



INVESTMENT REVIEW

We have reviewed the market data and economic conditions resulting in an amendment to our allocation models. Our Strategic Portfolio Service provides an active quarterly fund review; please let us know if you would like more information on this. Our quarterly market outlook provides our views on markets and economic factors that influence our investment strategy.

The main themes currently are:

EXECUTIVE SUMMARY

The fate of the world economy and the prospects of financial markets in 2012 depend primarily on three main areas of concern:

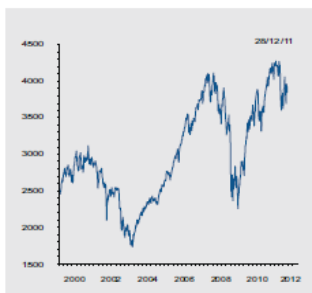
- The outcome of the Eurozone debt crisis remains very unclear, with Greek officials openly discussing the possibility of leaving the Euro.
- The US has seen some improvement, limited to certain sectors of the economy, but other headwinds will persist.
- The Chinese economy remains excessively dependent on external demand and hence vulnerable to the deepening downturn in Europe.

ECONOMIC OVERVIEW

The deteriorating situation in the Eurozone is likely to lead to outright recession as financing costs in the periphery rise, banks restrict credit and fiscal austerity plans bite. The only solution we see is that Germany gives into quantitative easing by the ECB in return for support and strict IMF fiscal monitoring for Italy and others. There may be more short-term pain before Germany changes this stance. This action could eventually restore confidence but damage will have been done.

The current steps where the leaders are committing countries to a greater measure of fiscal discipline and boosting various stabilisation tools or rescue funds are laudable but financial markets are likely to require far more tangible measures and a more urgent timetable. The current measures may help avoid the next crisis, but they are not capable of solving the current crisis. Banks and sovereigns in the euro area are locked in a mutually destructive embrace - if sovereigns default then banks face ruin, but if private markets refuse to recapitalise impaired banks, only sovereigns with no fundraising power remain.

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The knock-on effect is felt most keenly in the south of Europe with the possibility that the UK will also drop back into recession as trade and exports fall. The US may also be hit by the loss of Eurozone demand and cutbacks by European banks. In addition, we see more fiscal tightening this year, especially following the failure of the so-called super committee in the US to agree the President's extension to various stimulus. However, some economic data has improved in recent weeks and not everything may be doom and gloom. The American housing market has fallen by some 30% and is stabilising, but it is still the case that over 22% of mortgage borrowers are in negative equity which in turn will constrain their ability to consume. It is not feasible for the US economy to experience a bounce-back of strong 3% to 4% growth typified in recent recoveries. The US though should still grow at 1% to 2% real GDP and avoid an outright recession.

Asian economies have strong trade links with the Eurozone and the crisis, should it deepen, will only reinforce the slowdown currently underway in China.

On the policy front, with central banks unable to cut interest rates further we expect the Fed, ECB and Bank of England to all embark on quantitative easing this year. Should this happen with a beefing up of the European Financial Stability Facility and if the US Congress were to agree the extension of the fiscal stimulus, Asian central banks allow further appreciation of their currencies, a stronger global outlook may occur. The Eurozone may then suffer only a mild recession and the US should maintain their recent improvement in performance. Asian and emerging markets may also be a winner in a better global environment.

However, a disorderly breakup of the Euro where Germany holds its line on not allowing QE, resulting in the ECB being unable to cap Bond yields could see a series of defaults in Italy, Spain and others. There may be a more orderly breakup, but the difficulty of putting in place a sufficient firewall to limit contagion in the event of any single country leaving makes this unlikely.

EQUITY MARKETS

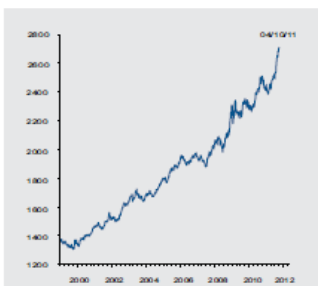
The Chinese economy has also been losing momentum with weaker domestic demand coupled with a distinct slowing of export growth. We do not see a so called hard landing, but should the Eurozone deteriorate significantly, China's growth will shrink greater than expected. China's economic success has sustainable roots with high domestic savings and strong foreign investment, other factors as strong government balance sheet and a sustainable migration of workers will support growth in the medium to long-term.

In such continuing economic stress, medium to smaller sized companies can struggle with the headwinds they are faced with. We currently favour large multi-national companies who can maintain a strong dividend payment. The defensive stocks all look relatively cheap and most markets have generally traded at significantly discounted levels to their long-term price to earnings ratios. There is a delicate balance at play here, where Asian and emerging markets appear to offer the greatest value in the long term, but have been the most affected by the Eurozone crisis. We see this continuing in the first half of 2012 until some form of resolution is found. Therefore in order to protect portfolios we need to protect assets in the short-term by becoming defensive in stock selection and temporarily reduce our exposure to risk markets although the long-term potential in the east is still greatest.

Price to book ratios also indicate that there is value to be found in equities. Although we all know that given the sentiment currently in markets there is a 'risk off' attitude and aversion to equities at present due to the unlikely but possible breakup of the Euro. Should the outcome in sentiment only marginally improve there is a possibility of a significant recovery of risk assets and therefore we remain balanced across portfolios to equity risk in general.

FIXED INTEREST

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Government bonds have gone from strength to further strength with the UK still retaining the safe haven appeal. Ultimately should the situation deteriorate, the UK will retain this status for a little while longer. To buy some protection we have looked at inflation-linked bonds as cheap insurance. In the UK the breakeven inflation rate between five year gilts and five year index-linked gilts is only 1% on a CPI basis. This means the market is currently pricing in significant disinflation, but in a world of printing money and fuller employment being an unspoken target we anticipate index-linked bonds to be currently mispriced. In addition to this the Bank of England now owns 25% of the debt issued by the UK government and as the largest continuing buyer of government bonds there is a market expectation that the bank will have to turn to index-linked bonds for future purchases. Inflation is unlikely to fall back to levels below the Bank of England 2% target for long with inflation possibly exceeding 3% on average over the coming months, making inflation-linked bonds attractive as a defensive security.

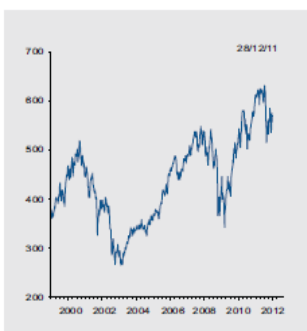
In addition to this we believe that both investment grade and high yield bonds represent good value at the current price levels and in the unlikely event that a significant recession occurs the value of quality bonds will rise. Many corporates have stronger balance sheets than governments and ultimately the market will recognise this one-day, therefore value exists at many levels.

COMMERCIAL PROPERTY

Commercial property is relatively stable and unexciting at present but continues to provide stability in the overall mix of assets. Rental yields again maintain the most attractive elements of this asset.

ASSET ALLOCATION

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We are maintaining our cautiously positive position in equity weightings based on the potential upside from the current position. However, the Eurozone crisis means that we must look to protect assets within our portfolios without taking too much risk off the table. We are underweight government bonds in general, but use index-linked bonds to maintain an allocation in a portfolio context as they offer a degree of insurance against the worst case scenario. We expect a choppy first half to 2012 as the European debt crisis continues to take centre stage. We may well revert to the long-term theme of Asian and emerging markets should European politicians provide some confidence that they are managing the situation successfully, a move unlikely until the second half of the year. In the meantime our equity exposure is shifted towards global businesses with strong, well established brand names and efficient balance sheets. Overall we believe that carefully selected UK and global blue chips enable our investors to supplement their portfolio with assets purchased at deep long-term value, at a time when most market participants are more concerned about the short-term. We continue to see the best risk-adjusted opportunities among the equity and corporate debt of high-quality businesses operating in more stable market sectors, which have greater scope to grow regardless of the broader macroeconomic backdrop. In difficult and volatile circumstances, the ability both to survive and deliver a dividend should be increasingly valuable.

A recession in Europe will have an impact on emerging markets through trade and financial channels, as European banks, dominate lending into Asian. We have reduced our emerging market exposure temporarily, but a weak global economy in 2012 could provide a good long-term buying opportunity later in the year. Corporate bonds are attractive and within equity markets we favour the US, which has relatively defensive attributes and despite the fiscal deadlock is still the most likely economy to stimulate in order to protect economic growth and jobs. Economic policy is more pro-growth than in other developed markets with the Fed willing to take aggressive action when required and the Democratic administration likely to table fiscal stimulus and housing support programs.

In summary, investment conditions remain difficult and we expect short violent economic cycles driven by bouts of unprecedented fiscal and monetary stimulus. Diversification across a range of asset classes remains an attractive proposition with the opportunity to add value through a sensible tactical asset allocation policy.