HSBC hit by fear factor as downturn spreads to Asia

Market report

Peter Stiff

HSBC has long been favoured in the UK banking sector, with its Asian exposure seen as making it the best placed to ride out the downturn.

However, now that a global recession is almost a certainty, it too, is likely to come under increasing pressure, according to analysts at Dresdner Kleinwort.

Yesterday the broker cautioned that with bad loans rising and its main Asian countries beginning to suffer, HSBC may cut its 2009 dividend substantially. It said that while HSBC remained capable of withstanding the impacts of a global recession, with one of the strongest balance sheets in Europe and good deposit inflows, it was not immune.

Dresdner is forecasting that the bank's dividend will fall 39 per cent between 2007 and 2009, to 74 cents in 2008 and 55 cents in 2009.

It has subsequently reduced its rating on the stock to "hold" from "buy" and cut its price target to 800p, down from £11.00, noting that while HSBC had been a core buy for it all year, recording a stellar 34 per cent outperformance against its peers, it now looked relatively expensive.

HSBC shares fell 17p to 733p following the rest of the banking sector, which weighed heavily on the FTSE 100, as concerns grow about levels of bad debts from both consumers and businesses.

These fears were exacerbated after **HBOS**, down 20.1p to 67½p, said that worsening market conditions and falling house prices had raised the number of bad loans and led to further asset impairments. **Lloyds TSB**, which is buying HBOS, was the index's second biggest faller, down 28.1p to 129.9p. **Royal Bank of Scotland** fell 10p to 56.1p and Barclays lost 13.1p to 148p.

Overall, the FTSE 100 slumped more than 2 per cent, falling 108.34 points to 4,280.35, with stock markets around the world taking fright after a huge bailout deal for US carmakers collapsed.

Man Group dropped 45p to 245¼p, after Moody's, the ratings agency, put the hedge fund manager's debt on negative watch, citing the growing pressure on sales and redemptions that the hedge fund and asset management industries are experiencing.

Royal Dutch Shell A fell 49p to £17.50 after reports that its Dutch pension fund has fallen into deficit, with stock market turmoil knocking 40 per cent off its value.

GlaxoSmithKline rose 2p to £19.99½ amid positive results in a study on Tykerb in combination with Novartis drug Femara.

In the FTSE 250 **Cattles** dropped another 7p to 23p as dealers continued to sell out after news Thursday that its banking licence would be delayed. Numis reiterated its thinking that the company needed the licence, which would allow it to accept deposits, or industry support in order to survive.

Travis Perkins, the building supplies group, rose 19p to 301½p, after saying it expects full year earnings to be in line with market expectations.

● **New York:** Stocks tumbled in morning trading amid mounting fears of a collapse of the Big Three US carmakers after the US Senate failed to agree a $14 billion rescue plan for them. The decline was in line with moves earlier in the day in Asia and Europe as the White House sought ways to save the industry. The Dow Jones industrial average was down 68.98 points at midday at 8,496.11.

Buyout puts Omega on the boil

Smaller companies

Shares in Omega International jumped more than 60 per cent yesterday after the kitchen furniture group's management offered to buy the company for £30.5 million.

Francis Galvin, the chief executive, said that given the current economic climate, the management team felt it was in the best interests of both employees and shareholders to take the company private.

The recommended offer of 108p a share represents a 74.6 per cent premium on the group's closing price on Thursday and will also entitle shareholders to an additional dividend of 2p a share. Shares rose 39½p to 102½p.

JJB Sports continued its slide, falling 1.49p to 7¾p, after Citigroup reduced its price target on the retailer to just 1p from 20p. Citi said the group's fate was in the hands of its lending banks, possibly leaving shareholders with little equity value.

Minerva rose ¼p to 14p after Nathan Kirsh, the South African investor, through his Kifin investment vehicle, raised his stake in the commercial property group to about 22.4 per cent. Mr Kirsh initially bought a large stake last month.

Smartfocus, the marketing software group, fell 1½p to 4½p after giving warning that annual results would be below market expectations because of contract and project delays. It remains cautious about its 2009 outlook.

MJ Gleeson, the urban regeneration group, is to cut jobs and curb pay to fight the property downturn. Excluding its profitable Powerminster unit, it will slash headcount to 50 from 224, reducing its annual payroll to £3.5 million from £12 million. Non-executive directors will also take a pay cut and there would be no formal bonus scheme in 2008-09. Paul Wallwork, chief executive, will step down. The shares fell 1p to 63p.

One of the safer havens when times get tough for investors

Nick Hasell
Tempus

The task of Lloyd's insurers may be to provide financial protection to their policyholders but over the past year they have done a pretty good job of protecting their shareholders, too.

The non-life insurance sector is one of the few corners of the stock market that has actually risen in 2008: up 3 per cent, against the 37 per cent slide in the FTSE all-share index. Since the sector's trough in October, that trend has been even more pronounced: up 25 per cent, relative to the 1 per cent advance of the wider market.

The most tangible sign of that strength came with this week's promotion of Amlin — now valued at £1.8 billion — to the FTSE 100, the first time in the index's history that a Lloyd's vehicle has won blue-chip status. Further down, that pattern was repeated in the elevation of Chaucer and Novae, formerly SVB Holdings, to the FTSE 250.

That progress says much about the peculiar dynamics of the non-life market that serve to insulate it from the wider woes of the financial services industry: whether from banks, asset managers — which they in some ways resemble — or even general and life insurers. But it also demonstrates the extent to which the unusual conjunction of credit crunch and a harsher than expected US hurricane season — a perfect storm, if you like — has played straight into its hands.

Non-life insurance is odd in that it has a cycle that is driven by catastrophe rather than by the economy's ebb and flow: typically a disastrous event, such as Hurricane Andrew in 1992 or the attacks on the World Trade Centre in 2001, that trigger big payouts to policyholders and huge losses for the underwriters, take capacity out of the market (from the payment of claims and the failure of those insurers not strong enough to take the hit) and, by dint of reduced supply, sends premium rates steadily higher.

That so-called "hardening" of rates boosts insurers' profitability but also attracts new capital into the industry such that, over time, increased competition for underwriting causes premium rates to fall. So it was that, before the events of this September, non-life insurers were 18 months into a downturn — the latter end of the cycle started by September 11 2001 — that might otherwise have been expected to run another four years or so.

But that cycle was abruptly reset this autumn. The immediate cause was turbulence in financial markets in the wake of Lehman Brothers's collapse that left insurers nursing estimated $100 billion losses in their investment portfolios. The casualties included AIG, previously the world's biggest insurer, which was rescued by the US Government, XL Capital, whose shares lost 90 per cent of their value, and Hartford, which sought an emergency cash injection from Allianz of Germany.

But disaster simultaneously struck elsewhere: in the Gulf of Mexico, where damage from Hurricane Ike proved worse than expected. After two quiet years in the aftermath of Hurricane Katrina, catastrophe losses have suddenly soared again — this year's losses are now put at $40 billion. The problem is that while insurers might usually be able to replenish their balance sheets with fresh funds, distress in the capital markets means that is not an option. Meanwhile, the weakening of AIG means that there should be less competion for new business.

The upshot is that analysts now predict that premium rates will start to head higher. One harbinger of that trend can be seen in resinsurance markets, where a lack of capacity to back "high level" business — risks of $20 billion and above — has sent rates up between 10 per cent and 20 per cent.

In a heavyweight circular issued this week, Numis Securities said it expects average non-life premium rates to rise 5 per cent in each of the next two years — a sharp turnaround from an estimated 8 per cent fall in 2008. As a result, Nick Johnson, analyst, has raised next year's profit forecasts for the sector by an average 15 per cent, and those for 2010 by a heady 21 per cent.

But how recession-proof can non-life insurers prove? Tougher times should, in theory, make businesses more risk-averse and more inclined to take out cover for assets they otherwise could not afford to replace. The flipside is that the incidence of insurance fraud tends to rise in a downturn and that severe pressure on cashflows could even cause business to cancel their policies. The broader worry is the potential lessening of demand from a slowdown in global trade, a decrease in spending on private sector capital projects and a straightforward decrease in the number of companies through insolvency. Shareholders should also prepare for equity fundraisings from insurers: a process begun by this week's £130 million share placing by Omega Insurance.

The broader comfort is that Lloyd's insurers are being helped by a stronger US dollar — the currency in which they do roughly 60 per cent of their business — and that the sector's share prices typically peak between 18 months to two years after the bottom of the cycle: a point by common conensus that was passed two months ago.

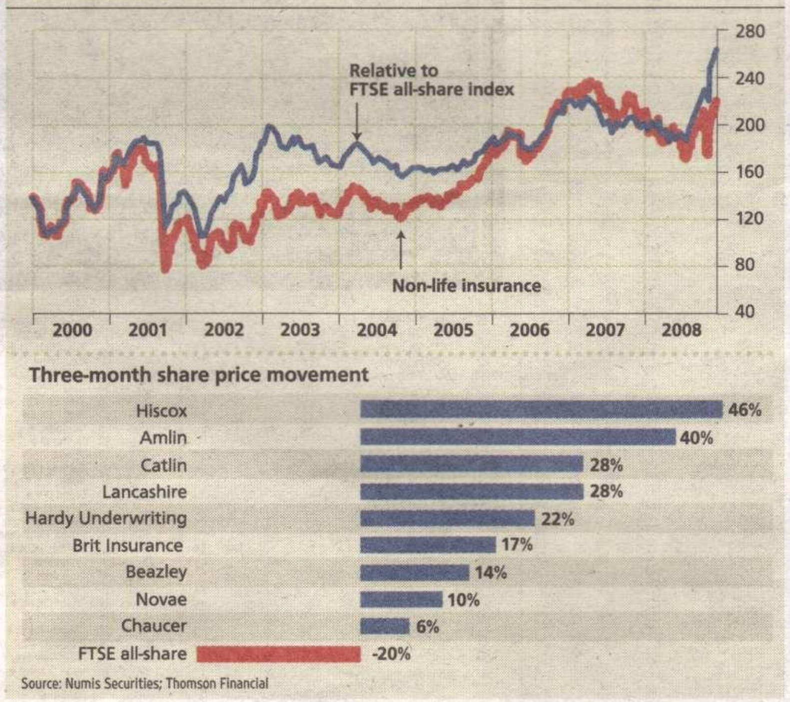
So where to invest? Numis picks out Beazley, Brit Insurance, Hardy Underwriting and Lancashire Holdings — all of which, apart from the latter, also come with a yield.

Online

Read Tempus online, weekdays at lunchtime

timesonline.co.uk/markets

Port in a storm



Source: Numis Securities; Thomson Financial

Gilts

Renewed fears about the health of Britain's financial sector helped gilts to outperform their eurozone counterparts, while a hunt for short-dated, liquid assets steepened the yield curve. Thin volumes made for choppy trade, with rising risk aversion the dominant theme. The long gilt future was five ticks higher at 118.28.

Rumour of the day

Hunting, the oil services group, fell 14p to 411p on fear that the £626 million sale of Gibson Energy to Riverstone, the private equity firm advised by Lord Browne of Madingley, the former chief executive of BP, may fall through because of lower oil prices. Such concerns are thought to be wide of the mark, with both sides hoping to sign this weekend.

Deal of the day

David Phipps, chief executive of Commoditrade has bought 700,000 shares in the commodities group. This is Mr Phipps' first purchase since joining the company in September. The group, up 0.88p to 4.375p, has one of the largest teams on the London Metal Exchange and recently bought Amco, the base metals fund manager.

Bet of the day

HBOS shareholders have approved its takeover by Lloyds TSB. Both stocks were under pressure after HBOS revealed £8 billion in bad debts and charges for mortgage, loan and business arrears. Cantor Index offers evens that the combined bank will need even more capital from the government than it has already been granted by the end of Janurary.

Tiddler to watch

Hilton Foods stayed firm at 143½p yesterday after Shore Capital, in a review of small and mid-cap food processors, gave the meat supplier a "buy" rating. The broker said the entire sector had been sold down too aggressively in the recent downturn and that Hilton in particular was too lowly rated given its tight business model.

HSBC hit by fear factor as downturn spreads to Asia

Market report

Peter Stiff

HSBC has long been favoured in the UK banking sector, with its Asian exposure seen as making it the best placed to ride out the downturn.

However, now that a global recession is almost a certainty, it too, is likely to come under increasing pressure, according to analysts at Dresdner Kleinwort.

Yesterday the broker cautioned that with bad loans rising and its main Asian countries beginning to suffer, HSBC may cut its 2009 dividend substantially. It said that while HSBC remained capable of withstanding the impacts of a global recession, with one of the strongest balance sheets in Europe and good deposit inflows, it was not immune.

Dresdner is forecasting that the bank's dividend will fall 39 per cent between 2007 and 2009, to 74 cents in 2008 and 55 cents in 2009.

It has subsequently reduced its rating on the stock to "hold" from "buy" and cut its price target to 800p, down from £11.00, noting that while HSBC had been a core buy for it all year, recording a stellar 34 per cent outperformance against its peers, it now looked relatively expensive.

HSBC shares fell 17p to 733p following the rest of the banking sector, which weighed heavily on the FTSE 100, as concerns grow about levels of bad debts from both consumers and businesses.

These fears were exacerbated after **HBOS**, down 20.1p to 67½p, said that worsening market conditions and falling house prices had raised the number of bad loans and led to further asset impairments. **Lloyds TSB**, which is buying HBOS, was the index's second biggest faller, down 28.1p to 129.9p. **Royal Bank of Scotland** fell 10p to 56.1p and Barclays lost 13.1p to 148p.

Overall, the FTSE 100 slumped more than 2 per cent, falling 108.34 points to 4,280.35, with stock markets around the world taking fright after a huge bailout deal for US carmakers collapsed.

Man Group dropped 45p to 245¼p, after Moody's, the ratings agency, put the hedge fund manager's debt on negative watch, citing the growing pressure on sales and redemptions that the hedge fund and asset management industries are experiencing.

Royal Dutch Shell A fell 49p to £17.50 after reports that its Dutch pension fund has fallen into deficit, with stock market turmoil knocking 40 per cent off its value.

GlaxoSmithKline rose 2p to £19.99½ amid positive results in a study on Tykerb in combination with Novartis drug Femara.

In the FTSE 250 **Cattles** dropped another 7p to 23p as dealers continued to sell out after news Thursday that its banking licence would be delayed. Numis reiterated its thinking that the company needed the licence, which would allow it to accept deposits, or industry support in order to survive.

Travis Perkins, the building supplies group, rose 19p to 301½p, after saying it expects full year earnings to be in line with market expectations.

● **New York:** Stocks tumbled in morning trading amid mounting fears of a collapse of the Big Three US carmakers after the US Senate failed to agree a $14 billion rescue plan for them. The decline was in line with moves earlier in the day in Asia and Europe as the White House sought ways to save the industry. The Dow Jones industrial average was down 68.98 points at midday at 8,496.11.

Buyout puts Omega on the boil

Smaller companies

Shares in Omega International jumped more than 60 per cent yesterday after the kitchen furniture group's management offered to buy the company for £30.5 million.

Francis Galvin, the chief executive, said that given the current economic climate, the management team felt it was in the best interests of both employees and shareholders to take the company private.

The recommended offer of 108p a share represents a 74.6 per cent premium on the group's closing price on Thursday and will also entitle shareholders to an additional dividend of 2p a share. Shares rose 39½p to 102½p.

JJB Sports continued its slide, falling 1.49p to 7¾p, after Citigroup reduced its price target on the retailer to just 1p from 20p. Citi said the group's fate was in the hands of its lending banks, possibly leaving shareholders with little equity value.

Minerva rose ¼p to 14p after Nathan Kirsh, the South African investor, through his Kifin investment vehicle, raised his stake in the commercial property group to about 22.4 per cent. Mr Kirsh initially bought a large stake last month.

Smartfocus, the marketing software group, fell 1½p to 4½p after giving warning that annual results would be below market expectations because of contract and project delays. It remains cautious about its 2009 outlook.

MJ Gleeson, the urban regeneration group, is to cut jobs and curb pay to fight the property downturn. Excluding its profitable Powerminster unit, it will slash headcount to 50 from 224, reducing its annual payroll to £3.5 million from £12 million. Non-executive directors will also take a pay cut and there would be no formal bonus scheme in 2008-09. Paul Wallwork, chief executive, will step down. The shares fell 1p to 63p.

One of the safer havens when times get tough for investors

Nick Hasell
Tempus

The task of Lloyd's insurers may be to provide financial protection to their policyholders but over the past year they have done a pretty good job of protecting their shareholders, too.

The non-life insurance sector is one of the few corners of the stock market that has actually risen in 2008: up 3 per cent, against the 37 per cent slide in the FTSE all-share index. Since the sector's trough in October, that trend has been even more pronounced: up 25 per cent, relative to the 1 per cent advance of the wider market.

The most tangible sign of that strength came with this week's promotion of Amlin — now valued at £1.8 billion — to the FTSE 100, the first time in the index's history that a Lloyd's vehicle has won blue-chip status. Further down, that pattern was repeated in the elevation of Chaucer and Novae, formerly SVB Holdings, to the FTSE 250.

That progress says much about the peculiar dynamics of the non-life market that serve to insulate it from the wider woes of the financial services industry: whether from banks, asset managers — which they in some ways resemble — or even general and life insurers. But it also demonstrates the extent to which the unusual conjunction of credit crunch and a harsher than expected US hurricane season — a perfect storm, if you like — has played straight into its hands.

Non-life insurance is odd in that it has a cycle that is driven by catastrophe rather than by the economy's ebb and flow: typically a disastrous event, such as Hurricane Andrew in 1992 or the attacks on the World Trade Centre in 2001, that trigger big payouts to policyholders and huge losses for the underwriters, take capacity out of the market (from the payment of claims and the failure of those insurers not strong enough to take the hit) and, by dint of reduced supply, sends premium rates steadily higher.

That so-called "hardening" of rates boosts insurers' profitability but also attracts new capital into the industry such that, over time, increased competition for underwriting causes premium rates to fall. So it was that, before the events of this September, non-life insurers were 18 months into a downturn — the latter end of the cycle started by September 11 2001 — that might otherwise have been expected to run another four years or so.

But that cycle was abruptly reset this autumn. The immediate cause was turbulence in financial markets in the wake of Lehman Brothers's collapse that left insurers nursing estimated $100 billion losses in their investment portfolios. The casualties included AIG, previously the world's biggest insurer, which was rescued by the US Government, XL Capital, whose shares lost 90 per cent of their value, and Hartford, which sought an emergency cash injection from Allianz of Germany.

But disaster simultaneously struck elsewhere: in the Gulf of Mexico, where damage from Hurricane Ike proved worse than expected. After two quiet years in the aftermath of Hurricane Katrina, catastrophe losses have suddenly soared again — this year's losses are now put at $40 billion. The problem is that while insurers might usually be able to replenish their balance sheets with fresh funds, distress in the capital markets means that is not an option. Meanwhile, the weakening of AIG means that there should be less competion for new business.

The upshot is that analysts now predict that premium rates will start to head higher. One harbinger of that trend can be seen in resinsurance markets, where a lack of capacity to back "high level" business — risks of $20 billion and above — has sent rates up between 10 per cent and 20 per cent.

In a heavyweight circular issued this week, Numis Securities said it expects average non-life premium rates to rise 5 per cent in each of the next two years — a sharp turnaround from an estimated 8 per cent fall in 2008. As a result, Nick Johnson, analyst, has raised next year's profit forecasts for the sector by an average 15 per cent, and those for 2010 by a heady 21 per cent.

But how recession-proof can non-life insurers prove? Tougher times should, in theory, make businesses more risk-averse and more inclined to take out cover for assets they otherwise could not afford to replace. The flipside is that the incidence of insurance fraud tends to rise in a downturn and that severe pressure on cashflows could even cause business to cancel their policies. The broader worry is the potential lessening of demand from a slowdown in global trade, a decrease in spending on private sector capital projects and a straightforward decrease in the number of companies through insolvency. Shareholders should also prepare for equity fundraisings from insurers: a process begun by this week's £130 million share placing by Omega Insurance.

The broader comfort is that Lloyd's insurers are being helped by a stronger US dollar — the currency in which they do roughly 60 per cent of their business — and that the sector's share prices typically peak between 18 months to two years after the bottom of the cycle: a point by common conensus that was passed two months ago.

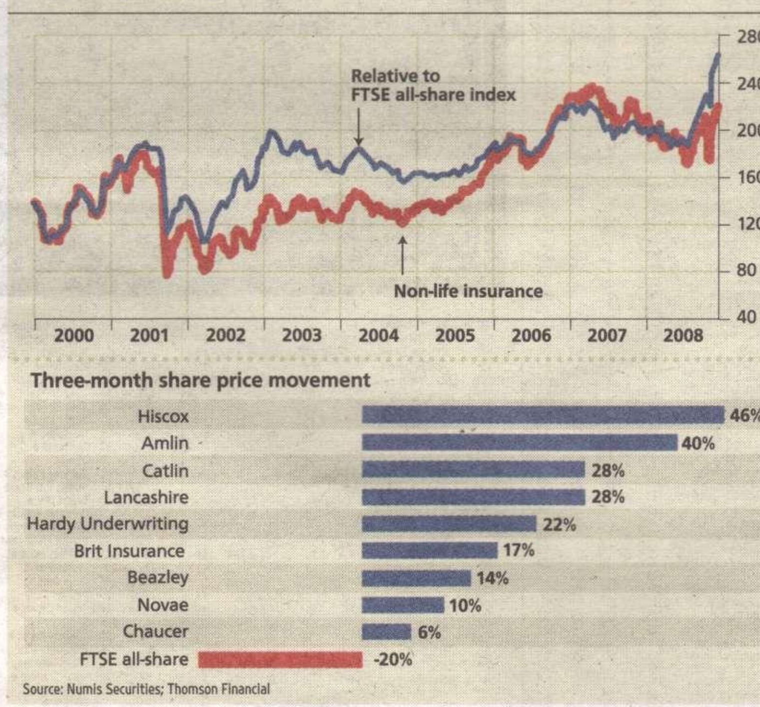
So where to invest? Numis picks out Beazley, Brit Insurance, Hardy Underwriting and Lancashire Holdings — all of which, apart from the latter, also come with a yield.

Online

Read Tempus online, weekdays at lunchtime

timesonline.co.uk/markets

Port in a storm



Source: Numis Securities; Thomson Financial

Gilts

Renewed fears about the health of Britain's financial sector helped gilts to outperform their eurozone counterparts, while a hunt for short-dated, liquid assets steepened the yield curve. Thin volumes made for choppy trade, with rising risk aversion the dominant theme. The long gilt future was five ticks higher at 118.28.

Rumour of the day

Hunting, the oil services group, fell 14p to 411p on fear that the £626 million sale of Gibson Energy to Riverstone, the private equity firm advised by Lord Browne of Madingley, the former chief executive of BP, may fall through because of lower oil prices. Such concerns are thought to be wide of the mark, with both sides hoping to sign this weekend.

Deal of the day

David Phipps, chief executive of Commoditrade has bought 700,000 shares in the commodities group. This is Mr Phipps' first purchase since joining the company in September. The group, up 0.88p to 4.375p, has one of the largest teams on the London Metal Exchange and recently bought Amco, the base metals fund manager.

Bet of the day

HBOS shareholders have approved its takeover by Lloyds TSB. Both stocks were under pressure after HBOS revealed £8 billion in bad debts and charges for mortgage, loan and business arrears. Cantor Index offers evens that the combined bank will need even more capital from the government than it has already been granted by the end of Janurary.

Tiddler to watch

Hilton Foods stayed firm at 143½p yesterday after Shore Capital, in a review of small and mid-cap food processors, gave the meat supplier a "buy" rating. The broker said the entire sector had been sold down too aggressively in the recent downturn and that Hilton in particular was too lowly rated given its tight business model.