

Informed Choice

Investment Outlook

1st Quarter 2009



Highlights:

- **Markets remain volatile and uncertain, but some signs of recovery are starting to emerge**
- **Cash rates continue to fall making this asset class look unattractive in 2009**
- **Higher than expected default rates have been priced into corporate bonds**
- **The commercial property sector could be hit hard in 2009**

About Informed Choice

Informed Choice Ltd works with individual clients and small business owners in Surrey and the surrounding counties to help them to build, manage and protect their wealth.

By turning complex personal finance issues into simple plain English solutions, we ensure that our clients are always fully in control of their money.

As one of only five IFA firms in the UK to hold the Gold Standard for Independent Financial Advice we excel not just in service but in all areas important to consumers of financial products and services.

We are a firm of Chartered Financial Planners. This means we have satisfied rigorous criteria relating to professional qualifications and ethical good practice. It means you can be confident that you are dealing with one of the UK's leading firms that is wholly committed to providing you with the best possible advice, service and support.

Our Quarterly Investment Report sets out our views on the general investment climate and creates a robust framework for our investment advice decisions. It also enables us to make tactical alterations to our strategic asset allocation models.

To find out more about our investment advice process please visit www.informedchoice.ltd.uk/investment.htm.

Photograph by Andrew Neligan
London Eye at Dusk



Foreward

Martin Bamford BA (Hons) CFP APFS
Joint Managing Director,
Chartered Financial Planner



Welcome to this edition of our *Investment Outlook* report. We publish this document once a quarter to record the findings and thoughts of the Informed Choice Investment Committee.

Investment markets remain incredibly volatile as news about the worsening global and domestic economies continues to be released on a daily basis. It is worth remembering that, because they are largely driven by sentiment, investments tend to recover before the underlying economic conditions. This makes any timing decisions very difficult to make.

Last year was a very challenging year for most investment asset classes, but we hope that 2009 will be a little better. For many investors this will be a year when they hope to recover some of their losses and ensure their portfolios are well positioned for the long-term.

We hope that you find this report interesting and I would personally welcome your feedback. You can email me at martin@icl-ifa.co.uk or call me on 01483 274566.

Regards,
Martin

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General outlook

The investment outlook for the foreseeable future remains uncertain and volatile, although there are now some signs emerging that some investment sectors could be staging a recovery.

It is very important not to try and time a market recovery. This is very difficult to do well consistently. History tells us that missing even a few of the best days of a bull run can have a big impact on the overall performance of your portfolio.

Remember that even professional investors have a poor track record of trying to predict the bottom of an investment market. Be wary of any 'expert' who tries to tell you that this is the bottom of a market or a short-term buying opportunity.

Cash

The Bank of England Monetary Policy Committee made a further 0.5% cut to the Bank Rate on 8th January 2009, taking it down to 1.5%, the lowest level in the history of the Bank. We expect to see further rate cuts in 2009, and the Bank rate could now go as low as 0% by the end of the year.

Savings rates have been falling in line with Bank Rate cuts, and the average savings rate is now 1.48%. After income tax on interest and price inflation, savers are unlikely to see any real return on their cash savings.

Despite the prospect for minimal (or even zero) returns from cash in 2009, it still makes sense to maintain a cash emergency fund. It is also still important to hunt around for the best interest rate as there is a great deal of difference between the most and least competitive rates available.

Fixed Interest Securities

The spreads on corporate bonds are now at levels not seen since 1929. Sub-investment grade bonds are currently pricing in default rates of between 35% and 40%, but the worst case scenario historically has been a default rate of 2.4%.

The investment grade bond markets are currently pricing in 6% default rates whereas current levels of defaults are running at 1.4%.

We do not believe that the inflated default rate assumptions will be realised in full, which makes corporate bonds look very attractive. It is however important to be careful with stock selection and not buy into this asset class blindly. A lot of value could be added to a portfolio of corporate bonds with good management skills.

Bond markets typically recover before equities after a period of economic hardship.

UK Equities

There are some very positive signs now that the markets will stage a recovery ahead of improving economic data.

Whilst we cannot accurately predict the start of a bull market, or say with any certainty that UK equity markets have reached their absolute bottom, the markets appear less volatile now than before and the level of falls seen in 2008 give us some indication that the long term investor should benefit from investing at current levels.

Overseas Equities

All global equity markets were hit hard in 2008. Continued weaknesses in global economies means there are no obvious preferences for investment opportunities, but worldwide some encouraging signs are starting to emerge.

The US economy continues to look weak but there is a sense of confidence and optimism as a result of the Presidential election. As one of the first major economies into recession, there has been the view that they should emerge from recession first as well.

Far Eastern markets continue to look quite resilient to global economic woes as a result of their lower levels of debt. They are unlikely to escape completely unscathed, but should be relatively well positioned for recovery.

In the global emerging markets we feel that some of the market falls witnessed in 2008 were substantially greater than they should have been based on company valuations and earnings predictions. Some of these markets could bounce back quite quickly and sharply should their economies start to show positive signs again.

Property

We remain cautious on the commercial property asset class.

Some recent research found there is £22.7bn of commercial property debt scheduled to be refinanced in 2009. This could force firms to sell property assets to manage their debts, even if they have to sell at a loss.

It is likely that capital values will be driven even lower in 2009 as more commercial property comes onto the market priced for a quick sale.

At the same time, retail rents fell for the first time in fifteen years last year and are unlikely to return to previous levels until 2013. Last year it was rental income that was supporting this asset class against the backdrop of falling capital values. With a large number of major retailers seemingly in financial difficulty after a poor Christmas, we could start to see some sectors of the property asset class fall even further.

The average house price in the UK, according to Halifax, now stands at £159,896. This represents an 18.9% fall in 2009. Residential house prices fell by 2.2% in December and we expect house prices to fall further in 2009, although lower interest rates and more accessible finance should start to slow down the decline.

Current House View

Asset Class	Comments	House View
Cash	Interest rates continue to fall making the short term outlook negative after inflation	NEUTRAL
UK Corporate Bonds	Higher default assumptions priced in but unlikely to materialise.	HEAVY
UK Index Linked	Inflation has started to subside allowing Bank Rate cuts	LIGHT
International Corporate Bonds	Still attractive for diversification purposes and access to previously unavailable sovereign debt opportunities	HEAVY
UK Gilts	Yields under pressure as investors continue to seek a safe haven	NEUTRAL
UK Equities	Signs that the markets are beginning to turn and investor sentiment gradually improving ahead of economic recovery	HEAVY
European Equities	Remains volatile but potentially good value	NEUTRAL
North American Equities	Weak economy but first economy into recession so more likely to be first out. President Obama factor	HEAVY
Japan Equities	Could be resilient to some global economic pressures	NEUTRAL
Asia ex-Japan Equities	Remains vulnerable to major slowdown in global economic growth	NEUTRAL
Emerging Market Equities	Major falls in some markets in 2008 overstated, presenting some opportunities now	HEAVY
Property	Large amount of refinancing required in 2009 and rental income now under pressure	LIGHT

The terms 'heavy', 'neutral' and 'light' represent our view of tactical asset allocation adjustments to a well diversified portfolio.

The Small but Important Print

We have tried to minimise the use of jargon and technical terms in this document to make it more readable whilst also containing some worthwhile information.

This attempted simplification inevitably means that some caveats must be added to ensure that the limitations of the document are clearly stated:

- Past performance is not necessarily a guide to the future. The value of investments can go down as well as up.
- The value of tax concessions depends on your circumstances and may change.
- All assumptions and estimates are approximate and intended to serve as initial guidelines only. You should seek professional independent financial advice before making any investment decision.
- This report is based on our understanding of your current circumstances, priorities and aims along with our knowledge of current legislation and HM Revenue and Customs practice. All of these may change in the future and affect the suitability of any financial arrangement.
- Regular reviews of all financial arrangements should be undertaken to review progress and make adaptations where necessary.
- Informed Choice Ltd is authorised and regulated by the Financial Services Authority.