

International Equity Monthly Newsletter February 2010

Review

International equity markets were modestly negative over the month, though W.P. Stewart accounts remained down to a lesser degree. Overall, global markets were down in the mid-single digits with International investor concerns remaining focused on China and India tightening their monetary policy to keep inflation in check as well as a possible Greek sovereign bond default and a potential bailout. We continue to believe that these concerns are not particularly significant but a pause in the market's recent run was very likely, and these issues have provided an excuse for a pull back.

Broadly speaking, earnings reports continue to show evidence the economy is improving, which the market had been waiting for. At the same time, perhaps as an indication of greater economic vitality, there have been early signs that the cheap money, made plentiful by regulators seeking to support the economic recovery will become less available. In particular the Chinese government announced its second move to limit lending to consumers and businesses by again raising the reserve ratio. We believe this signals a desire to contain inflation expectations and manage the risk of asset price bubbles post last year's expansion in credit. The impact of any tightening is likely to be a period of consolidation before the market moves ahead again based on better economic fundamentals.

Portfolio Changes

We initiated a position in Banco Santander de Brasil, formerly part of the Santander banking group of Spain and now listed as the third largest bank in the country. The company has operations in retail, commercial, private banking and asset management services. Synergies are likely to flow through from the acquisition of the local arm of ABN Amro, a strong branch expansion programme out to 2013, and growing mortgage penetration in Brazil should underpin our estimated high teens growth rate over the next five years. We believe the valuation was at a compelling entry point as it touched 11x estimated 2010 earnings, given the differentiated franchise and growth prospects.

To fund the position in Banco Santander de Brasil, we sold our remaining Jupiter Telecom position, which was being bid for, and trimmed Nitto Denko which was strong relative to earlier in the year.

Outlook

With 3% cash holdings on balance, we remain close to fully invested and enthusiastic about the potential for the companies we own to deliver accelerating earnings growth as the economy improves. Moreover, price-to-earnings multiples remain below historical averages, which suggests there could be some improvement in valuations if market sentiment becomes more bullish. That being said, we are cognizant that regulators remain wary of inflation, and that the bias to interest rates is positive. An outlook for higher interest rates could quell some of the market's enthusiasm for all types of financial assets, irrespective of improvements in the economy. We would note that growth equities generally fare far better than fixed income in a rising interest rate environment. We believe a commitment to high quality growth equities continues to offer the greatest potential to achieve long-term wealth creation.