



MARKET COMMENTARY - FOURTH QUARTER 2009
MARKET OUTLOOK
Spring 2010

INVESTMENT REVIEW

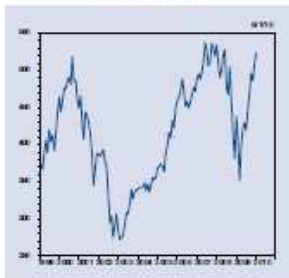
We have reviewed the market data and economic conditions resulting in an amendment to our asset allocation models. Our successful Strategic Portfolio Service which has now been running for 12-months provides an active quarterly fund review; please let us know if you would like more information on this. Our quarterly reviews provide our views on market and economic factors that influence our investment strategy.

EXECUTIVE SUMMARY

- Evidence continues to build that the US and Global recessions are over and sustained economic recovery has begun.
- Central Banks are expected to leave interest rates at current levels until the autumn.
- Sterling and Gilts may come under pressure as quantitative easing ends.

ECONOMIC OVERVIEW

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A consensus of economic forecasts shows the UK economy growing by 1.2% in 2010, whilst the US fares better at 2.7%. In contrast to this, emerging markets are expected to rise at a pace greater than 5% with China in danger of over heating with figures approaching 9%. Prospects for the UK economy look lack lustre given the excessive Government and household debt. The UK remains at the lower end of the economic spectrum in terms of both timing and strength of the recovery. There remains a weak jobs market, low real wage growth with higher taxes expected on the way and the reduced availability of credit still signalling an anaemic recovery in 2010. House prices may remain too high relative to disposable incomes with the ability to service debt for some meaning growth in mortgage arrears and credit card default continues.

UK investors may despair about the domestic economic outlook, however many larger UK companies have good global prospects given their international status and overseas earnings ability. It is Asia that has led the global economy out of recession thanks to the financial stimulus measures and improved trade amongst the region itself rather than exporting to the West. Prospects for the debt ridden developed Western World are less favourable. Recovery is being engineered by the immense level of liquidity pumped into economies by Central Banks, but clearly this will not last forever.

INTEREST RATES

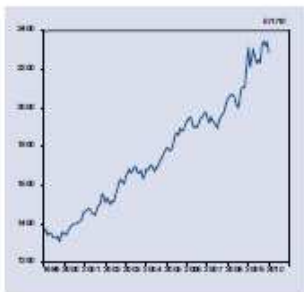
It would appear that the Federal Reserve will maintain their highly accommodative policy on interest rates for sometime to come and we don't expect to see any interest rate rises until the labour markets start to improve, which is not expected to happen until the second half of 2010. We expect UK interest rates to remain flat for most of the year, as the Government will not wish to kill off any signs of sustained economic recovery.

The UK Government faces a significant medium-term fiscal challenge. Weak growth, banking loss of profitability and falling employment have caused tax revenues to fall markedly. The budget deficit continues to be financed by Gilt issuance and absorbed by the Bank of England quantitative easing programme which, in all reality, is due to end in the near future.

FIXED INTEREST

If the budget deficit is not addressed by policy makers there is a reasonable chance that the UK sovereign credit rating is downgraded by one if not more, of the Credit Rating Agencies. It is clear that recent problems in Dubai followed by the downgrading of Greece and Portugal, as well as problems in Spain and Ireland mean that this eventuality is a possibility. We remain bearish on UK Government Bonds for the coming year. Borrowing is expected to be £178 billion in 2009 with a similar figure required for 2010. The public debt ratio is projected to rise to 78% in 4-years time. This huge supply of Government Bonds that are likely to be issued over the next few years will put considerable upward pressure on yields, resulting in capital value falls.

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Once the support for quantitative easing by the Bank is withdrawn, there is a concern that Gilts will significantly weaken.

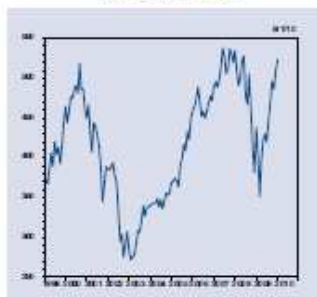
It is estimated that £110 billion of Bond purchases will be taken up by UK Banks required to strengthen their balance sheets. This will provide some support, as would a return to investor risk aversion, with Gilts seen as a safe haven for temporary assets. Bond yields in excess of 4%, whilst base rates remain at 0.5% seem attractive, however issues of supply and demand appear to be overwhelming in this case although markets may already be pricing in some of the factors aforementioned.

We believe fundamentally Corporate Bonds and High Yield Issue remain relatively strong; however there may be a knock-on effect of weakening Gilts in other credit markets with Corporate Bonds coming under pressure.

EQUITY MARKETS

Although the UK economy looks weak, it is quite possible that the UK Stock Markets as well as the outlook for global equities will be strong for 2010. The first strong reaction since March 2009 may have surprised many but this is quite possibly the start of a new sustained run for equities. There are always going to be concerns over short-term setbacks, however these should be seen as buying opportunities and not confused with the start to the next downward leg.

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We remain positive on equities especially large international companies with overseas earnings and as well as the obvious Asian and Emerging Markets, we believe the US has adapted to the recovery phase better than Europe which persists with restrictive labour practices and relative strength of the Euro.

Perversely, any decent recovery in economic growth and hence asset prices, would leave the Bank of England able to start nudging up interest rates. This reversal in monetary policy could cause significant headwinds for equity sentiment and kill off the economic recovery. Conversely though, should the Bank of England leave monetary policy too loose for longer than the rest of the world, the consequences for Sterling and Gilts could be detrimental. Certainly the pace of recovery and the maintenance of low rates are likely to dominate sentiment to UK stocks for much of the year. Electoral nervousness in coming months will no doubt unsettle markets as opinion polls shift resulting in a likely increase in volatility in markets for the next few months. Encouragingly however, valuations on UK equities remain supportive and in no way stretched, which should limit any downside during such periods of volatility. UK equities still offer far more than pure UK based profit streams. Companies have been exceptionally swift at cutting costs to protect profits and therefore we believe equity markets will show greater strength than the underlying UK economy.

COMMERCIAL PROPERTY

The commercial property sector is now showing strong signs of recovery with competition for attractive saleable properties increasing substantially in the last 6-months. We continue to believe that this asset class offers exceptional levels of rental income combined with sustainable increases in underlying valuations. We are therefore increasing our exposure to this asset class as an attractive diversifier for equities.

ASSET ALLOCATION

Our outlook for equities remains positive and the theme of favouring Asian and emerging markets continues. We are reducing exposure to smaller UK stocks which reflect directly the state of the UK economy in favour of larger international exposed stocks, in particular funds which have defensive qualities such as pharmaceuticals, utilities and healthcare. Our nervousness regarding Gilts also reflects the possible knock-on effects for Corporate Bonds and therefore asset allocation to Fixed Interest is being reduced accordingly. Our exposure to equities still needs to be balanced by non-correlating assets and therefore the increase in commercial property funds alongside greater use of absolute return strategy funds maintains the diversity of asset selection. We continue to believe that whilst further strong rises in equity markets are unlikely, returns could surprise on the upside as economic recovery remains on-track and the stock selection ability of the fund managers we use continue to out-perform the market in general.

Source: Datastream