



The UK budget has restored some credibility, and will create opportunities for the right companies despite the weak growth outlook. Cartesian fund managers David Stevenson, Jeremy Hall and Andrew Kelly share their views on the outlook for the UK stock market.



David Stevenson, Andrew Kelly
and Jeremy Hall

Credibility restored

Prior to the UK election, a malaise hung over financial markets as investors pondered the various outcomes, and what they might mean for the fiscal and monetary environment in the UK. As commentators are fond of remarking, markets hate uncertainty and political instability. The budget of the 22nd of June, combined with the seemingly solid footing of the coalition, has done much to assuage these fears, and the UK is now enjoying a resurgence of credibility. This took immediate effect in credit and gilt markets, and we now expect to see a degree of confidence return to equities. Certainly, for asset allocators working on global models, the UK will look more attractive than its continental European neighbours, many of which are still struggling with sovereign debt issues and a credibility deficit. The decisiveness and solidarity of the UK coalition looks appealing by comparison.

But at what price?

This credibility, however, has come at a steep price. Over the course of the next parliament, the government intends to cut a total of £113bn worth of spending, through a combination of cuts to welfare programmes and departmental budgets and tax rises. The ratio of cuts to tax rises is in the region of four to one under the current plans. Over the 13 years of the Labour government, the UK's economic growth was underpinned by an expansion of the public sector. This expansion will now be quickly reversed, meaning that future growth must be driven by the private sector. It is likely that growth will be below trend during this period of tightening the strings of the public purse.

Increasing performance differentials create opportunities

In this environment, there will be an increase in performance differential among companies. For an active fund manager with flexibility and experience of different market conditions, this environment should offer ample opportunity. In general, we are cautious on companies with earnings derived mainly from the public sector. Projects that will require new capital, such as building hospitals or upgrading IT systems, will be much less common so companies such as those specialising in public

construction and infrastructure projects will suffer. Also, many of the sectors that have experienced a rally from low levels should leave investors wary as tighter economic conditions are likely to make the trading environment more challenging.

Focus on companies offering value

Cartesian is positioned for a period of depressed consumer confidence. Around a half of the UK population in employment is directly or indirectly working in the public sector. Many of these individuals will now be concerned about job security, and all public sector employees earning over £21,000 face a pay freeze for two years. Undoubtedly, these factors will affect people's economic decision making, particularly towards discretionary spend, such as big-ticket items. Therefore, we like those companies that offer consumers a value proposition. Halfords, for example, will stand to benefit as more people choose to refit or repair their cars rather than replace them. Similarly, companies that can offer cost savings to the government may do well. Although spending overall is reducing, if a company can offer an outsourced solution that saves the government money, it will be in a position to pick up profitable contracts. We also like areas that are orientated towards areas of consumer spending that will not be affected too greatly by a dip in confidence. Tobacco, food and transport all fall into this category.

Diversity and growth

One of the great strengths of being a UK equity investor is the diversity and international nature of the companies listed in London. Many investors have been seeking UK-listed proxies for international growth, with many of our competitors focusing on the mining and industrial sectors. We believe, however, that risk adjusted valuations in these areas are too high, and that there are more attractive opportunities in areas of the market less geared to an unprecedented scale of stimulus.

Stockpicking

As always, we are focussed on constructing a portfolio of good quality companies whose shares are underpriced. We are emphatically bottom-up stock pickers, aiming to place confidence on the performance of individual companies rather than macroeconomic developments. At the moment, the only macroeconomic scenario that would significantly challenge our positioning would be a full-blown resurgence in the recovery, which seems to be something of an outlier in terms of probability, particularly given the Conservative party's attitude to fiscal stimulus. We look for companies that can help themselves and have the strength in management and balance sheet to profit from a challenging situation.



The Cartesian Fund Range

Ignis Cartesian UK Opportunities Fund

Fund manager: David Stevenson (lead)
Ratings: 'AA' fund rating by Old Broad Street Research (OBSR) (at 31/05/10)
Fund size: £64.4 million (at 31/05/10)
Launched: 29 December 2005
Objective: To achieve above average returns by investing predominately in UK listed companies. The fund will consist of a concentrated portfolio of approximately 30-60 high conviction stocks. It is a 'best ideas' UK all-cap stock-picking fund, completely unconstrained and designed to deliver consistent long-term outperformance through varied economic and stock market conditions.

Ignis Cartesian UK Equity Long/Short Fund

Fund manager: Andrew Kelly (lead)
Awards: Short-listed for 2008 EuroHedge Best UK Equity Hedge Fund Award
 Short-listed for 2007 Hedge Fund Review European Performance Awards – Best Fund on a Risk Adjusted Basis
Fund size: £36.8 million (at 31/05/10)
Launched: 28 April 2006
Objective: To generate strong absolute returns from long and short strategies from across the entire UK equity market. The emphasis is on medium-sized companies, with selective exposure to small and large caps. The target return of the fund is 12-15% per annum. The fund is designed to achieve both long and short alpha over time, and has low correlation with other long/short managers.

Ignis International Cartesian Enhanced Alpha Fund

Fund manager: Jeremy Hall (lead)
Ratings: 'A' rating by Standard and Poor's (at 31/05/10)
Fund size: £38.2 million (at 31/05/10)
Launched: 8 November 2007
Objective: To provide long-term capital growth through investments primarily in equity and equity derivative products, which may include contracts for difference (swaps), traded options and financial futures. The fund aims to hold long positions of up to 130% and short positions of up to 30% while generally maintaining close to 100% market exposure. The fund blends Cartesian's proven process of investment in long and short strategies across the whole UK equity marketplace.

In addition to the funds listed above, Cartesian manages segregated UK all cap institutional mandates totalling around £335 million (at 31/05/10).

Fund	Fund structure
Ignis Cartesian UK Opportunities Fund	UCITS – Long only
Ignis International Cartesian Enhanced Alpha Fund	UCITS – Long only with limited shorting
Ignis Cartesian UK Equity Long/Short Fund	Hedge fund (QIF) – Long/Short

(The Enhanced Alpha Fund is Ireland-domiciled with UK distributor status)

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B965.07.10



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