MARKET SHARE

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Why worry about deflation?

The slump in the oil price means that headline inflation may turn negative in the coming months in many advanced economies, just as it has in the euro-zone. In general, deflation in consumer prices can be positive for economic growth. The problems come when deflation is reflected in falling nominal incomes and in asset prices, or when expectations of falling prices become ingrained.

The recent decline in the cost of oil is similar in percentage terms to that which took place in the wake of the global financial crisis in 2008. With core inflation just as low, this means that headline consumer prices across the OECD may also be likely to fall again. Indeed, data released recently confirmed that the euro-zone CPI fell by 0.2% y/y in December. We also expect the headline CPI to decline in the US and in Japan in the months ahead, and forecast inflation to fall well below 1% in the UK. The near-term prospects won't be much different whether the oil price remains at circa $50 a barrel , or recovers to around $60 (as we expect).

So why worry about deflation. Most households would regard falling prices as good news, given the boost to their spending power. What's more, it is reasonable to distinguish between deflation due to some favourable external shock or supply-side development, such as the slump in oil prices, and a more general decline in the prices of goods and services due to weak demand. So called "good" deflation may simply increase the amount of money that people have to spend on other items. But even where falling prices are a symptom of weakness in domestic demand ("bad" deflation) the resulting boost to real incomes may still mean that deflation is part of the cure.

So what's the problem? Broadly speaking, there are three potential risks. One is that rather than simply boosting spending power, falling prices may lead to outright declines in nominal incomes. This in turn will increase the burden of servicing debts, which are typically fixed in nominal terms. The second risk is that asset prices also fall, particularly property and other assets used as collateral, further increasing financial strains.

The third risk is that expectations of ever-falling prices become entrenched. This could encourage households to delay spending, hoping to eventually be able to buy goods more cheaply. It could prompt companies to cut back investment, for fear that future returns will be lower. This sort of deflationary spiral was avoided in 2009 partly because major central banks responded with bold monetary easing to boost inflation expectations and keep real interest rates positive. But with nominal interest rates now near zero, they have much less room for manoeuvre.

So who is most at risk? Heavily-indebted economies with high unemployment, low trend real growth and already low expectations for inflation are particularly vulnerable. However, these conditions apply in varying degrees to the euro-zone and to Japan, strengthening the case for further unconventional policy easing there, but much less so to the US or UK, where labour markets in particular are tighter.

Gary Rusby - GHC Capital Markets - Reproduced from a report by Capital Economics

Key events

Prudential Group *Their M&G brand has seen a big inflow of funds in the last year.*

Persimmon *a big beneficiary from the changes to the stamp duty regime..*

ACAL PLC *Earnings per share to increase circa 15%*

Jane Durant joins GHC *Jane will be responsible for monitoring several exciting projects*

In This Issue

Asset Allocation

The best performing asset classes in sterling over the last two months have been gold bullion and Gilts. Most of the gain in gold bullion has come from the strength of the US Dollar but Gilts continue to remain in favour as inflation falls and they are perceived as "safe haven" investments.

UK equities have held up reasonably well but both the oil producers and large food retailers have been under pressure as their margins have come under severe pressure. We remain confident that UK equities will produce positive results going forward as they are reasonably priced and there is an underlying confidence in the UK economy which is still on course to growth, albeit at a slower pace than in the last twelve months.

European equities have held up reasonably well in face of some very disappointing GDP figures from the Eurozone and from a worryingly fall in inflation. The major question is whether the ECB will ignore German concerns and start full blooded QE at the end of January and whether the ECB can do it on a large enough scale to make a difference. QE will be good for equity prices but very bad for the Euro. We have already seen the Euro fall in anticipation of QE. We will remain underweight in European equities.

The outlook for UK Fixed interest is fairly positive as it is unlikely that the Bank of England will raise interest rates in the near future. The spread between Gilts and investment grade corporate bonds may narrow slightly in the coming months. We will retain our current weighting to this asset class.

The overall investment outlook is more uncertain than twelve months ago as there are a number of political and geo-political worries ahead of us but with interest rates and inflation to remain low we are happy to be fully invested inequities and overweight UK commercial property. The price of oil is unlikely to make a major recovery and the US Dollar will continue to be strong.

The UK economy is forecast to have positive GDP growth of 2% in 2015. The fall in petrol and food prices will undoubtedly help consumer spending and it is unlikely that interest rates will rise until the later half of this year. We remain bullish for UK equities which are not expensive on a long run basis.

The Bank of England is unlikely to raise rates in the short term and with low inflation set to continue Gilts will at least hold their own. UK investment grade corporate bonds offer reasonable value and we are happy to remain at a neutral weighting for this asset class. The only headwind in the near future is if the MPC decided that it wants to dampen down the retail property market by raising interest rates early.

The sharp fall in the price of crude oil is the result of an oversupply of the commodity and a fall in demand. OPEC has consequently taken action to protect its market share by maintaining full production which has driven the price down. Marginal producers and shale oil and gas producers will be forced out of business in the longer run and it is only then when we can expect any sort of real recovery in the price.

Richard Harper - Head of Asset Management GHC Capital Markets Limited

Jane Durant joins GHC team.

We are pleased to announce that we have been joined by Jane Durant, formerly head of special projects at Berkeley Burke. Prior to that she has at different times been successfully involved in the installation of the back office system used by the general insurance arm of a major Leicester broking house, the sale of bespoke SIPPs to the regulated intermediary market, and even the sale of chimney liners to the building trade.

Jane will be responsible for monitoring several exciting projects at GHC Capital Markets Limited, which will see a major overhaul of many of our systems, helping us to provide better customer services and throughput for our clients.

Jane Durant
Project Manager

Share in focus

Acal is a custom electronics firm that designs and makes products for use in their customers end products. The products are high margin, highly differentiated and complex. 50% of what they sell is customised and 20% of their turnover represents products for which they are the sole supplier.

They have bought several complementary companies recently and, as the industry is fragmented, there are opportunities to grow by acquisition.

Products include sensors for Nespresso coffee machines, for which there is only one other supplier. Other clients include GE Healthcare - for whom they make power transformers for MRI scanners. They supply Stanner Stairlifts with custom cabling. And SAAB - where they effectively make an industrial pc for unmanned aircraft.

Acal believe their market (electronic hardware) will grow fast and above GDP. The 'Internet of Things' (a term you are likely to hear during 2015) is set to gather pace & increase growth further.

Estimates are for Earnings per share to increase circa 15% to FY15 and 13% to FY 16, while the stock trades on a PE of 13x 2013 earnings. This is a discount to sector peers. There is also a 3% and growing dividend yield.

Paul Coffin
Capital Financial Management

ACAL Logo from website

Top Stocks

This is where Jonathan Bishop of GHC Capital Markets takes a look at the background to a few of the stocks and shares that have been popular with people trading through GHC over the past two months

Prudential Group: Shares in the Prudential group look very interesting at these levels. The company provides insurance and financial services. It has a strong market position in Asia where it benefits from its terrific distribution and looks to be in a good place to grow in the region. Their M&G brand has seen a big inflow of funds in the last year. The company has a very strong balance sheet and looks a good investment on a three year view.

Chesnara: They have recently appointed a new chief executive John Deane and has recently agreed to buy the Dutch closed life business Waard. With a yield above 5% the shares represent real value at these levels.

Persimmon: Shares in the house builder have been a big beneficiary from the changes to the stamp duty regime.. The company constructs new houses using four brands Persimmon homes, Charles Church, Space 4 and Westbury Partnerships. Profits rose 57% in the first half and with a good yield of 4% the shares look well placed to grow in 2015.

Carillion: For clients looking for yield it is worth looking at the shares in Carillion where the yield is 5%. The company boasts a very strong order book and the share look to be due a rerating during 2015.

Sky: Shares in Sky look a very interesting investment ahead of the forthcoming auction for the Premier League broadcasting rights. The shares are trading at 15 times forecast earnings and look certain to be rerated in the year ahead. In the last five years it has grown its sales by 43%.

City Recommendation

Our review of what market analyst are recommending:

Stock	Date	Price (P)	Broker	View	Target (P)
Emis Group	**08/01/2015**	**850p**	**Panmure Gordon**	**Buy**	**980p**

Panmure Gordon ups its target price on Emis Group to 980p from 906p to reflect the strategic and financial impact of a bolt-on acquisition just before Christmas. The broker estimates that the deal will enhance earnings by 4% in both fiscal 2015 and 2016. Panmure remains a buyer. Shares flat at 850p.

Marks & Spencer	**08/01/2015**	**466p**	**Societe Generale**	**Hold**	**492p**

Societe Generale cut their recommendation on Marks & Spencer to hold from buy although the retailer remains a "very strong gross margin recovery story." Adds that M&S shares are also worth holding for the dividend yield and potential cash surplus returns. Says that the recommendation downgrade is predicated on the share price recovery since the H1 results in November that has "almost reached our (new) target price of 492p (trimmed from 496p)." Shares trade 2.4% lower at 466p.

Tesco	**09/01/2015**	**204.8 p**	**Barclays**	**Equal**	**205p**

Analysts at Barclays think Tesco's shares are nearing full value after Thursday's sharp rally, and may need additional impulses to push them further. "Improving sales trends, better visibility and strong cash generation are all key factors in driving up a food retailer's earnings multiple, but at 23x 2015/16E PE (and still 17x 2016/17E PE) Tesco's multiple may struggle to expand further for now." Barclays reiterate their equal weight rating and 205p price target. Shares trade 2.1% lower at 204.8p.

Interserve	**09/01/2015**	**554p**	**Numis**	**Buy**	**718p**

Numis is moving its rating on Interserve to buy from add following share price weakness which the broker believes reflects Middle East concerns on lower oil. Numis also trimmed its 2015 EPS estimate to 63.1p from 65.2p to account for higher investment plus the broker's view that there could be a short term hiatus in activity this year in the UK due to the General Election. Numis retains its 718p target price. Shares +1.2% at 554.0p.

Horizon Discovery	**08/01/2015**	**207.5p**	**Singer**	**Buy**	**233p**

Singer upgrades its target price on Horizon Discovery Group for the second day in a row, to 233p from 229p, after the life science company said it is acquiring Haplogen Genomics for an initial GBP6M. The brokerage also ups its fiscal 2015 and 2016 revenue forecasts by GBP0.3M and GBP0.5M respectively, saying it is a sensible acquisition for the company. N+1 Singer remains a buyer. Shares are up 0.5% at 207.5p.

Boohoo.com	**08/01/2015**	**23p**	**N+1 Singer**	**Buy**	**31p**

N+1 Singer cuts its pretax profit guidance for Boohoo.com by 31% to GBP11.7M for fiscal 2015 and by 40% to GBP15M for 2016 after the retailer's second-half sales growth came in below expectations. The broker also lowers its target price to 31p from 58p to reflect the downgrade. N+1 Singer remains a buyer and says it sees the weakness as an opportunity. Shares are up 3.4% at 23p, having plummeted by over 40% on Wednesday.

Standard Chartered	**09/01/2015**	**989p**	**Investec**	**Buy**	**1250p**

Standard Chartered has outperformed all other U.K. banks since the FSTE 100 hit its 2014 low in mid-December, the shares up 8% over this period. Investec highlights from today's announcement that the bank is closing its loss-making cash equities business and is on track to deliver at least the targeted $400 million of cost savings in 2015, with more to come in 2016. Investec looks for Standard Chartered to deliver further sustained outperformance during 2015. Retains a buy rating on the stock with a 1250p target price. The shares trade up 2.8% at 989p Wednesday.

TSB Banking	**09/01/02015**	**280p**	**Barclays**	**Equal**	**270p**

Barclays starts coverage of TSB Banking Group with an equal weight rating and 270p target price. Says the retail-focused U.K. challenger bank has strong branch distribution, a solid balance sheet, plenty of opportunities and currently a low market share. However the near-term trajectory is clouded by the relatively complex relationship with Lloyds Banking Group and while there is scope for the shares to double in price, it could be five years plus for the

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