WEALTH MANAGEMENT

IFPC Market Commentary October 2012

Market commentary - for the period 6th April 2012 to 5th October 2012

The good start to the first quarter of 2012 ebbed away between March and June over renewed fears of slowing economic growth in emerging markets and slow progress on structural reforms in the Eurozone. On July 26th, Mario Draghi, the President of the European Central Bank, made a speech in London and to the surprise of the audience stated "…the ECB is ready to do whatever it takes to preserve the Euro…and believe me, it will be enough". This provided some much needed confidence for investors as markets promptly rallied throughout the summer. There is now a tentative feeling that Europe may have passed a watershed moment in the current crisis as investors were discounting a potentially catastrophic event most likely to emerge from the southern peripheral nations who are struggling to finance their ever increasing debt pile. Clearly, the crisis is far from over but politicians have created some breathing space to enact the much needed structural reforms starting with a framework for banking union. In September, the U.S. Federal Reserve announced QE3 (Quantitative Easing, the 3rd tranche) embarking on a new $40 billion program of purchasing mortgage backed securities to add yet further monetary stimulus to the fragile global economy.

UK equities FTSE All Share Index +5.2%

The FTSE 100 fell from 5989 to 5230 in the second quarter, a full 12.7% in price terms, taking the index to below the level that it started In January before recovering to a respectable 5887 at the end of the reported period. From a sectorial point of view, mining companies have continued to perform poorly as commodity prices have remained weak whilst banks and other financial corporations alongside general retailers have continued their tentative recovery throughout 2012. Companies with strong balance sheets, stable cash flows, predictable profit streams and high dividend yields have attracted strong demand by fund managers since the onset of the financial crisis bidding up valuations to a level where they can now be termed as 'expensive defensives'. The valuations of companies with business models sensitive to the business cycle , generally referred to as 'cyclicals', are looking ever more compelling on a relative valuation basis but tend to produce volatile share prices and will be highly susceptible to an economic downturn. Opinions amongst fund managers and strategists alike remain polarised ahead of a highly uncertain outlook for the global economy in 2013.

The UK economy continues to face severe structural headwinds as government policy is to reduce the budget deficit through austerity measures but at the seemingly inevitable expense of economic growth. The UK still stands out amongst its western counterparts as the economy with the most excessive level of corporate and household debt as a percentage of national GDP, currently in excess of 200%. This is a rising trend which has persisted for over twenty five years although there is increasing evidence that a period of debt restructuring and repayment since the financial crisis does appear to have reversed this phenomena. Needless to say, it will take many years of austerity to reduce the debt levels back to manageable levels whilst economic growth will stay below the level of inflation and the UK will flirt with recession on a regular basis. The UK economy is forecast to grow by 1.1% in 2013 and is unlikely to grow above historic trend rates until at least 2015.

In September 2012, the annual rate of inflation measured by the Consumers Price Index (CPI) stood at 2.2% and is the slowest rate since November 2009. The significant utility bill rises of September 2011 have now dropped out of the index calculation whilst rising fuel prices and the higher cost of recreation & culture over the last year are putting upward pressure on the inflation number.

International equities FTSE World (excl. UK) Index +4.4%

In the U.S., the S&P 500 Index which is a broad measure of American stock market performance returned +5.3% during the period under review. The dollar depreciated by -1.9% reducing total returns to Sterling based investors. Having been at the heart of the financial crisis, the housing market in the U.S. is showing signs of life. The National Association of Homebuilders (NAHB) reported sales and new builds running at twice the rate they were at the lowest point of the financial crisis. However, the recovery is starting from a very low base and there are no signs of the pick-up being driven by increased mortgage lending suggesting cash buyers are driving the market. In a wider context, the U.S. economy is undergoing a mild recovery but there are substantial long term issues. By the turn of the new year, tax cuts enacted in the Bush era will come to an end coinciding with long overdue spending cuts to the national budget putting the U.S. economy on the edge of a 'fiscal cliff'. Whilst the political landscape in

America is gridlocked, a compromise agreement between the Republicans and Democrats will have to be negotiated to avoid the worst. From a historical perspective, the process of 'de-leveraging' (reducing debt) has only just begun and will continue to dominate the investment, economic and political landscape for many years to come.

European markets have been relatively calm compared with 2011 and appear to have turned a corner since Super Mario's comments. Indeed, since July, Spain equities have rallied by +25%, Italy by +19.7% and Germany by +11.9% producing some of the best returns in developed markets over that period. More broadly, the FTSE Europe (excl. UK) Index has returned +9% since April. Angela Merkel made a visit to Athens and was generally supportive of the Greek efforts amid mass public demonstrations against the severe austerity measures. In the European government bond markets, interest rates have come down substantially since July as the Spanish government can now borrow money over ten years at +5.7%, the Italians at +4.9%, the Greeks at +17%, Irish at +5% and Portuguese at +8.6%. These are much lower rates than at the peak of the European Debt Crisis and should aid a recovery plan.

According to the latest numbers from the International Monetary Fund (IMF), core Europe and the crisis nations are making tangible progress in reducing budget deficits although government austerity is having a severe impact on economic growth rates across the region. The short term crisis may have been averted and near term numbers look encouraging but the mid-term outlook for Europe still remains weak with GDP growth forecast to be +0.8% in 2013.

In Japan, the TOPIX 500 Index fell -9.8% over the period although the Yen strengthened by +3.2% to dampen losses for Sterling based investors. There is a marked contrast between the improvement of forward looking indicators which recently reached the highest level since 2007 and the prevailing stock market performance. Current valuations imply that conditions are worse than the months following the Lehman collapse which is clearly not the case. In many respects the market has suffered a bout of indiscriminate selling and companies are indicating compelling valuations particularly when compared to their western peers.

Investors in the Asia Pacific region have turned their attention to the impact of capital outflows from China prompting fears for the prospects of the Chinese economy. On further analysis, it does appear that Chinese private and corporate investors are investing their capital abroad and choosing to hold more of their assets in foreign currencies rather than repatriating their cash back to the Chinese currency, the Reminbi. This does not appear to be a reflection of the state of the Chinese economy but rather symptomatic of a more progressive, outward looking and wealthier Chinese investor. The government has clearly communicated that it will oversee a transition from a steady 10% p.a. growth rate to a lower target level of 7.5% p.a. The Chinese stock market has declined by over 32% since 2008 and with evidence of stabilisation in the economy assuming the 'soft landing' scenario then Chinese equities could start to recover. The MSCI Far East (excl. Japan) Index posted a +1.3% gain over the period as did the MSCI Emerging Markets Index which is a broader performance measure of global emerging stock markets.

Fixed Interest Securities FTSE British Government All-Stocks Index +4.0%

Ten year UK Gilts are yielding +1.75%. This yield is indicative of the annualised return that an investor should expect to receive, based on some simple assumptions, should the Gilt remain held for a ten year period. These are clearly poor potential returns but the yield is representative of investors' nervousness about the state of the global economy and their desire to purchase safe haven assets at any level to ensure that their capital is returned. One of the many major investment themes of the post financial crisis world remains the lack of safe havens for investors to store their money for security. Even if the country of origin is deemed investable, a rising interest rate environment poses significant risks to investors effectively forcing them to look further along the risk spectrum for higher yielding assets. This provides some of the explanation for the good performance of investment grade and high yield corporate bonds over the last few years. However, investment grade corporate bond yields in both the UK and the United States now yield approximately 1% above their respective government bond markets and represent rather poor value given that downside risk alongside potential liquidity issues are still a major consideration when investing in this asset class.

Commercial property IPD UK All property Index +0.9%

Offices returned +1.8%, retail +0.01% and industrial units +1.6% including rents. Following a 'V-shaped' recovery after 2008, real estate markets are entering a new and uncertain phase. Capital values are still down 30% since the market peak. The yields on commercial property are significantly higher than UK Gilts and have represented one of the alternative safe havens in recent years however, the initial recovery has now come to an end and even rents in Central London are stalling. Property managers continue to analyse their portfolios from an income security and quality of asset perspective to avoid or reduce potential capital losses.

Alternative investments

The spot price of Gold reached $1,789 per ounce in October and currently trades some 10% down from the September 2011 peak and has been consolidating around this price for fifteen months now. For good measure, I am repeating the reasons to stay positive on gold, namely its role as an alternative to fiat currencies, central bank gold allocations are historically low and will surely rise particularly in the developing and emerging nations and interest rates below inflation ensures there is no financial penalty for holding gold.

If you would like to find out more or speak to one of our advisers, please contact us:

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Important Information

Indices performance are for the period 6th April 2012 to 5th October 2012, total return with income reinvested for sterling based investor. Source of statistics: Financial Express, Alpha Terminal, Bank of England, Office for National Statistics, Investment Property Databank, CFA Institute (UK)