

# Informed Choice

## Investment Outlook

3rd Quarter 2008



### Highlights:

- **The UK and US equity markets are on the verge of entering 'bear market' territory**
- **Oil has now exceeded \$140 a barrel, placing greater inflationary pressures on consumers and companies**
- **Expected rate rises are now being priced into the US, European and UK markets**

[www.informedchoice.ltd.uk](http://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](http://www.informedchoice.ltd.uk/investment.htm).

Photograph by Martin Bamford  
Highland Cattle by the River Wey in Guildford, Surrey



## Foreward

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**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 FTSE 100 is on the verge of officially entering a 'bear market', having lost 140 points (or 2.5%) in morning trading one day earlier this week. Extreme volatility in the equity markets is the theme which continues to dominate investor behaviour.

It is easy to feel completely despondent about the state of investment markets, or lose focus on the most sensible long term investment strategy.

We remain advocates of the investment wisdom that it is time in the market rather than timing the market that delivers the best long term returns.

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](mailto:martin@icl-ifa.co.uk) or call me on 01483 274566.

Regards,

*Martin*

## **Summary**

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## **General Outlook**

Since our last report, when oil prices has reached \$107 a barrel, we have seen the price of oil hit a new record high at over \$140 a barrel. This, in turn, is placing greater inflationary pressure on a whole range of goods and services.

Following threats from Libya that it could cut its output, OPEC has commented that the price of oil could go as high as \$170 a barrel later this year. We should all expect the oil price to get much higher before it falls again.

A report from the Chartered Institute of Purchasing and Supply showed that UK manufacturing has fallen to the lowest level since the US terror attacks on 11th September 2001.

Consumer Price Inflation was recorded at 3.3% in June, causing the Governor of the Bank of England to have to write to the Chancellor, explaining why it had missed the inflation target.

Consumer confidence has now fallen to the lowest level since March 1990, suggesting that the British public are feeling the strain of higher prices and lower wage increases.

The world economy is working hard to deal with the dual shocks of the credit crunch and higher commodity prices. We still expect to see global economic growth in 2008, but at much more modest levels than originally forecast.

## Cash

At the start of this year we expected interest rates to fall or be kept on hold as the 'credit crunch' continued to linger.

The past few weeks have seen rate rises priced into the market in respect of the US Federal Reserve, European Central Bank and Bank of England. The prospect of interest rate rises in the second half of this year, largely to counter rising inflation, is looking more probable.

Interest rates available for depositors continue to exceed those set by central banks. This is a result of the liquidity requirements of banking institutions, who are happy to entice savers with more attractive looking rates so they can continue with their profitable lending activities.

Investors who are attracted by the prospect of higher interest rates on cash need to be mindful of two factors—the financial strength of the bank or building society and the impact of inflation on the real value of their capital.

The Retail Prices Index (RPI) is now running at 4.3% which means that a higher rate taxpayer would need to find a gross interest rate of at least 7.17% to beat inflation. The majority of savings accounts still fail to offer rates in excess of this level.

Another key consideration when investing in cash is the timing decision. Cash might look attractive in the short term during a falling equity market, but it is all too easy to misjudge the timing when the markets start to turn. Investors who play this game are more than likely to miss out on any upside in the equity markets.

## **Fixed Interest Securities**

The expectation of rate rises in the second half of this year has pushed up yields in the short-term government bond markets.

At the sub-investment grade end of the fixed interest sector, the fear of defaults appears to be growing.

We have not yet seen any significant defaults but credit spreads (the higher rates paid by high risk borrowers) have been growing since mid-May.

An important question is whether these credit spreads at this end of the corporate bond sector adequately compensate investors for the level of risk they are taking. That question is currently very tough to answer, which leads us to shift our focus towards investment grade bonds.

## UK Equities

Negative returns and extreme volatility continue to be the main themes in the UK equity sector.

The natural resources sector now makes up a much larger proportion of the FTSE 100 index. This creates the risk of over exposure, particularly for UK equity investors who have also attempted to gain access to commodities through a specialist fund.

In an attempt to combat increased volatility, the Financial Services Authority has made a ruling to declare short selling positions greater than 0.25% in companies conducting rights issues. Short selling is the practice of selling securities you do not own, in the hope you can buy them back later at a lower price. Some analysts blame an increase in this practice for greater market volatility.

Star fund manager Anthony Bolton has refined his earlier call on the UK financial sector, now saying that he expects to see further capital raising and potential business failures before the market turns. He still believes that the current credit crunch will help to clean loan books and restore business margins in the banking sector.

We think that valuations within some of the more defensive sectors, such as beverages, now look stretched which means that this sector is likely to underperform.

Investors in the UK equity sector should ensure that they hold a well diversified portfolio and look carefully for over exposure to the natural resources sector.

## Overseas Equities

The US equity markets are teetering on the edge of an official bear market, where an index has fallen by 20% or more over at least a two-month period. The S&P 500 has actually fallen below this level during daily trading but recovered sufficiently to avoid this label at the end of the day.

In the US, it is still questionable whether they will suffer a full blow recession, which could have implications for the stockmarkets. The US housing market continues to be a major source of weakness, but other data (particularly in terms of manufacturing) has remained resilient throughout. The weak dollar continues to make the US equity market look reasonably attractive.

European markets continue to be sensitive to investor confidence, which is not unusual in the short term. Pressure on costs is the main driver of fear when it comes to corporate profits. Both raw material and energy prices are certainly higher which could have an impact on profits if firms cannot pass these on to the end consumer.

We continue to see some opportunities in emerging markets, where growing affluence is likely to lead to increased consumer demand. However, there is always the risk that an investment market can quickly overheat, so exposure to this asset class should remain fairly modest within a well diversified portfolio.

Some overseas equity markets, such as Japan, appear to have the resilience to outperform western markets during this period of economic turbulence. It is this sort of negative correlation that investors will increasingly look for as volatility remains in place within domestic investment markets.

## Property

It is mostly doom and gloom within the UK residential property sector. Price falls appear to be sensitive to regional difference, highlighting the important difference between local property markets rather than a single property market.

Some recent research from Rightmove suggests a property to buyer ratio of fifteen to one and an average wait of around ten weeks to get an acceptable offer. The market appears to be driven by what estate agents refer to as the 'three D's' - death, divorce and debt.

With a mixture of optimistic and seriously pessimistic outlooks, the actual outcome seems likely to fall somewhere in the middle.

We expect recent buy-to-let investors, and particularly those who purchased 'discounted off-plan' flats from unregulated property investment clubs, to be the hardest hit by any fall in prices.

The outlook for the commercial property asset class also looks quite bleak in the short term. Equity based commercial property funds (those which invest in the shares of property or land investment companies rather than actual bricks and mortar) are likely to suffer as the construction industry starts to feel the pinch of the credit crunch.

Within some areas of the market there are suggestions that prices need to fall by a further 10% to convince investors that now is a good time to buy. However, fewer new builds and purchases should lead to higher rental prices which will benefit the total return aspect of existing property investments.

We remain quite positive about the long term outlook for commercial property, particularly for diversification purposes. The short term outlook is less positive. We may continue to see some falls in capital values which, we hope, will be at least partially offset by increased rental income.

## Current House View

Asset Class	Comments	House View
<b>Cash</b>	Expectation of rising interest rates, banks wanting to attract savers	HEAVY
<b>UK Corporate Bonds</b>	Fear of defaults growing for sub-investment grade bonds, credit spreads growing since mid-May	NEUTRAL
<b>UK Index Linked</b>	Markets have already priced in prospect of higher price inflation	NEUTRAL
<b>International Corporate Bonds</b>	Still looks attractive for diversification purposes and access to previously unavailable sovereign debt opportunities	HEAVY
<b>UK Gilts</b>	Flight to security makes this asset class look attractive	HEAVY
<b>UK Equities</b>	Quite volatile and about to enter a technical bear market, but no exchange rate risk for domestic investors	HEAVY
<b>European Equities</b>	Sensitive to investor sentiment but potentially good value	NEUTRAL
<b>North American Equities</b>	Still waiting to see if the US will enter a full blown recession, weak dollar makes long term investment look attractive	HEAVY
<b>Japan Equities</b>	Appears to have resilience to outperform western markets during period of economic turbulence	HEAVY
<b>Asia ex-Japan Equities</b>	Region remains vulnerable to major slowdown in global growth	NEUTRAL
<b>Emerging Market Equities</b>	Growth led by increased consumer demand, but risk of overheating	NEUTRAL
<b>Property</b>	Prospect for further short term capital values could be offset by increased rental income	NEUTRAL

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.