

# Schroders Talking Point



## Buxton's 'Top of the Stocks'

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Equity markets continue to follow a rollercoaster ride at the moment, with the pervading gloom interspersed with brief flurries of optimism. Although uncomfortable for many investors, this is largely the backdrop we anticipated for the start of 2009 given that a raft of poor economic and company news would be set against some already fairly dire expectations about the slowdown and some consequently very low UK share prices.

We expect to see just this kind of sentiment-driven volatility for the next few months, although remain confident that there is no justification at present for a prolonged drop below the current UK market levels. On the contrary, we continue to look to the remainder of this year and into next as we believe that investors will soon start to come around to the idea that the recession is not going to be any worse than is already factored in.

#### A pro-cyclical stance

We believe the stocks to favour in this potentially more optimistic environment are those with more cyclical characteristics; notably stocks that have been beaten down despite good business models and strong medium to long-term prospects.

In our opinion, such names currently include national carrier British Airways. This may, at first glance, seem a strange stock to choose given the significant global slowdown and collapsing airline passenger numbers. However, as the recession imposes a 'survival of the fittest' on the industry, solid, stable names such as BA should emerge amongst the winners. The company's share price also looks very compelling at present compared to the value of its assets, and its likely merger with Spanish carrier Iberia should deliver huge strategic benefits. All in all, this leaves us confident that BA's share price should be one of those to take off as investor sentiment begins to turn around.

IT companies Logica and Misys also look like strong opportunities even though investors tend to see these kinds of firms as some of the last to be hit during a recession. Indeed, fears that the worst has yet to come for these names means that both remain extremely weak, and, in our opinion, extremely under-priced. Our confidence in Logica is based on good order and revenue growth (as shown in the latest results) and the fact that the management team's efforts to bring the disparate company together are beginning to pay off. Misys' share price also looks very low given its strongly performing healthcare division and the fact that virtually no value is currently ascribed to its still solid financial services division. Such considerations make both of these firms look very attractive even taking into account the possible pressures.



Merged business information group Thomson Reuters is a similar example – a good firm that seems to be afflicted by investors' bad memories from the last bear market. Indeed, the poor experience of the Reuters financial business last time around seems to be putting significant pressure on the combined company's shares. This is despite a much improved product offering within the financial division and the significant benefits that Thomson's far more defensive business areas are generating. Along with the substantial cost savings arising from the merger, these factors are producing some very good results, which we feel are not yet being adequately rewarded by investors.

The final two names that we feel are worth mentioning are oil & gas firm BG and beleaguered banking stock Royal Bank of Scotland – two stocks with little in common but, potentially, a lot to gain. The first has been a favoured name for many years and has continued to outperform its peers in what has been a relatively resilient sector. With exposure to all the right markets, particularly the fast-growing Liquefied Natural Gas (LNG) market, BG continues to be one of our top stock picks.

Perhaps somewhat controversially, so is RBS. While no-one is likely to have missed the extraordinary problems that have befallen this name and the global banking sector, we believe there is some significant value in RBS, particularly given government assurances that there is no desire to fully nationalise the sector. Indeed, with fewer players in the industry and significant government assistance, we believe RBS should be capable of rebuilding its long-term strength, and, with the shares currently priced well below the value of RBS' assets, we believe this leaves plenty of scope for the shares to rise.

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