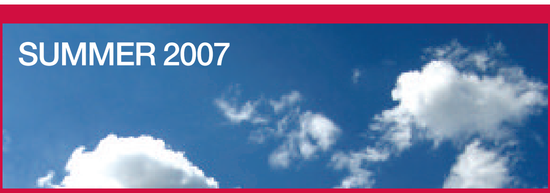
investment update



A CONTINUING RECOVERY

Slow but sure

OUR INVESTMENT STRATEGY

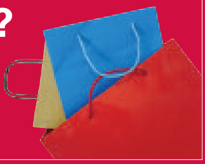
A broad approach

FTSE 100 INDEX – OUR DAILY BREAD

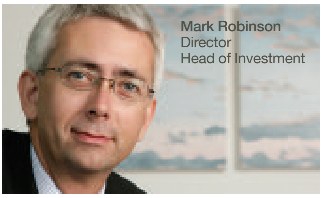
But not what it seems

INTEREST RATES – WHERE TO NOW?

A slower impact on spending



BERRY



Believe it or not, global stockmarkets have got off to a reasonably good start to the year, with the FTSE World Index rising by 7.4% in sterling terms. It has seemed more difficult than this: risk aversion is back on the agenda for many investors, fixed interest markets have been weak and equity markets have been more volatile than usual.

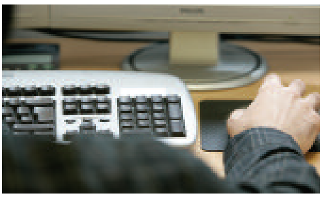
At this juncture it is constructive for market participants to revisit some basic principals of investment by buying inexpensive assets low and selling expensive assets high. Companies are really only as good as their ability to make profits and pay dividends to shareholders, and debt is only as good as companies' ability to service it. When we look at these facets, we find good support for markets generally. With the exception of some hotspots in mid and small cap stocks, valuations are reasonably attractive across most developed markets and even some headier valuations in developing markets are counteracted by strong growth rates. Company balance sheets have been cleansed after the last downturn, and the focus by companies on more shareholder-friendly initiatives, including progressive dividend policies, is a positive step. It is easy to read the press and feel rather despondent at times, but actually the fundamental corporate backdrop is still quite healthy.

Global financial markets have had more than their fair share of headwinds over the past few years, but fundamentally companies are in much better shape than they were. We are still reasonably confident of surpassing previous high points again in the UK and elsewhere fairly soon, but acknowledge that there are still some further hurdles to overcome in this rather drawn out recovery.

Jamie Berry

July 2007

OUR INVESTMENT STRATEGY



What are we doing to navigate through these somewhat more difficult waters?

First, we are not looking to make sweeping changes to the portfolios under our management or switch heavily into cash – we are aware that the latter decision can often lead to very poor longer term returns as the reinvestment risk of being out of markets can often outweigh the risk of being in them. Second, over the past few years we have been prepared to sacrifice some of the strong returns exhibited in stockmarkets, knowing that the momentum would not go on for ever. Instead we have preferred to diversify clients' assets into a wider range of asset classes, some of which have a much bigger disconnect with general market behaviour than traditional equity and bond investments. Returns have not been as spectacular as those from a fully exposed equity portfolio, and at times some of these alternative asset classes have exhibited a higher correlation with some of their riskier counterparts than we had expected. But as the bull run has gathered momentum, so the maintenance of balance and introduction of future dependency into portfolios has gained in importance.

"...we have preferred to diversify clients' assets into a wider range of asset classes…"

FTSE 100 INDEX – OUR DAILY BREAD

For the observer of the UK stockmarket, the behaviour of the FTSE 100 Index is the staple diet of both the financial press and most investors, both professional and private.

As a collection of the UK's largest companies, the Index keeps us in general touch with what our investments are doing, without having to reach for the pocket calculator. It is, however, quite a dangerous yardstick, at times giving quite a misleading picture of the state of 'the market'. For example, three companies, HSBC, BP and Vodafone, currently make up around 20% of the FTSE 100 Index by market capitalisation; the top 20 companies account for 43% of the Index as a whole. Any one of these can therefore exert significant influence on the Index and the general 'mood of the market'. By the time we reach the 100th company by size, however, its influence on the Index's direction, up or down, is getting close to negligible, yet we are still talking about a company with a market capitalisation of around £3bn!

“It is, however, quite a dangerous yardstick...”

A broader measure of the UK stockmarket is the FTSE All Share Index. Although still dominated by the top 100 companies, it also includes the medium and smaller sized company shares which have performed so well in recent years. Although a very small component, their collective presence has been influential in making the FTSE All Share Index a particularly tough benchmark to beat in recent years, unless of course one has had a meaningful exposure to medium and smaller company shares in one’s portfolio. That is until very recently: since the start of this tax year the FTSE 100 Index has risen by 4.1% but the FTSE 250 and Small Cap Indices have both fallen in value.

Maybe this is the start of better times for larger company shares and more challenging times for mid and small cap shares that we have been forecasting for a while.

“…three companies currently make up 20% of the Index...”

INTEREST RATES – WHERE TO NOW?

Probably the biggest conundrum for investors over the coming months is judging when the current phase of interest rate tightening in the US, UK and eurozone will come to an end. This can only happen when there is real evidence that inflation and consumer spending habits (including property-related spending) see some moderation. One observation is that the time lag between rate rises and their impact on consumers' spending habits seems to have widened in this economic cycle. This is possibly because we are only facing quite minor adjustments to interest rates rather than the massive hikes seen in, for example, the late 1980s. The task for policymakers is to cast their gaze slightly further into the future to look for signals of moderation – if they don't there is a real risk that their actions could precipitate a greater economic slowdown further down the line. As things stand at present, and reading between the lines of recent policymakers' statements, there is a strong possibility that we are very close to the end of the tightening phase in the UK and US. This should provide measured reassurance, rather than fuel further complacency, amongst borrowers and consumers and provide a more stable backdrop for investment.

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