

# Best investment options for 2008

Despite seemingly cheerless market conditions, there are a number of tempting possibilities out there for those with a long-term view

**A**fter a tumultuous year for virtually all asset classes, the investor could be forgiven for keeping their money under the mattress in 2008.

There have been painful losses in Irish equities, in global financial stocks, in various credit instruments – and it also hasn't been much fun for anyone trying to sell domestic residential property.

However, market volatility, and the irrational fear that goes with it, will always throw up interesting opportunities for those brave enough to take an independent long-term view. With that in mind, I will ignore the wise counsel of Casey Stengel ("Never make predictions, especially about the future") and attempt some suggestions for the year ahead.

Stock markets may be down, but it's too early yet for a broad commitment to equities. However, against a gloomy backdrop, there are still some stocks and sectors offering value for money.

So what are the alternatives to under the mattress?

## 1. US dollar exposure is good

The dollar has had a dramatic decline (down by 10 per cent against the euro in just the past three months), and sentiment towards it seems as negative as it can get. The climate now feels very similar to late 2004, when the greenback had been sliding steadily for two years, and expert predictions of further weakness reached a deafening crescendo.

What happened next? From a low of 1.35 against the euro at year-end, it rallied by more than 17 per cent over the next 12 months. When market consensus arrives at an extreme, the price will usually reverse direction.

Of course, the dollar's long-term decline has been driven by fundamental negative factors, but these may now be about to turn. The US trade deficit has been shrinking of late, thanks largely to the impact of the weaker currency, and fell by a whopping 14.5 per cent in the September quarter.

## 2. High-quality credit risk is now being well rewarded

While financial equities are a high-risk play, short-term bank bonds may be an attractive alternative to cash or government paper. For example, Bank of Ireland 6.45 per cent



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bonds, maturing in February 2010, yield 5.3 per cent, more than 1.5 per cent over the equivalent government bond. Is it completely safe? Put it this way: in any scenario where the risk of a Bank of Ireland default reared its head, the investor would have much bigger worries than the value of his bond holding!

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## 3. Commodity exposure

Major commodity prices have been rising for a number of years, most notably crude oil. Price trends in this area tend to be persistent, sometimes for decades, and in that context we could still be in the early phase of a prolonged upswing.

Viewed as a distinct asset class, commodities can play an important role in diversifying an investment portfolio. Moreover, they can serve as an infla-

tion hedge – important at a time when the risk of higher inflation is significant. Achieving commodity exposure is much easier than in the past. There is now a range of Exchange-Traded Commodities (ETCs) available for investment. These are equity securities, listed on one of the major exchanges, which are structured to give a return exactly in line with the return of the relevant underlying commodity or commodity index.

Which commodities? The rise of agricultural products (soft commodities) has started more recently than energy or metals, and looks to be well underpinned by the combination of bio-fuels production and greater demand from the populations of the major developing economies.

Those of a gambling bent may want to play ETCs on individual products, but the conservative approach might be to buy the ETFs Agriculture D-IAGCI ETC, which is listed in London and tracks an index basket of soybeans, wheat, corn, sugar etc.

## 4. The Irish stock market?

Last week I suggested that the woes of the Irish market are not yet over, and it may not be as cheap as claimed by its fan club. However, within it, some babies have been thrown out with the bathwater.

CRH, down 38 per cent from its highest level, has paid a heavy price for its 'construction' label. It is broadly diversified across markets and geographies, with only a small exposure to Irish housebuilding.

The company has been very well run through successive generations of management, and while achieving consistent and profitable acquisition-led growth. At the current price (€23.60), it stands on a forward P/E ratio of 8.2, yielding 2.6 per cent. This represents solid value.

DOC has suffered much negative press in the recent past. Irrespective of any impact arising from its legal problems, the underlying business is very solid and well spread among a range of largely defensive activities. Like CRH, it has a proven ability to make consistently good acquisitions a surprisingly rare quality among public companies. Its difficulties in selling the Manor Park stake have been well aired, but with the stock down 39 per cent any bad news has been well discounted. On a forward P/E ratio of 9.1, it looks too cheap.

## 5. Global financial stocks?

Bank stocks have been at the epicentre of the credit crisis, for obvious reasons. No end to the trauma is yet in sight, as almost every day another "credit cockroach" seems to emerge, bringing fresh revelations of multi-billion write-offs.

This fire started in the area of US sub-prime mortgage lending, but may spread to a variety of other debt classes. In particular, the huge volume of leveraged loans extended to fund private equity buyouts, could present problems if profits suffer the headwinds which I expect. Against this backdrop, it would be prudent to stand clear from bank stocks as a whole for now.

However, there are some individual names worth a look for those who are tempted to dip a toe in the water. Lloyd's TSB, listed in London, has had the good fortune to be capital-constrained in recent years. This has saved it from joining its peers' lemming rush into bad assets.

It has, quite deservedly, fallen less than the sector, but at the current 144.73 it offers good value. The yield is now 7.6%, and the dividend looks safer than most in the sector.

## 6. Global drug stocks

The pharmaceutical sector has had a miserable performance throughout the recent bull market. The difficulties faced by the industry are well known: patent expiries, competition from generic producers, disappointing product pipelines, and relentless pricing pressure from governments.

But what's been well aired tends to be well discounted, and the sector's offsetting attractions bear re-stating: steady demand growth driven by aging populations, little exposure to economic cycles, persistently high returns on invested capital.

Pfizer, one of the largest names in the group, has had an especially tough time, falling to a 20-year relative valuation low.

The patent expiry in 2011 of its largest drug, Lipitor, presents a major challenge. But on a P/E just over 10, yielding close to 5 per cent, and with a large restructuring program under way, there should be limited downside risk from here.

For those with a lesser appetite for stock-specific risk, it's worth considering the iShares S&P Global Healthcare Sector ETF. This is an exchange-



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traded fund, listed in New York, whose underlying portfolio will exactly track the global healthcare sector.

As with ETCs, these ETF instruments can be traded and held in the same way as individual stocks. Annual charges are very reasonable – 0.48 per cent in this case.

## 7. European telecoms

The European telecom sector

has started to perform strongly, but it could have much further to go.

The group has been cheap, thanks to the well-known issues dogging it – new technologies undermining business models, regulatory pressures and so on. But it is characterised by very strong and defensive cash flows, and the infrastructure funds which have been snapping up other utility assets all around Europe

are likely to turn their attentions in this direction.

The simplest way to play the sector is to buy the relevant ETF in this case, the StreetTracks MSCI Europe Telecom Services ETF. This instrument is listed on the Paris exchange.

## 8. The mattress

Given the degree of volatility which lies ahead, it's worth keeping some powder dry for

further opportunities which are likely to arise through the year. So leave some cash under the mattress, sit tight, and be prepared to embrace fundamental value where and when it presents itself.

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