Preferred

Investment Market Review

Issue 2 2010

We are pleased to provide you with our latest Investment Market Review.

The UK economy pulled out of the recession more strongly than first anticipated as GDP growth for the final quarter of 2009 was upwardly revised to 0.3% from 0.1%. Similarly, US GDP figures were revised from 5.7% to 5.9% amongst much positive economic data from both the UK and US.

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The risk of the UK slipping back into recession has receded, as quarterly GDP growth is now predicted to be in excess of 1%. Companies reporting in the first quarter of 2010 have shown increased profits and revenues, beating expectations in the US & UK.

The Bank of England's Monetary Policy Committee (MPC) maintained the record low UK interest rate of 0.5% and held the Quantitative Easing (QE) programme at £200 billion. The recent Inflation figure of 3.5% looks to be artificially high and it is likely that economic factors such as high unemployment and lower consumption in the UK will push the rate back to below the government's 2% target in the second half of 2010.

2009 / 2010	RPI (%)	CPI (%)	Unemployment (%)	GDP Growth (%)
August	-1.3	1.6	7.8	Q2 - 3.6
September	-1.4	1.1	7.9	
October	-0.8	1.5	7.8	Q3 - 3.3
November	0.3	1.9	7.8	
December	2.4	2.9	7.8	Q4 - +0.3
January	3.7	3.5	7.8	
February	3.7	3.0		Q1 - +1.3*

**Independent forecast data from HM Treasury Based on percentage change on previous year Economy*

Further signs of economic stabilisation are evident as UK unemployment fell back, although this may be due to additional seasonal employment at Christmas and may level-out in coming months. US and Eurozone unemployment figures were also unchanged at 9.7% and 9.9% respectively, providing further support to the notion that levels may well start to decline.

The recent decline in Sterling was perpetuated by the weakening of the Conservatives' lead in the UK General Election polls, prompting fears of a hung parliament that may delay plans to cut government borrowing. The US Dollar has continued to strengthen in the first quarter of 2010 as the Euro has suffered due to serious questions over the increasing debt levels within Eurozone member states.

These heavily indebted nations of Europe have gained unwanted attention recently as fears have grown that they may not be able to satisfy all of their debt obligations. The most heavily indebted is Greece, whose national debt in 2009 stood at 86.1% of GDP. Greece plans to raise a total of €54billion in debt this year and has instigated a major austerity campaign. There are concerns that Spain could be the next major European country to be forced to face up to debt-repayment problems, but the debt in this case would be significantly larger.

The Chancellor's annual budget included some positive news for businesses and investors. As well as doubling the Entrepreneurial allowance and holding the Capital Gain Tax Rate, the increased ISA allowance was also extended to everyone this month and will rise with inflation from next year. The Inheritance Tax threshold was 'frozen' for the next four years at the current rate of £325,000.

So, what does all this mean for your portfolio?

Fixed Interest

Corporate bonds continued to outperform government bonds (gilts) throughout the quarter, with higher income bonds benefiting the most. This was driven by increased investment, expectations of a drop in corporate bad-debt throughout 2010 and an aversion to gilts by the market.

Gilts rose slightly in the first quarter when the prospect of further QE was mentioned in the Bank of England's Monetary Policy Committee meeting's minutes. An auction of £3billion 2019-dated gilts was popular with investors and received enough demand for double the available amount.

In our models, we currently hold very little exposure to conventional gilts. There remains some uncertainty (founded or not) over the UK's AAA rating, furthermore weak Sterling and potential inflation could perpetuate this situation. We remain content that a proportion of Index-Linked Gilts is appropriate within Cautious, Conservative and Balanced portfolios to benefit from current inflation levels and any potential longer term rise, and to add top-quality diversification to a blend of fixed interest instruments within lower-risk portfolios. These include a bias towards strategic bonds, which have a more flexible mandate and can hedge against potential interest rate rises.

We anticipate that returns will be yielded from income more than from capital appreciation in this sector this year. As such, we are confident that our wide range of high quality, UK and international corporate debt funds can help to mitigate country-specific risk. Such diversification is even more important than usual in the current economic climate.

Equities

A steady stream of positive news from reports and data releases in the US has pushed American, and in turn the UK markets up after significant dips in January and February. These drops were largely due to concerns over the national debt, as well as fears of tighter regulation for financial institutions.

The FTSE 100 broke through 5700, just days after the one-year anniversary of the beginning of the stock market's rebound from its lows last March, a rise of nearly 60%.

Despite the fears over certain European nations, our European funds have returned above-average gains in the first quarter due to some selective stock-picking. Having minimal exposure to the so-called 'PIIGS' (Portugal, Italy, Ireland, Greece and Spain) in our portfolios provides protection, as the single currency's weakness will be felt across the Eurozone.

China took its first steps towards fiscal tightening, which sparked fears that they could trigger a slowdown in the global recovery, but China's pro-active fiscal policy looks set to continue and the nation is still predicted to grow by 8% this year. Politically, as well as economically, we remain concerned about China and their often-strained relationship with the West. Recently, the US has clashed with China over the Copenhagen Climate Summit, Censorship (via Google) and Iranian and Taiwanese arms sales.

Property

The property sector has experienced a positive start to the year so far; funds have gained up to 3% in the first quarter from capital appreciation alone. Income from Property remains high, with up to 6% per annum still being paid by large direct property funds. It is anticipated that the recovery in property will be slow and that returns from property investments will benefit much more from the income produced than from capital appreciation over the remainder of 2010.

The reduction in the value of Sterling has attracted further foreign investment in UK property and could continue to do so, as the prospects for the currency are uncertain. We can envision introducing a larger proportion of property into our more cautious and balanced investment models in the future, as the long-term prospects are very positive and whilst the yield remains far above the current rate available on cash. We believe valuations to be attractive and that the falls experienced in the past couple of years are firmly overcome.

Commodities/Specialist

The Oil price briefly dipped below $70 when markets were losing ground at the start of the year, but later a weaker dollar and positive employment data pushed it back above the $80 mark.

Oil has recently been boosted by positive news in the form of China's plans to extend its stimulus package, and global recovery hopes have propelled oil prices since the lows in February this year.

The prospects for gold are mixed and are dependant on as yet unknown factors. If concerns over certain Western economies continue to emerge, gold could be a valuable 'safe-haven'. Equally, if growth in Emerging Markets continues to increase, the demand from these regions will continue to be high. Alternatively, gold is frequently used to mitigate the eroding effects of inflation; the strength of dollar may put pressure on high gold prices if the currency maintains its potency.

Our recent reduction in exposure to both oil and gold prevented some unwelcome volatility during the first quarter of this year, and we are content for these to remain at current levels for the time being.

Conclusion

From the gains we have made this year, we expect to see modest signs of growth in the rest of 2010, and we continue to anticipate setbacks. Volatile market movements have already been seen this year and may become more common as markets get overstretched, or conversely undervalued. Paying down debt on a state, company and individual basis will continue to hold back growth in the UK in the short to medium term as consumption and investment spending will be reduced.

Economic data seems to be in favour of hard-fought, moderate positive growth in markets; low interest rates and other accommodative monetary policy along with strong corporate earnings and improving labour markets indicate that the economy is moving in the right direction, but this position remains precarious. Our investment models continue to utilise a strong and stable asset-base and the aim in all models is to use high income-producing elements where growth may be more difficult or volatile. We remain content with our exposure to property, as we believe that commercial property may continue to improve over the next quarter. The high degree of income generated from this will also help to drive returns. On this basis, we are not recommending any rebalancing of portfolios this quarter.

As ever, it remains very important that your portfolio continues to reflect your attitude to investment risk, your current circumstances and should be regularly reviewed. If you are taking income, then we would recommend further regular reviews as to the ability of your portfolio to sustain the required level of income to meet needs and requirements.

It is important to note that returns from investment funds are not guaranteed and the value of your capital and any income taken can fall as well as rise. Past performance should not be seen as a guide to future returns. The views expressed in this Market Review are based on our current understanding of market conditions.

Gibbs Denley Investment Committee
April 2010

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