

Henderson's US fund manager comments on recent events in the US financial sector

Nicholas Cowley, US Equities

Global markets have been rocked by the collapse of the US financial sector. It's unsurprising that the collapse of an institution such as Lehman Brothers - with a heritage dating back to 1850 - followed by the enforced takeover of Merrill Lynch and the emergency bailout of AIG, draws parallels with the great stockmarket crash of 1929. After that first Black Thursday, the Dow Jones took a quarter of a century to recover. Will 2008's Meltdown Monday provoke a similarly prolonged depression?

Now that we have seen the demise of three major brokers (Bear Stearns, Lehman Brothers and Merrill Lynch) the guessing game starts as to who will be next. There are currently major concerns surrounding AIG and Washington Mutual, and going forward the ongoing travails of the financial sector will have a significant and long-lasting effect on the US economy.

However, while the financial sector is forced to take its medicine, the short-term pain will prove beneficial in the long-run. We have long held the view that there were too many US banks fighting for market share and that a period of consolidation was necessary. As this enforced merger and acquisition continues, and as the Federal Reserve's aggressive interest rate cuts and other liquidity injections take effect, the industry will steadily become healthier. Those institutions strong enough to survive the cull should be well-placed in the years to come.

In terms of portfolio positioning, the Henderson Horizon American Equity Fund remains underweight in the financial sector, although we have been steadily - and selectively - reducing the scale of this position since the start of the year. We have continued to avoid those banks with balance sheet risks that are difficult to assess. Therefore our exposure is in companies with strong franchises who we believe will emerge from the credit crisis in a stronger competitive position.

We currently hold **Bank of America**. This is the only traditional bank stock in the portfolio, and we are sticking with it. The acquisitions of Countrywide and Merrill Lynch are not without risk. However, both deals make strategic sense. Bank of America is gaining a valuable private wealth management franchise in Merrill Lynch, and should emerge much stronger once the dust settles.

We recently opened a position in **Lazard**, a firm that offers M&A advice and investment management services. We feel this is a very strong direct play on the acceleration of strategic M&A, a theme that we have highlighted in the past. After a strong period of earnings growth, the bulk of US companies have strong balance sheets and so are well positioned to take advantage of more attractive valuations, whilst there are also signs that overseas companies are taking advantage of a weaker dollar to buy US assets. Lazard receives fees for acting as a financial advisor on these deals, but does not provide any financing. They have recently been involved in InBev's takeover of Anheuser-Busch, as well as Dow Chemical's acquisition of Rohm and Haas.

For US investors looking to take some positives out of the recent announcements, it is encouraging that earnings expectations for 2009 are being steadily re-set, presenting the opportunity for upside surprise as the economy slowly begins its recovery. The price of oil and commodities has come down significantly of late, with oil now back to its levels at the start of the year. This suggests that inflation is going to be much less of a concern going forward and provides respite for the US consumer. Outside of the financials sector there remain some well-managed companies with strong balance sheets and valuations that do not appear over-stretched.

The US banking sector and broader economy is seeing an unparalleled policy response, something that has yet to happen in most other major economies. In our view, the crisis in the financials sector will lead to continued volatility, but it is becoming clearer who the long term survivors will be. At the stock-picking level there are still opportunities to find attractively valued companies that have been indiscriminately downgraded by the market and that will be at the forefront of a recovery.



Industry Views

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