Investment Market Summary

Review 2008

2008

We will begin this latest summary with an overview of the previous twelve months. At the risk of reliving the pain of the previous year it is worth a quick reminder of what has become, in living memory, the most difficult year for UK and global markets, financial institutions, businesses and consumers from all walks of life. The investment rule books have been torn up and are still in the process of being rewritten as Governments across the world have been forced to intervene to prevent the implosion of the financial world.

The year started as it meant to go on with the FTSE 100 dropping below 6,000 for the first time since August 2007 amid fears of a US recession. The Federal Reserve cut US interest rates from 4.25% to 3.5% in a shock move to improve market confidence. Continued falls in the commercial property market led to many providers imposing deferral periods on withdrawals from property funds.

In March JPMorgan Chase bought Bear Stearns at the knock-down price of £116m after the bank received emergency funding from the US Federal Reserve. Bear Stearns saw 98% of its share price wiped off in the market. This was the first big name in the spot-light and few predicted the extent of what was to follow. The Fed continued aggressively cutting interest rates by a further 0.75% in a bid to boost markets although the Bank of England Monetary Policy Committee (MPC) deemed no such action was yet necessary in the UK. Unfounded rumours that HBOS had been forced to seek emergency funding form the Bank of England led to a mass sell-off of HBOS shares.

In May oil prices hit record highs pushing through the $125 a barrel mark bringing with it rising inflation from considerable increases in commodity prices. Towards the end of June, Bank of England governor Mervyn King wrote his second letter in just over a year to Chancellor Alistair Darling, prompted by inflation breaking through the 3.0% barrier.

Previously experienced market volatility paled into insignificance by comparison to the turbulence experienced on a global scale in September and October. Lehman Brothers posted a loss of £2.2bn in its financial results for the three months to August which saw its share price tumble as concerns were raised about its financial position and firms refused to trade with it. Meanwhile, it emerged that Merrill Lynch and AIG were also in trouble and while the US Government bailed out AIG, Bank of America came up with a $50bn buyout deal to save Merrill Lynch. However, the US Government refused to bail out Lehman which filed for chapter 11 bankruptcy protection. The fallout from the collapse of Lehman was massive as banks around the world announced huge exposure to the firm. UK bank shares dropped on the back of these events with HBOS shares plummeting by nearly 40 per cent in one day. The FTSE 100 dropped below the 5,000 mark for the first time since June 2005. Meanwhile, HBOS and Lloyds TSB announced they were to merge.

Icelandic banks became the latest casualties of the credit crunch as the Icelandic Government moved to nationalise its three largest banks - Landsbanki, Kaupthing and Glitnir. This not only had a knock-on effect for UK savers with money in Icelandic accounts, but local councils and charities also lost hundreds of thousands of pounds.

UK markets grew increasingly unpredictable as a result of the word ‘recession’ being used regularly. It seemed we had reached the point of fearing fear itself. The FTSE 100 index dropped to a new low of 3781 on 21st November although it has steadily increased to close the year around 4400.

2009 - Markets

In December Fidelity fund guru Anthony Bolton was the first high profile ‘expert’ to call the bottom of the market and said he believed a bull market was likely in the first quarter of 2009 followed by a period of consolidation. However, very few share this optimism with the consensus opinion being that most stock markets around the world will not start to recover properly until the second half of 2009 and in the case of the UK it may take longer; being hindered by a huge debt mountain, rising unemployment and weak currency. Although if UK markets can hold their current levels throughout January and maintain the gradual rise since the low of November, they will appear to be forming a base which we have been waiting for.

For those speculative investors prepared to take the pain of short-term fluctuation, attractive long term investment opportunities are beginning to appear around the world.

2009 - Economy

Most major economies are expected to remain in recession or at least in relative stagnation through most of 2009 with possible modest recovery in 2010. 2009 is likely to be a year of recession and rising unemployment across most developed economies, and slowing growth in many emerging economies. The convulsions of the global credit crunch over the past fifteen months have demonstrated that the world needs a much better managed credit cycle in the future, but those monetary and regulatory changes are unlikely to be attempted while governments and central banks are grappling with the immediate crisis.

The Council of Mortgage Lenders in the UK is predicting that some 75,000 homes will be repossessed and an estimated 500,000 homebuyers will rack up arrears, mostly due to rising unemployment which is expected to hit 3 million by the end of 2009. Meanwhile house prices are predicted to fall by anything up to another 15%.

The household and financial sector balance sheet problems created by excessive borrowing during the past decade means it will take time to work through the process of balance sheet repair and generate economic recoveries. 2009 should see more government intervention in banks’ activities.

The silver lining to this enveloping gloom is that inflation almost everywhere should decline, allowing central banks' expansionary policies to start to take effect.

	2008 Estimate		**2009 Consensus Forecast**	
US	***Real GDP***	**CPI Inflation**	***Real GDP***	**CPI Inflation**
EU - 12	*1.2%*	4.0%	*-1.3%*	0.3%
UK	*1.0%*	3.3%	*-0.9% **	1.4%
Japan	*0.8%*	3.6%	*-1.5%*	1.2%
Australia	*2.3%*	4.5%	*1.1%*	2.8%
Canada	*0.7%*	2.4%	*-0.1%*	1.2%
China	*9.3%*	6.1%	*7.8%*	1.7%
India	*6.9%*	8.1%	*6.3%*	6.2%

Source: Consensus Economics, Dec 08

** The Chancellor was recently predicting growth of -1.0% for 2009.*

2009 - Monetary

Central bank interest rates have declined in all the developed economies. In the US the Federal Reserve has fired all its bullets by effectively taking the base rate down to zero and the UK base rate stands at an all-time recorded low of 1.50%. Despite this, mortgage rates remain stubbornly high by comparison. Of course, the returns on high street cash deposits are now decidedly unattractive offering around 1.75% to 2.00%.

In our experience, by the autumn of 2008, people had become more concerned about the security of the institution holding their cash than the interest rate they were receiving. However, with base rates cut dramatically there is again genuine concern amongst savers that their real returns, net of tax, will not even keep pace with inflation let alone make any profit.

Source: Capel Court, Citywire, Henderson Global Investors, Money Marketing, PIMCO, Standard Life
Past performance is not a guide to future performance. The value of investments and the income from them can go down as well as up, and it may be effected by exchange rate fluctuation and the investor may not get back the amount invested.

This letter is meant to provide a general overview of the investment markets and economic climate and does not constitute advice.