

Money Marketing August 2006

Concerns over the global economy mean the hunt is on for sectors that are less sensitive to economic slowdown, that are under-owned and where valuations are attractive.

MitonOptimal is exploring a number of potential opportunities. The first is biotechnology and healthcare. The healthcare sector suffered a sell-off this year and within this sector, biotech appears the most oversold. The price falls in large cap biotech stocks left the mean absolute and relative biotech valuation at its lowest point ever. The potential for second half earnings in 2006 and earnings for 2007 to surprise should help to improve sentiment in biotech. There is also potential for merger & acquisition activity in the biotech sector. Indeed, Pfizer has gone on record this year saying that it is looking to acquire three biotech companies in the \$1-4 billion market cap range.

So, valuations are attractive and the sector is also under-owned. Investors have been focussed on cyclical areas of the market such as commodity and energy sectors rather than growth sectors like biotech. This can be seen by following flows for health and biotech funds relative to other sector funds.

From the economic viewpoint, a slowdown might impact cyclical parts of the market but should benefit non-cyclical growth sectors such as biotech as investors change focus to high quality growth stocks.

The same thought processes have also encouraged us to dip our toes into water as a sector; not just utility companies but water treatment, water technology and environmental services. I visited a house-building project recently where every aspect of power and water supply was provided by alternative means with much greater efficiency and at significantly lower cost to the householder. In the UK we are always bleating that despite all the rain we get, most of it runs into the rivers and then to the sea. On the project, every house has a plastic-lined well, into which flows all the rain water that falls on the house. This water passes through a simple filtration system and is then pumped back into the house so that the first water used every time a tap is turned on is recycled rain water, and the homeowner is particularly happy because it's not metered. This is a private enterprise aimed at government officials to encourage the inclusion of some or all of the technologies in all future house-building projects. The technology is there and if adopted could bring substantial reward to investors.

As with all commodity stories, China also has a part to play; China's water problems, specifically high pollution levels and persistent droughts, are set to continue in the years ahead despite Beijing's plans to sharply expand water-related infrastructure. In recent weeks, scorching temperatures have caused a drought in the southwest that has decimated crops and caused drinking water shortages for millions of residents. Cities need to do more to conserve and treat water if they are to avoid crises, according to Qiu Baoxing, vice minister of construction.

Mr Qiu said that China would spend Rmb1,000bn (\$125bn) over the next five years on water projects. This includes around Rmb330bn to construct urban wastewater treatment facilities and Rmb320bn for two major south-north water diversion projects. "The next few years will be the time when Chinese cities will see the fastest urbanisation and when industrialisation will proceed most swiftly," Mr Qiu said. "This period is when water pollution will be most serious. Now is the peak period for investment."

Although investment conditions seem more difficult, MitonOptimal believes that adaptive asset allocation continues to be the key to delivering strong absolute returns.