

Stock Market Review



Edward Rizzo

Mr Rizzo is director of Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

The stock market in 2010

It's that time of the year when some look back at the outcome of the past 12 months and others discuss what the New Year may bring. Today's article aims to highlight the likely themes for the stock market in 2010.

Following the strong recovery in equity markets worldwide over the past nine months, a frequently asked question is whether this is likely to continue during the course of 2010. Although the local equity market recovered by circa 30 per cent since its 2009 lows seen in mid-April, the market's performance is substantially below that seen in many international stock markets.

While the continuing recovery of local share prices is likely to be influenced mainly by the financial results of the larger capitalised companies (HSBC Bank Malta, Bank of Valletta, International Hotel Investments and Go) and any other important announcements from these companies, the main theme of 2010 could be centred around "dividend plays", i.e. those equities which are trading on historically high dividend yields following the downturn in their share price. Should such companies maintain a high dividend payout in respect of the financial year which is coming to an end, they are very likely to attract investors.

This was evident when BoV published its September 2009 full-year results and distributed a handsome dividend to its shareholders. Other companies which have paid attractive dividends include HSBC, Go, Malta International Airport, Malta-post and Plaza Centres. The current gross yields based on their last full-year dividend payment range from a low of 6.7 per cent to a high of 8.5 per cent. These levels should be considered as highly attractive especially in the light of the current low interest rate environment. As such, investors are very likely to remain focused around the dividend announcements by these various companies commencing with Maltapost on January 21.

On the international front, with European shares having rallied by over 60 per cent from their March lows, opinions on the likely performance of the main European markets vary widely. Some analysts expect the upturn to spill over into the early months of 2010, but technical analysts say the market will become vulnerable to deep corrections thereafter. The focus by worldwide analysts will be on the company's earnings reports as the bulk of the improvement to profitability in 2009 resulted from one-off cost-cutting exercises.

Morgan Stanley reckons that profit growth has already been priced into current valuations and as a result forecasts the UK's FTSE 100 finishing 2010 at the 5,000-point



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level, representing a decline of circa 7.5 per cent from current levels. Other UK stockbrokers also argue that there is a considerable risk that companies do not hit their earnings targets. In particular, these brokers view that the risk of an earnings miss is highest among mining and banking companies, which are those sectors that have led the recovery in 2009.

However, not all stock market followers share the same view and a recent poll conducted by Reuters indicates that the FTSE 100 is expected to rise to 5,800 points in 2010 as the global economy continues to recover and interest rates remain at record lows. The scaling back of economic stimulus programmes in the coming months as well as the sovereign debt problems are other factors dampening expectations for global equities in 2010.

While markets have so far seemed to shrug off the bad news coming out of Dubai, Greece, Spain, Eastern Europe and the Baltic states, some economists argue that the debt problems in these countries could be one of the factors negatively affecting investor sentiment in 2010.

With most economists expecting interest rates across the eurozone to remain at historically low levels throughout 2010, given the fragile nature of some economies such as those of Greece, Spain and Ireland, the demand for fixed interest rate securities is likely to remain buoyant as investors continue to focus on achieving a more respectable return from their savings.

This buoyant demand (as evidenced locally also by the recent overwhelming response to the Mizzi Organisation Finance plc bond issue) is likely to attract a number of new corporate bond issues throughout 2010. With increased availabil-

ity of new bonds next year, investors are likely to watch the credentials of companies and their risk factors more attentively.

Nevertheless, should a number of new companies tap the bond market in 2010 these will present investors with another good opportunity to further diversify their portfolio across a range of companies operating in different economic sectors helping them to also achieve a more frequent income stream during the year. This will also continue to build upon the success achieved in 2009 as the local capital market has become a reliable alternative means of financing for many companies. The international bond markets also had an eventful year during 2009. Earlier in the year, investors were still flocking to the safety of government stocks with most corporate bonds dropping to very low levels amid growing concerns from the financial crises.

While some bonds may have defaulted, some amazing bargains were evident as a number of highly rated companies had their listed bonds offering high yields in the market. As sentiment in the markets improved, corporate bond prices rallied, giving investors equity-like returns from these investments. Key factors that are likely to dominate the international bond markets during 2010 include the growing concerns of a potential sovereign default as well as the timing and speed of eventual interest rate hikes in the eurozone and beyond.

On the currency markets, the focus is likely to remain on the US dollar and sterling following their very weak performance throughout most of 2009. The performance of both currencies against the euro in 2010 will depend on the region's economic performance and any

indications from the various central banks of the likely timing of future interest rate hikes.

The US dollar is widely expected to stage a comeback and has already seen a marked improvement in recent weeks. From a low of \$1.51, it has since climbed by 4.6 per cent to \$1.44. While some argue that this is due to some year-end "adjustments", a number of international banks are forecasting the USD/EUR exchange rate to strengthen by around 13 per cent over the coming year to circa \$1.25.

The future levels of the British currency are more debatable with some skeptics even talking about a risk of a currency crisis at some point in 2010.

The withdrawal of the quantitative easing policy by the Bank of England coupled with growing concerns over the ballooning UK government deficit increases the risk of a failed auction of government stocks by the UK Treasury as investors demand higher yields.

This could dent any prospects over a recovery for the British pound in 2010. Furthermore, the outcome of the UK general elections and resulting opinions on the new government's economic policies are likely to materially influence the pounds movements versus both the USD and the EUR.

After the catastrophic effect the near-collapse of the global financial system had on stock markets at the turn of last year, it's fair to say that few were expecting the strength of the market rally from March 2009, and while the above themes are most likely to dominate 2010, investors should not underestimate the possibility of other exciting developments and challenges which may surface and affect their fortunes during the coming 12 months.

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