

Informed Choice

Investment Outlook

2nd Quarter 2008



Highlights:

- **Fears of an economic slowdown continue to dominate investor sentiment**
- **Banks are scrambling for cash in wake of the 'credit crunch'**
- **Emerging markets continue to offer an interesting investment story**
- **The outlook for commercial property is much more positive than for residential**

www.informedchoice.ltd.uk

About Informed Choice

Informed Choice Ltd provides a range of wealth management solutions for private and corporate clients in the UK. As a professional advisory firm we charge fees for the advice, implementation and review of the solutions we provide.

Our clients come from many different walks of life. We take pride in our friendly and professional independent advisory service. As one of only three 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 Chartered firm of 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 Martin Bamford
Galway Bay, Ireland

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.

As I write this the global 'credit crunch' continues to bite. After Northern Rock came the near-collapse of US investment bank Bear Stearns. It now looks like the Icelandic economy could be in real trouble, with interest rates now up to 15% to shore up the value of their currency.

This investment theme is likely to continue to run for some time. At the start of this year we hoped that the investment markets would become less volatile as we moved into the second quarter, but there are no signs that this will happen in the near future.

The rest of this report looks at the positive and negative factors associated with each of the four main asset classes—cash, fixed interest securities, equities and property. We also share our current House View for each asset class. This House View is used to make tactical adjustments to our asset allocation models for different investor risk profiles.

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

Fears of an economic slowdown in the US continue to dominate investor sentiment along with worries about *stagflation*—a macroeconomic term used to describe a period of inflation combined with slow economic growth or recession.

Bad news continues to arrive from the banking sector and research from Swiss bank UBS¹ suggested that the banking industry was likely to lose \$350bn. Of this, only \$160bn has already been written off, so there could be some further revelations yet to come.

Oil prices have well and truly pushed through the \$100 a barrel mark and even hit \$107 recently as concerns about tightening supplies were combined with the news that an important export pipeline in Iraq had been damaged in an explosion.

It is always interesting to look at where investors are placing their money in times of volatile stockmarkets. Feedback from Fidelity² tells us that during February the UK market was the most popular for investors, with the UK Equity Income and UK All Companies sector in the top two places for best selling IMA sectors.

This was followed closely by the Cautious Managed sector in third place, the Specialist sector in fourth, and the UK Corporate Bond sector in fifth place.

The Outlook for the foreseeable future continues to be volatile and uncertain, so a well diversified portfolio with a long term financial objective is the most appropriate approach to follow.

¹ UBS—February 2008

² Fidelity FundsNetwork—20th March 2008

Cash

When looking at a business, the expression 'cash is king' is often used in the description of overall business health. Well, that expression also rings true when looking at investment portfolios at the moment. If you took a short term and more cautious view of investing, you would almost certainly want to be in cash right now.

Banks continue to scramble for cash in wake of the 'credit crunch' and the cost of borrowing amongst lenders has increased past the 6% mark for the first time since December. This is good news for savers who are able to benefit from higher deposit rates.

The Bank of England has pledged further assistance to banks to help ease liquidity problems and restore confidence in the sector, but over the next quarter it should be possible to find some attractive interest rates as banks are keen to get their hands on the cash to lend out.

The Bank of England cut interest rates by 0.25% to 5.25% in February, following the first cut in over two years that took place in December. Most analysts believe that it is only a matter of time before another rate cut takes place.

Investors are currently prepared to sacrifice part of these returns for greater capital security. Some of the most common questions we are asked at the moment are about the financial security of different institutions as well as the mechanics of the Financial Services Compensation Scheme.

Whilst cash does play an important role in a well diversified portfolio, the over use of cash means you need to make a timing decision when you feel that investment markets have started to recover. It is notoriously difficult to time the markets with any accuracy and a better approach is to invest for the long-term—it's 'time in' rather than 'timing' that really matters.

Fixed Interest Securities

Corporate bonds have been under pressure from the general liquidity problems associated with the 'credit crunch'. Whilst there is still potential for issues arising from the banking sector, we believe that corporate bonds look reasonably attractive and investors should not be discouraged by the low or negative returns from this asset class of the past twelve months.

With inflationary pressures continuing to persist there is a high likelihood of further interest rate cuts from the Bank of England. These rate cuts are unlikely to be as aggressive as they were predicted to be a few months ago but the prospects for corporate bonds are still good.

The prospect of higher inflation should make index-linked gilts look attractive but there is not a huge amount to go for at the moment because the markets had already anticipated this period of higher inflation. Investors who are concerned about long-term inflationary pressures could consider devoting part of their portfolio to gold or an emerging market where you could benefit from higher inflation.

International bond funds are continuing to offer investors greater diversification in the fixed interest securities asset class as well as access to sovereign debt that is not typically available to private investors.

Because there are periods of time when international bonds outperform UK corporate bonds it makes sense to invest in both, as accurately predicting when each of these will outperform the other is a near impossible task.

UK Equities

After starting the year at 6456.90, the FTSE 100 index of leading company shares finished this quarter over 11% down. The position over twelve months is only slightly less depressing with a negative return of just under 10%.

Some recent research by Citywire shows that the majority of their rated fund managers believe the recently revised prediction for GDP from the Chancellor Alastair Darling is still too high. GDP is an important guide to national productivity so a dip in GDP could signal an increased threat of inflation.

There is a general consensus amongst these fund managers that it will take at least six months for improved liquidity to return to the UK market. If the 'credit crunch' continues to be a problem in the UK it will stifle the prospect of company growth as well as reducing merger and acquisition activity that has been a great source of investment returns in recent years.

Share prices in the UK remain depressed and there are few positive indications available to suggest that this will change anytime soon.

What is noticeable is the increased volatility we have witnessed in the UK stockmarket recently. We believe that much of this is fuelled by hedge fund trading strategies and also general speculation. Investors who try to time this market will find it increasingly difficult to make the right timing decision to re-enter the market before it rises again.

On balance, we are currently 'heavy' on the UK equity sector. It is more attractive than other equity asset classes because of the absence of currency exchange rate risk.

Overseas Equities

“When the US sneezes, the rest of the world catches a cold”. This old adage is often challenged but it has never been as relevant as it is today. The global ‘credit crunch’ started in the UK and now a weak dollar is having an inflationary impact on other world markets.

The jury is still out over whether or not the US economy will enter a full-blown recession. Presidential election years have historically been very good for the US stockmarket but this factor alone may not be enough to drag the US markets up. Investors should consider the benefits of buying US company shares at a time when it only takes 50p to buy \$1.

Some recent research from Scottish Widows Investment Partnership suggested that advisers are continuing to take a cautious approach when it comes to overseas equities this year. Only 19% of investment advisers expect global equity market returns to be higher this year than in 2007.

Emerging markets continue to offer an interesting investment story. They might have lost some of their appeal in the first quarter but the recent increases in the wealth of these economies, and the prospects for continued growth, are hard to ignore.

More speculative investors would do well to consider a small amount of exposure to these markets but it would be unwise to invest too high a proportion of an investment portfolio in a single asset class or single set of economies.

¹ Scottish Widows Investment Partnership—28th March 2008

Property

Residential property is looking vulnerable to falls this year and next. A recent poll by Reuters found that fears of rising unemployment and a possible recession are both having an impact on the price of houses in the UK.

The quarterly Reuters poll is based on the views of banking, investment firm and research institutes analysts. It found that there is a 78% chance of a house price fall on an annual basis at some point this year. This compares to a 65% when the poll took place in January and just 30% last October.

The expectation is that house prices will fall by 0.8% in 2008 and 2% in 2009, but the range of possible falls predicted by analysts predicted as much as a 10% fall through to a 3% rise!

The outlook for **commercial property** is much more positive. Despite a market downturn in 2007, we believe that this was a correction with the asset class having been overpriced after several years of exceptional returns.

Property is an important addition to a well diversified investment portfolio because it has a low correlation with both fixed interest securities and equities. The returns from commercial property come from a combination of income and capital growth. In the ten year period to 2007 around 46% of the total return came from capital growth with the rest from income.

There is a lot of regional variation within the UK for the commercial property asset class. Investors should look for a fund with a high level of regional diversification to avoid overexposure to one particular region that could become overheated. Given the choice between traditional 'bricks and mortar' funds or property share funds, we are still recommending the former for long-term investors where liquidity is not a sensitive issue.

Current House View

Asset Class	Comments	House View
Cash	Continued demand from lenders means attractive rates and cash offers a good short-term home in volatile markets.	HEAVY
UK Corporate Bonds	Poor returns over the past twelve months but now look reasonably attractive.	HEAVY
UK Index Linked	Prospect of high inflation but the markets already anticipated this.	NEUTRAL
International Corporate Bonds	Access to greater diversification and previously unavailable sovereign debt opportunities.	HEAVY
UK Gilts	Investors will continue to seek the security of this asset class.	HEAVY
UK Equities	Fears of a lower GDP and liquidity problems, but absence of exchange rate risk for UK investors.	HEAVY
European Equities	Vulnerable to continued worldwide economic pressure.	NEUTRAL
North American Equities	Fears of a recession continue but the weak dollar offers buying opportunities and an election year is historically significant.	HEAVY
Japan Equities	When compared to other Far East markets there is nothing significant to note.	NEUTRAL
Asia ex-Japan Equities	This region remains vulnerable to a major slowdown in global growth, but more attractive than Japanese Equities.	NEUTRAL
Emerging Market Equities	Continues to offer an interesting investment story for a small proportion of a portfolio.	HEAVY
Property	Commercial property has a positive outlook following a correction last year.	HEAVY

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.