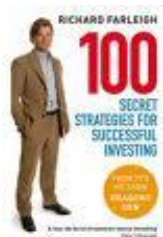




The Trend is Your Friend

Hello again, and welcome to the second installment of my regular investment e-letter. This month, with global stock markets trading relatively range bound at eleven week highs, and the general recovery moving unremarkably through its early stages, it seems appropriate to look at why investing with the consensus is usually the right approach, and, secondly, why an emerging market like Brazil is such an interesting investment opportunity over the longer-term.

The Trend Is your Friend...



I recently read a great little book by **Richard Farleigh**, a highly successful investor and member of the expert panel on the popular UK TV show Dragon's Den.

His "100 Secret Strategies for Successful Investing" is a wealth of common sense investment ideas, but the one message that I most endorse is that investing with the trend is highly rewarding.

In fact, I'd go further, and say that I am a firm believer that 'swimming with the tide rather than against it' is the single most effective investment strategy there is.

Indeed, we can sum up this simple yet effective approach in one easy phrase, "**The Trend is your Friend**". It's an idea stressed by Farleigh, who says:

"Far from being skeptical of the consensus view, I believe it is a very powerful and persistent driver of the market. [...] Economic cycles often take years to complete, and there can be plenty of opportunities to jump on board."

Rather than try to time short-term movements in the markets, I believe it is far more effective to look for trends that can last for years, jump on board and enjoy the ride. With the right advice investors can do very well following the consensus, as trends are slow to get going and fully develop.

Trends are slow to get going and fully develop; There's plenty of time to get on board, take a handsome profit and then exit cleanly.

Or as Farleigh has it, the reasons why trend investing is profitable are as follows:

- Markets tend to under-react, not over-react
- Big, obvious ideas offer great opportunities
- It is safe to invest with a consensus view
- Price changes are slowed by inertia and scepticism
- It is best to enter and exit markets at the right times instead of always staying invested
- Rising prices attract buyers: and economic cycles breed market cycles

Perhaps the most poignant of the above are the last two points - I strongly believe that the days of buy and hold are over.

This is why it is essential to understand what drives and creates trends: underlying macroeconomic fundamentals and psychology.

Human nature is at work here and there is a psychology and herd mentality that drives a trend. For example, consider that economic theory tells us that when the price of a good rises, demand falls. If the price of shoes doubles then it's highly likely that, all other things remaining equal, we will buy fewer pairs of shoes.

However, in finance the opposite tends to happen.

When the price of a financial asset such as single share or an index such as the S&P 500 rises, demand actually increases as new buyers appear, driving the price even higher.

Why? Simply because investors believe that they will profit as the price continues to rise - and they believe that as other buyers are buying it must be a good idea, and feel more confident as they are not alone.

Looking back we can identify many such trends that have offered excellent opportunities, and here are a few significant examples:

- An 18-year secular bull market began in 1982 and ended in 2000. Over this period, the S&P 500 index - the broader US equity market benchmark - rose by over 1300%.
- In the last nine years the price of gold has rocketed some 400%.
- And thirdly, UK residential property from 1996 to July 2007 showed a 161% average price increase from trough to peak.

But, the real knack in trend investing is not just in identifying the prevailing trend, rather it is knowing when to join and, perhaps more importantly, when to exit, with the latter usually signaled early by a turn in basic macro economic indicators such as interest rates or GDP growth.

Hence, the caveat to my original advice is thus: "**The Trend is your Friend, except at the End,**" as markets are notoriously quicker to fall than to rise.

The real knack is knowing when to leave a trend and reversals are signalled early by a turn in macro indicators

So, when to exit? Timing will never be perfect but the signals are always there, for example bonds will fall in value when central banks begin the cycle of interest rate rises- which they will soon do - and the rise in the price of gold will abate if inflationary fears subside and the US begins the reduction of its national debt.

Yet, the average investor doesn't know how to read these signs and all too often suddenly realizes that they are invested in a trend that has already reversed and it's far too late to do anything about it.

But an effective investment advisor will have a deep understanding of all the factors - both economic and psychological - that create and drive trends on the way up and on the way down and, therefore, with the right knowledge and expertise in your corner, the trend really can be your friend.

Brazil - much more than beaches, bikinis and football



I've recently had lots of people asking me about Brazil, and how I view investing in this up and coming economy. My answer is two fold - firstly, as with the other major emerging markets, I'm a firm believer in its long-term investment case for reasons I'll lay out below. Secondly, I'd advise short-term caution as Brazil has racked up some hugely impressive gains in the last 18 months and a small correction may occur.

But investors should be looking beyond soccer, samba and Copacabana beach. Here is a large democratic country, rich in natural resources, with a strong banking and corporate sector, a rising middle class and 2010 GDP growth forecast at 6%.

I should also mention that Brazil has significant foreign reserves, investment grade sovereign debt and, remembering last month's Ring of Fire warning, low levels of borrowing.

Oh, and don't forget the 2014 World Cup and the 2016 Olympics, both of which will further stimulate the already buoyant domestic economy.

Just one year after the global recession, Brazil's economy is forecast to expand by a strong 6%

Yet, when we look at the BRIC (Brazil, Russia, India and China) countries that Goldman Sachs believes will dominate the future world economy, it appears that Brazil has in the past been viewed as the odd one out.

But not any more. The global recession has highlighted the resilience of Latin America as a whole, and specifically Brazil's strong, profitable banking sector, which had very little exposure to the US sub-prime debacle.

In addition, Brazil's stable domestic consumption allowed the economy to tough out the downturn much better than many so-called more developed economies, notably those in Western Europe.

As The Economist magazine noted in a recent special 'Brazil Takes Off', the country was one of the last major economies to feel the recession and one of the first out of it.

Brazil is not an 'if', but a 'when': By 2025 it will likely be the world's fifth-largest economy.

To paraphrase the report, unlike China, (and some might say Russia), Brazil is a fully functioning modern democracy. Unlike India, it has no religious conflict or border disputes: India has a hostile nuclear neighbour, whereas Argentina and Brazil save their battles for the football pitch. Furthermore, whilst Russia is heavily dependent on energy exports for future growth, Brazil has many more irons in the fire.

And yet, whilst I sing its praises, there are factors to note when considering investing in, directly or indirectly, in Brazil or Brazilian companies.

Like many emerging markets there are currency issues - the Real is appreciating fast, putting pressure on exporters, making imports cheaper and leading to inflationary pressures that the Central Bank must keep a lid on through increasing interest rates, which would have a negative impact on the equity market.

Government spending also needs to be reined in. Corruption and graft remain problems, as does crime and the deep, though reducing, chasm between Brazil's rich and poor.

And we must also note that in just over a year the Bovespa equity index has doubled and is within sight of its historical high.

It is therefore to be expected that investors may pause for breath and take stock of the situation.

But all these are not reasons to avoid investing in this versatile, robust emerging economy, simply things to keep a watchful eye on.

As I said at the start, I am firm believer in the long-term investment case for Brazil, and any short-term correction should be viewed as a 'buy on dips' opportunity, and not a signal to rush for the exits.

Indeed, consensus forecasts suggest that Brazil is not an 'if', but a 'when' - the widely-held belief is that between now and 2025 Brazil will be one of the world's five largest economies. There is a trend here, and one that I believe has the legs to last the course.

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All the best,
Richard Holmes



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