

UK recession comes to an end

By Tom Stevenson, 27 January 2010

Britain grew again in the fourth quarter of 2009 - only by a whisker, but it paves the way for good stock-picking returns.

This is the way the recession ends, not with a bang but a whimper, as T S Eliot almost said. The growth of just 0.1% in the UK's gross domestic product in the last three months of 2009 brought to an end the longest ever recession in Britain but only just.

The wafer-thin growth disappointed compared with a consensus expectation of a 0.4% expansion and it is vulnerable to being wiped out by revisions to the official figures over the next month or so. Britain is certainly not out of the economic woods yet.



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The slow recovery in the UK is a reflection of the country's relative exposure to the hard-hit financial services sector and the high debt levels in both the private and public sectors. Recovery is likely to be a long haul, especially as the Government turns its attention to cutting the budget deficit after the election, now most likely to be held in May.

Interestingly, however, the UK's stock market closed marginally higher on this latest piece of gloomy economic news on Tuesday. In part that reflects the recent weakness of the market, which has been hit by a cocktail of bad news from President Obama's populist attack on the banks to China's move to rein in its strong growth to a worrying spike in inflation in Britain.

Everyone knows that Britain faces a long haul back to economic growth so it no longer has the power to unsettle the stock market, which always looks forward and attempts to second guess what is not yet factored into share prices.

There is also a silver lining to slow growth as far as investors are concerned. With fiscal tightening a certainty in the second half of this year and into 2011 too, there is little immediate pressure on the Bank of England to raise interest rates. The economy neither needs nor can really bear both tighter tax policy and higher interest rates.

Another reason why the stock market is able to shrug off poor domestic economic news is that the London market is one of the world's most international. More than half the earnings of the companies in the FTSE 100 index are earned overseas so investors in those stocks are just as likely to be looking at the overheat in China as they are to worry about the big chill in Britain.

Many investors remain underweight equities because they are so cautious about the economic outlook and that is generally a good forward indicator for the stock market. Also valuations are by no means excessive, again because of the pervasive feeling of gloom.

Another reason to take a more optimistic line on shares is the fact that, with the economy stabilising, the outlook for mergers and acquisitions is more positive than since before the financial crisis. That should provide some underpinning for the market.

Many observers feel that the first half of this year may see a meaningful correction after the nearly year long rally since last March. This is entirely possible and would be a normal reaction to what was a sharp V-shaped rally through the middle of last year. But the setback needn't last long.

GDP announcements are backward looking figures and at times like these they can show the fag end of recession at a time when managers are already looking forward with renewed optimism to the future.

This is traditionally a good environment for stock-picking. The companies which have weathered the storm well are emerging as relative winners from the turmoil but are not yet over-priced by too optimistic investors. This can be a sweet spot for traditional research-led investment.

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