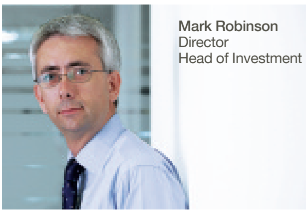
investment update

3rd quarter 2006

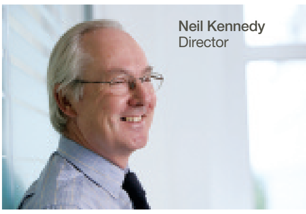
Inside

B E R R Y


Jamie Berry
Managing Director


Mark Robinson
Director
Head of Investment


Mike Browning
Director


Neil Kennedy
Director

A more difficult period

After several consecutive periods of strong performance over the past three years or so, it was perhaps only a matter of time before we faced a more difficult time for investment markets. The second quarter of 2006 saw some sharp falls in global equity and bond markets, although over the past twelve months as a whole investors have still seen some very attractive returns.

We noted at the end of the first quarter that complacency was quite high and risks were building in some sectors, driven in part by short-term capital. We had also become rather accustomed to markets moving ahead in a fairly orderly fashion over the past few years, so when the adjustment came in April it caught many off guard. Investors who were heavily exposed to the ‘hot’ sectors and markets, which had propelled markets to higher levels in the first place, felt most of the pain.

It felt as though a correction of some form was due, but what we did not know was when it would come, its magnitude or the trigger point. We have, after all, experienced mini corrections over the past three years – in the summer of 2004 and two periods in 2005 – but have recovered from these quite swiftly. Many believe that a change in Japanese monetary policy explains the initial setback in financial markets. This altered the map in terms of cheap sources of finance to invest in high growth areas – hence the speculative excesses in emerging markets and commodities.

Jamie Berry
July 2006

Not just equities, but bonds too

In parallel with a shake-out in equity markets, we have also seen high levels of volatility in global bond markets. Sentiment has fluctuated on the outlook for inflation and the US Federal Reserve's interest rate policy. Herein lies a second and linked explanation to the recent turbulence.

"we have also seen high levels of volatility in global bond markets"

Back in April it looked as though we might be close to a peak in US interest rates, but towards the end of June the mood had changed to one that suggested the next move might be an increase of half a percentage point, twice as much as expected. This shift in sentiment came about not because of actual higher inflation and other expansionary data, but rather the expectation of higher numbers.

Volatility in many asset classes

A significant pick-up in daily volatility has also been a characteristic of markets in recent weeks. Of the sixty-five trading days in the past quarter, twenty of these have seen moves of more than 1%, both up and down, from the previous day's closing value on the FTSE 100 Index.

In the same quarter last year there were just five days where the daily movement was of the same magnitude. It is also worth pointing out that intra-day fluctuations of 3 or 4% for major markets have not been uncommon in recent weeks, creating difficulties for short-term performance comparisons.

Our investment style embraces a number of asset classes, several of which have demonstrated low levels of correlation over the longer term, as well as defensive characteristics. However, over shorter periods many asset classes can move together, as has been seen over the past few weeks. Because the setback affected virtually every asset class, there was very little place to hide other than cash.

Where next?

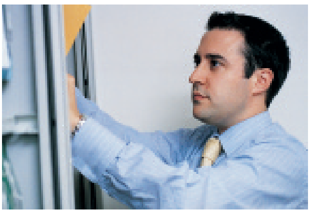
It appears that the correction that took place in May and June was very much a stock and bond market event rather than an economic one, and that the fundamental positive backdrop for investment has not altered too much. Whilst slowing in some areas, global GDP growth is still quite healthy and does not point to any imminent recession. If anything, equity valuations in most developed markets are even cheaper than they were at the start of the year, not just because markets have fallen but also because corporate earnings are still growing at a healthy rate.

Stockmarkets also have increasingly good support from attractive dividend yields, particularly relative to bonds and cash. We accept that higher energy costs will have an impact on corporate profits and consumer spending habits, but believe that many of these uncertainties have now been factored into current market valuations and expectations. However, external factors, such as missile testing by North Korea and the general threat of terrorism, will continue to play an important role in the markets' behaviour.

“Life is like riding a bicycle. To keep your balance you must keep moving.”

Albert Einstein once said that “life is like riding a bicycle. To keep your balance you must keep moving”. The same could be said of economies and financial markets. Central banks have looked at the road ahead and taken decisions based on what they have seen or think they can see around the corner. It is the same story with investment portfolios – one could argue that once a strategy is put in place a portfolio can tick along quite nicely without major modification.

But of course things do change, and like central bankers we must respond where action is required, but not over-react. Although markets have lost some momentum, the economic and corporate wheels are still turning quite fast. We therefore remain reasonably optimistic about the prospects for making investment gains during the second half of the year, but also acknowledge that heightened volatility in various asset classes is something that will probably continue for some time. Our aim is to maintain a balance between opportunity and caution, yet also to keep moving as conditions change.






Read my lips

Thankfully, the news at the end of June that the Fed had increased interest rates by just 0.25% calmed nerves, as did some reassurance in the Fed's accompanying statement, which incorporated a subtle, yet important, change in words. At the May meeting, the Fed said that 'the US economy is likely to moderate'. This phrase has now been replaced with 'is moderating from its quite strong pace earlier this year'.

> "…the Fed's accompanying statement, which incorporated a subtle, yet important, change in words."

the US economy is likely to moderate

…is moderating from its quite strong pace earlier this year

This suggests that we may be much closer to the peak in rates than markets had recently feared and that words can (and often do) speak louder than actions. This shift in tone alone has been sufficient to calm nerves in the short term about the direction of interest rates, with bond and equity markets staging a good recovery in the last few days of the quarter and in the first few of this new one as we write.

Just as former Fed chairman, Alan Greenspan, managed to manipulate the economy using words, so new man Ben Bernanke seems to be doing the same. It will be a difficult act to follow, but after early worries it does now seem as though Bernanke is singing from the same hymn sheet and is fully aware of the consequences of turning the monetary screw too tightly.

Timing is all

During times of great volatility there is often a temptation to bail out of financial assets and seek the safe haven of cash in the bank. This is a valid move if one's fundamental objectives have changed or there is a real danger that longer-term investment goals will be permanently damaged. In moments of fantasy we imagine just how good life would be if we could capture the good days and not the bad.

Unfortunately this is just fantasy; dipping in and out of markets, trying to second guess the next move, is about as dangerous as investment gets. Timing an exit from markets is a difficult decision, but knowing the moment when to reinvest is just as challenging. History shows us that missing out on the few days when stockmarkets bounce quite sharply can be very costly.

According to Fidelity, an investor who put £3,000 into a fund tracking the UK stockmarket at the beginning of 1996 would have an investment worth £6,418 by the end of 2005. But missing out on the ten best days for the stockmarket over that ten year period would have reduced the final total to £4,263. In the past quarter, investors who were out of the markets generally made better returns than those who were invested in them. However, knowing when to be in markets and out of them is an impossible task and a potential recipe for disaster.

Risk Warning, Disclaimer and Authorisation
The value of investments, and the income arising from them, can go down as well as up, and is not guaranteed, which means that you may not get back what you invested.

Whilst every effort has been made to ensure that the information contained in this Update is correct, the directors of Berry Asset Management PLC can take no responsibility for any action taken (or not taken) as a result of the matters discussed within it.

This Update is issued and approved as a financial promotion by Berry Asset Management PLC, which is authorised and regulated by the Financial Services Authority (FSA). It is not intended as an offer to acquire or dispose of any security or interest in any security.

Winner
Image & Reputation
– Boutiques
PAM Awards 2006

Shortlisted
Investment Performance
– Balanced
PAM Awards 2006

Shortlisted
Quality & Clarity of Reporting
PAM Awards 2006

Berry Asset Management PLC
101 The Chambers, Chelsea Harbour
London SW10 0XF

Telephone: +44 (0)20 7376 3476
Within UK: 0845 456 0586
Facsimile: +44 (0)20 7823 3348
E-mail: Enquiries@berry.co.uk
www.berry.co.uk

BERRY

BORDIER & CIE
BANQUIERS PRIVÉS DEPUIS 1844

Authorised and regulated by the Financial Services Authority