Click here if you are having problems viewing this email

Home | Unsubscribe from Thames River emails | Forward to a colleague

FUND UPDATE

Thames River Global Bond

January 2012

Peter Geikie-Cobb | Paul Thursby

Global Bond Team anticipates a bond bust this year and establishes a short position in UK Gilts

For some weeks now we have been looking to add to our overall short duration position in the portfolio (2 years short via Bund futures) by selling the UK gilt market short via long gilt futures.

Today we have established a 1 year short in gilts, taking the overall position to 3 years short. We intend to add to this position over time.

UK gilts have been well supported in recent months as foreigners have looked for a safe haven in the knowledge that the BOE are buyers of last resort as part of its QE programme. Domestic investors have been net sellers.

UK gilts have reached extreme valuation levels both in nominal and real yield terms. The government is running a primary deficit (i.e. excluding interest payments) of 8/9%. Even Greece and Italy will be in primary surplus by the end of this year. UK growth will remain anaemic, giving little hope of any significant improvement in the deficit in the near future and inflation remains stubbornly high. Inflation is projected to fall sharply later in 2012 but this was anticipated over the last two years with VAT hikes falling out of the YOY comparisons and yet has remained way above target both at a headline and core level. If the BOE were to pause on QE, the last support for gilts would be removed causing a major problem in funding the deficit.

However, the catalyst for pulling the trigger on selling gilts is the clear improvement in the US economy, which could cause upward pressure on US Treasury yields. Bunds and gilts, however, will be the underperformers as global investors are very overweight in the context of the size of these markets.

We are particularly impressed with the improvements in the US housing market. Rents are double the cost of a 30 year mortgage and this is finally feeding into final demand for both existing and new homes. The inventory of homes for sale has fallen significantly in recent months. An improving housing market is key to further job creation (again initial claims have trended down sharply in the last 6 months) and consumption has been robust. Both capacity utilisation and productivity rates suggest that large companies will follow the lead shown by SME in increasing employment. The competitiveness of the US dollar is also contributing to a more robust economic outlook than the consensus.

In addition, it is clear to us that there has been a regime change at the ECB, with a recent explosion in the balance sheet. We expect further large uptake in 3/5 year LTROs in February, signalling further stimulus.

As the market's assessment of growth improves, real yields will explode to the upside as they are at extremely low levels (even negative) in Germany and the UK,

especially if the political priority begins to shift away from fiscal austerity.

In summary, we expect significant medium term appreciation of the US dollar as the US proves to be the significant source of global recovery and a big upward correction in core government bond yields.

About this email
We provide a number of email subscriptions which are available in both plain text and HTML formats. If you wish to unsubscribe from any of these please reply to this email with the word unsubscribe in the subject line. Please be aware that if you unsubscribe from this list, you will no longer receive any communication from Thames River.

This information is intended for professional investors only.
This document is issued for information only by Thames River Capital LLP ("Thames River, the "Firm"), The Funds Business of the F&C Group. The Firm is authorised and regulated by the Financial Services Authority ("FSA"). Content relating to unregulated collective investment schemes is only directed at Eligible Counterparties, Professional Clients or investors meeting the FSA's COBS 4.12 categories. It must not be relied upon by non-qualifying persons. It does not constitute an offer by the Firm to enter into any contract/agreement nor is it a solicitation to buy or sell any investment. Nothing in this document should be deemed to constitute the provision of financial, investment or other professional advice in any way. The contents of this document are based upon sources of information believed to be reliable, however, save to the extent required by applicable law or regulations, no guarantee, warranty or representation (express or implied) is given as to its accuracy or completeness and, the Firm, its members, officers and employees of the corporate member do not accept any liability or responsibility in respect of the information or any views expressed herein. All data is sourced from the Firm unless otherwise indicated. This document may include forward-looking statements that are based upon the managers' current opinions, expectations and projections. The Firm undertakes no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements. This document is not aimed at persons who are residents of any country, including the United States of America ("USA") and South Africa, where the funds referred to herein are not registered or approved for marketing and/or sale or in which the dissemination of information on the funds or services is not permitted. This document should not be distributed to any third party without the express approval of the Firm. It has been designed for a professional audience only and should not be passed onto a retail audience. (110421)

Thames River Capital (UK) Limited is a limited company. Registered in England and Wales no. 3487043. Registered office, 51 Berkeley Square, London W1J 5BB