in Qatar. The five-year commission is valued at £104m. We continue to view Balfour as good value, trading on a 2011 p/e of 6.5x with a growing prospective dividend yield of 5.8% (2.6x cover). This announcement is a reminder that it is a global group and there is a need for infrastructure spending across the world.

CNA – Centrica – ADD 288p (TP 325p) Centrica has announced a series of acquisitions of oil and gas production assets in recent weeks to support its customers’ needs in the coming decade. There were also rumours that it was bidding for RWE; the more likely event is that it is negotiating to buy some of RWE’s North Sea assets. As RWE is under financial pressure it may be able to strike a good purchase price.

This Week’s Forthcoming Events

UK	Nov CIPS services PMI
UK	Nov Halifax house price index
UK	Oct industrial production (m/m, y/y)
UK	Oct manufacturing production (m/m, y/y)
UK	Oct visible trade balance (world)
US	Nov ISM non manufacturing
US	Dec University of Michigan sentiment
Emu	Nov Composite PMI
Emu	Q3 GDP (1st estimate)
China	Nov CPI
China	Nov PPI

Last Week’s Highlights

Dixons—downgrade to REDUCE
Burberry—upgrade to BUY
Berkeley Group—downgrade to HOLD

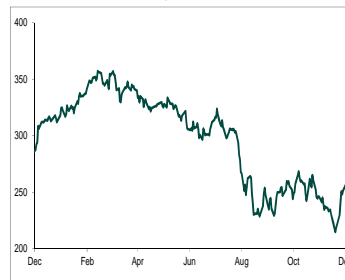
Sage



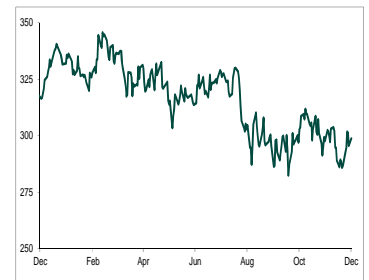
Marston’s



Balfour Beatty



Centrica



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