

Here's hoping for less excitement in 2010

By Tom Stevenson, 23 December 2009

After a two year roller-coaster, investors would welcome a quieter year

Investors have been through the whole gamut of emotions over the past two years, from despair and fear at one extreme in late 2008 to relief and optimism during the subsequent market rally of 2009. We would all be forgiven for hoping that 2010 proves to be a little calmer.

It is traditional at this time of year to make some predictions for the following 12 months so here is my "ten for 2010":

- **Markets.** The bounce in global stock markets since the March low has taken many investors by surprise. The rise in the S&P 500 was greater in the first six months of the rally than in any similar half year period since the 1930s. Emerging markets have more than doubled since their low point. The FTSE 100 is 50% higher than in March. That kind of growth rate is very unlikely to be repeated in 2010 but history suggests that markets can still grind higher after an initial V-shaped recovery as earnings growth shifts from hope to reality. I expect the UK stock market to end 2010 higher than it begins the year but not spectacularly so.
- **Tax and spend.** One certainty about 2010 is that there will be a general election. For whichever party wins the keys to Downing St, another inevitability is the urgent need to set the public finances on a more sustainable path. Public spending cuts and tax rises are unavoidable, the only real difference between the two parties being a matter of timing. For obvious political reasons, neither side has laid out firm plans this side of the election and the bond markets have so far been forgiving. I expect the pressure from international investors to increase after the vote, however, with both government bonds and sterling vulnerable unless the next Chancellor shows that he really is a man with a plan.
- **Emerging markets.** With developed markets facing continuing stresses next year, I expect emerging markets to remain a major focus of attention for investors. Although share prices are now pricing in many of the attractions of markets in Asia and Latin America, the long-run story is compelling while in the short-term the relative robustness of emerging markets' finances means some investors will see them as a safe haven in an uncertain world. People will talk of a bubble brewing in emerging markets, but we are a long way from that just yet.
- **Stock-picking.** The past nine months has been good for all investors in absolute terms because markets have risen across the board. In relative terms, however, investors who choose their stocks on the basis of fundamentals such as balance sheet strength, market position and management quality have fallen behind. This is because the best performers during the rally have been the shares which were hit hardest in the preceding bear market. Companies which investors expected to suffer badly, or even go bust, during the crisis bounced fastest when it became apparent that the end of the world was not nigh. I think 2010 will be a much better year for fundamental stock-pickers because in a low growth environment the ability to reliably improve earnings will be more highly valued than mere survival. After 2009's "dash to trash", I expect quality and growth to be the watchwords of 2010.



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- **Big is back.** For the same reason, I expect some of the best performing stocks to be large companies. Small companies tend to outperform in the early stages of a bull market because they are more exposed to the ups and downs of the domestic economy. If growth does disappoint next year then the relative outperformance of cyclical companies compared to their larger, more defensive counterparts will probably reverse.
- **M&A.** If growth becomes a rarer commodity next year now that the short-term benefits of cost-cutting are in the bag, then managements will be on the look out to buy growth if they cannot generate it internally. Mergers and acquisitions activity all but stopped during the financial crisis and is likely to pick up significantly next year. The boom days of highly-leveraged takeovers by private equity companies may not return but purchases by the cash-rich businesses which have emerged from the downturn leaner and stronger than they went into it will provide ongoing support to the market.
- **Interest rates.** Interest rates will stay lower than people think throughout 2010 because the scale of fiscal tightening required to repair the public finances will provide the necessary downward pressure on any resurgent inflationary impulses. With lots of spare capacity and little sign of wage pressures, the greater near-term danger is of a relapse into recession than a growth-fuelled inflation spike.
- **Equity income.** As a consequence of interest rates staying lower for longer, deposit accounts will continue to disappoint and high yield stocks and high quality corporate bonds will be attractive. With some high-yield stocks offering a better income even than corporate bonds from the same companies, let alone government bonds or cash, this could be a better year for income funds.
- **Commodities.** Commodities have been a major beneficiary of the stabilisation of the developed world and the ongoing growth in emerging markets. Next year will see a tug of war emerge between the long-run super-cycle, which will see continuing upward pressure on metals and food prices, and short-term valuation considerations. Like stock markets, commodities face a steady but not exciting year if the recovery continues, and a poor one if there is a relapse.
- **Housing market.** Finally, what about the investment which the British care about more deeply than any other – the house they live in? After an unexpected seven month rally, driven largely by an imbalance between improving demand and still inadequate supply, I expect house prices to tread water in 2010. They are still not cheap by historical measures and with unemployment likely to remain persistently high and credit still in short supply, it is hard to see what would be the trigger for further rises.

If 2009 has taught us anything it is that forecasts, fun as they are to make, are a pretty hopeless guide to what the next 12 months has in store. I don't suppose that too many people accurately predicted how things would pan out in 2009 at the end of 2008 and I don't imagine the pundits will do much better this year.

With that in mind, the boring but timeless reminders about diversifying your investments, not trying to time the market, taking advantage of the tax breaks that are still available and having a disciplined approach to regular saving still apply. The Chinese have a curse for their enemies: "may you live in interesting times". I hope, in financial terms, that 2010 is dull and prosperous for you all.

Performance over 5 years					
	Nov 04/ Nov 05	Nov 05/ Nov 06	Nov 06/ Nov 07	Nov 07/ Nov 08	Nov 08/ Nov 09
FTSE 100	15.3%	11.5%	6.3%	-33.3%	21.1%
S&P Composite US\$	6.4%	12.1%	5.7%	-39.5%	22.2%
MSCI Emerging Mkt US\$	29.0%	30.9%	42.1%	-57.6%	80.9%
Source: Datastream, years from 30.11.04 to 30.11.09					

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