FOR PROFESSIONAL ADVISERS ONLY

R.C. BROWN
INVESTMENT MANAGEMENT PLC

MARKET COMMENTARY - MARCH 2011

Bob Brown
Chairman

Welcome to the latest edition of our quarterly 'market update' newsletters, where we share our thoughts on what has been happening recently, and more importantly, what we believe will be the key influences in the near future.

There has been a lot of turmoil internationally since the beginning of 2011, with natural disasters and numerous requests for regime change by populations in North Africa and the Middle East, which has had a knock on effect on share and commodity prices. Add to this the inflationary concerns in the UK, we could be in for a bumpy ride.

Yesterday's Budget appears to be relatively neutral, as the Chancellor had little room to move. The reduction in Corporation Tax is positive for equities at the margin, however we remain concerned that overall levels of demand growth in the economy remain muted.

GENERAL MARKET OUTLOOK

The UK economy has continued its slow recovery from the Credit Crunch recession which lasted eighteen months from the second quarter of 2008 to the third quarter of 2009. The Comprehensive Spending Review was well received by markets. It did, however, expose some of the potential divisions in the coalition Government. Protests by students over increased tuition fees are unlikely to represent the only social unrest as cuts bite. Consumer spending has remained robust although that may change after the 4th January VAT rate increase. Static or gently falling house prices means that the UK economy will receive little stimulus from building or construction. The private sector should eventually take up the slack from the public sector but there is likely to be a modest rise in unemployment in the meantime. Inflation is rising because of food and commodity prices and the VAT increase bringing forward the day when the Bank of England starts to raise interest rates.

With obvious exceptions such as Greece and Ireland, most developed economies have also exhibited growth with some, such as Germany, surprising on the upside. The major developing economies have continued their rapid growth in spite of increasing interest rates to combat inflation.

Since early November bond yields have risen rapidly. For example 10 year gilts have gone from 2.95% to 3.7%. The extension of President Bush's tax cuts by President Obama means that the US economy is not reducing debt while most of the rest of the world is. Bond yields in Spain and Portugal have risen sharply following the problems of indebted Greece and Ireland. UK bond yields are now reasonable, although we much prefer the growing 2.9% yield from equities. Fortunately, the UK equity market becomes ever more international – UK economic activity accounts for less than 30% and oil and mining as much as 30%. Recent results suggest most companies are coping well. With obvious exceptions corporate balance sheets are strong and as a result we are seeing a pickup in corporate activity. This coupled with historically low valuations, a 2011 P/E of under 11, leads us to believe we will see good returns from equities over the medium and long term though setbacks will occur along the way.

MANAGED FUNDS

Glenn Meyer
Head of Managed Funds

Recent turmoil in the Middle East has so far been met with a degree of sang froid by investors, who appear to recognise they need to take some risk in order to earn a real return on their capital. Emerging market and energy related funds have been affected most on the down and upside respectively, but underlying support across the board indicates buyers of funds remain in place as a slow global economic recovery is maintained. However, some buying interest in equity funds has been driven by a move out of bonds in expectation of interest rate rises (used to control inflation) later in the year.

In response to these changing fundamentals we kept our bond exposure at the low end of the target bands for each of our asset allocation models and also retained our inflation hedge in property funds. In equity funds we made a shift in the European allocation to a more concentrated stock picking fund and we are contemplating a similar move in the UK equity portion. This will allow investors to maintain some exposure to companies with good growth prospects within a portfolio where volatility is moderated by retaining a broad diversification and a bias to underlying stocks that pay growing dividends.

BESPOKE PORTFOLIOS

Alan Beaney
Investment Director

Given the political turmoil in North Africa and the Middle East that has led to a surge in oil prices and the devastating impact of the Japanese earthquake and tsunami, equity markets (after a sharp drop in the immediate aftermath of the latter) have been remarkably resilient. They have been buoyed by encouraging economic numbers from around the world and valuations which look both historically and relatively cheap. When compared to the yield on cash 0.5% and 10 year gilt yields of around 3.5% the historic yield on the FTSE All Share Index of 3.0% looks very attractive especially as dividends are expected to grow in excess of 10% this year aided in part by the restoration of the BP dividend.

Whether this resilience is sustainable will depend on two factors; will the recent rise in oil prices be a permanent or temporary feature and what if any, will be the long term impact of the earthquake on Japanese economic growth. It is difficult to make a judgement either way at the moment, but clearly if oil prices remain at these elevated levels for any period of time world economic growth will be considerably slower and if the current Japanese power shortage is perpetuated economic recovery will be substantially delayed. If either of these scenarios occur it is difficult to see the equity markets being as resilient as they currently are. Nevertheless we do not see a major correction given current equity market valuations.

ETHICAL PORTFOLIOS

Oliver Brown
Investment Director

There is continued strong interest from clients in being able to apply ethical and environmental influences to their portfolios, and as we have previously mentioned in our newsletters, we understand that each of us has our own definition of what ethical investing means. This is why we only offer a 'bespoke' ethical portfolio service for sums of £250,000 and over, which may limit the number of clients who can access our expertise, but it does mean that we can absolutely screen according to the clients wishes.

An example of this came to light recently, when a prospective 'husband & wife' client told us that they had been having difficulty in finding an ethical fund that could satisfy their combined needs, without raising their risk profile. Mr X had specific exclusions he wanted to see and Mrs X wanted to apply some positive screening elements, but they didn't want to have two completely separate portfolios. They had looked at a number of funds, but none of them did exactly what the clients wanted, and they also felt using these funds would be compromising their own values.

We have been able to construct a single portfolio (in joint names) of equities and fixed instruments that they are both comfortable with, within their risk profile, and with the assurance that any future changes will still be screened according to their wishes.

On the performance front, as a consequence of our 'bespoke' approach, each of our ethical portfolios has seen slightly different performance, but as an indication The Marlborough Ethical Fund that we manage has grown by almost 18% in the last 12 months

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