investment update

WINTER 2008

THE REAR-VIEW MIRROR

Looking back to go forward

PROPERTY – WILL THE PAIN LEAD TO GAIN

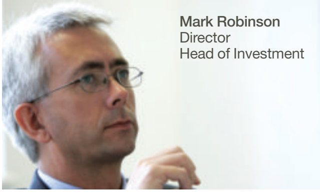
Building new foundations

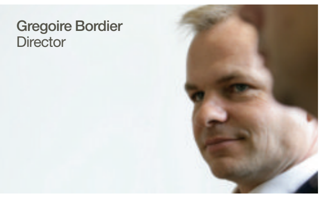
UP OR DOWN

A roller coaster ride in 2007

BERRY

THE REAR-VIEW MIRROR





The question most asked of investment managers at this time of the year is "where will the index be at the end of the year?" The index in question, of course, is the FTSE 100 – and it's a question that few of us relish answering: for one thing, investment managers are never keen on being pinned down, but, worse still, predicting the direction of this particular index means forming views (and getting them right) on just a handful of sectors.

Take 2007 as an example.

The FTSE 100 Index, including dividends, returned 7.4%. But this not entirely unsatisfactory return hides some extraordinary moves in individual sectors, which for most investors have led to some big differences in their own portfolio performance versus the Index. The Mining and Oil & Gas sectors, for example, which together account for more than a quarter of the FTSE 100 Index's value, rose by a massive 54% and 24% respectively during the year. At the other end of the spectrum, the beleagured Financials sector, which similarly accounts for more than a quarter of the same Index, fell by 14%. Extraordinarily, had it not been for the presence of just eight Mining sector shares, the 'market', as measured by the FTSE 100 Index, would have remained virtually unchanged for the whole of 2007.

“We need stockmarket indices to provide some sort of a reference point”

So questions asked about the future of this Index in particular require judgement calls on individual sectors which can have a massive impact on the outcome as a whole.

A further point to make is the negative influence that medium and smaller sized company shares have had on returns generally in 2007. At several points in the past year we made reference to the high valuations afforded to medium and small-sized companies, noting that our favoured area of the UK stockmarket in particular was towards larger capitalised companies. In the early part of the year mid and small-cap shares still had the upper hand, but as the credit crisis unfolded there was a huge swing back towards the relative safety of larger company shares – in the final quarter of 2007 alone, the FTSE 100 Index fell by 1.6%, whereas mid caps (FTSE 250 ex Inv. Trusts) fell by 6.4% and small caps (FTSE Small Cap ex Inv. Trusts) retreated by a massive 13.5%.

“the future of this Index in particular requires judgement calls on individual sectors”

We need stockmarket indices to provide some sort of a reference point for the returns that could have been achieved, but we must also be careful not to be guided too much by them in our investment strategy or in the conclusions that are drawn. This is relevant because they do not give a particularly fair representation of the economy as a whole. With the presence of many international and non-UK businesses in the FTSE 100 Index, one perhaps needs to look at the next tier of companies to gain a broader understanding of how the turmoil in credit markets has impacted share prices in the domestic economy. The FTSE 250 Index, measuring companies with a value of between around £400m and nearly £3bn, fell by 3.7% last year and is perhaps a more meaningful and representative indication of returns from UK plc.

So, enough of all the excuses – where is the FTSE 100 likely to be at year end? A straw poll of the investment team at Berry comes up with an average of 6,372. For me, I am going with 6,825. Mark Robinson, our CIO, is suggesting 6,750. Interestingly, as the two old hands in the office, we are also the most optimistic, which has rarely been the case in the past. We shall see.

"...where is the FTSE 100 likely to be at year end?"

Jamie Berry

January 2008

PROPERTY – WILL THE PAIN LEAD TO GAIN

One of the biggest casualties of the seizure in credit markets has been commercial property. Lending ground to a halt in the summer and hence the ability to finance property deals was severely affected.

The limited number of transactions that did take place in the latter part of 2007 tended to be initiated by forced sellers, typically meeting redemptions by property fund investors. These transactions therefore became the yardstick for property valuation purposes. Many open-ended property funds have temporarily closed their doors to redemptions until a more orderly market prevails, whilst the shares of many closed-ended commercial property companies are now standing at significant discounts to their underlying asset values.

However, it is important to recognise in all of this turmoil that occupancy of the properties in underlying portfolios is still very high, with tenants not only paying rent but also absorbing rental growth. Before we see an improved scene for commercial property, credit conditions need to improve and yields need to adjust in order to encourage buying activity.

There are signs that this is already happening – according to Knight Frank, the global property consultancy, City of London office yields have risen from 4.25% to 5.25%, whilst yields on South East offices (excluding London) have risen from 4.75% to almost 6%. Interest rates may need to come down a little more, but it is already good to see the lending arithmetic start to work in favour of the property investor once again. This should encourage transaction activity and free up some of the blockages in the sector.

In the meantime, for those medium to long term investors with commercial property exposure in their portfolios, it is a question of sitting out this turbulent period, collecting the income, and waiting for credit conditions to improve.

"Many open-ended property funds have temporarily closed their doors to redemptions…"

UP OR DOWN

After such a roller coaster year, in which virtually every asset class other than cash has been volatile, it is important to keep a focus on objectives and not be overly swayed by day to day events. Reading the financial press over the festive period has certainly not brought much cheer, and on balance several of the arguments for a continued period of difficult economic and market conditions are well-reasoned. However, it is also quite easy for the positive measures that are currently being taken (principally to counteract the problems in credit markets) to be overlooked by the media – after all, bad news sells more newspapers than good. Whilst they are still quite thin on the ground, there are positive factors that could create more favourable conditions for economies and markets during 2008, and with these should come some fresh and more positive material for the press. For the moment, however, the scales are still tipped in favour of maintaining a relatively cautious investment approach, which includes a generally higher commitment to cash than normal.

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