investment update

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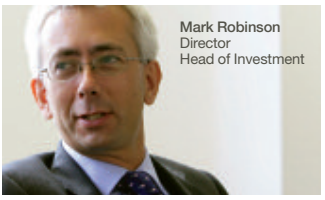
BERRY

NOWHERE TO SHELTER?



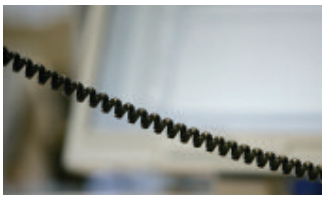
It has certainly not been an easy start to 2008, with most global stockmarkets seeing some significant falls in value. At its weakest in mid March, the London market, as measured by the FTSE 100 Index (including income), was down by over 15% from its level at the start of the year. Initiatives by central banks in recent weeks to improve liquidity and restore confidence have helped in brief spells, but rallies have generally been short-lived and wild swings in direction have been commonplace. The last few days of the quarter saw a reasonable recovery in share values across the world, but overall markets are generally still trading below their levels of one year ago.

Trying to hold on to the gains made in the period between March 2003 and early 2007 has been a challenge in itself, as the unwinding of leverage and the impact on the entire financial system has left very few places to hide. Even cash has, at times, felt rather insecure, with doubts circulating about the financial strength of several household banking names and lending institutions.

Stockmarkets always over-react on both the upside and the downside and this current phase of adjustment is no different. Global economies and stockmarkets are still on a knife-edge in terms of short-term direction, and for this reason we feel it is right to be maintaining a relatively cautious stance. But just some slightly better newsflow may be sufficient to lift us out of the present stalemate and enable markets to establish a base from which a more stable recovery can be built.

Mark Robinson April 2008

INTEREST RATES – WHERE NEXT?



Since the credit crisis started last summer, the US Federal Reserve's general monetary policy gradually seems to have been losing some of its potency.

Previously, the Fed's interest rate moves and statements had an ability to shift markets and sentiment, but there is a worry that this monetary medicine is starting to lose some of its immediate effectiveness, particularly with US interest rates now having fallen to just 2.25%, and the last decline by 75 basis points having had very little lasting market impact. There is more scope for cuts in the UK and eurozone, where base lending rates are still significantly higher.

But there are worries here too: the European Central Bank is stubbornly fixated with inflation and may therefore maintain the status quo, whilst the Bank of England's Monetary Policy Committee faces pressure to cut rates at a difficult time when the pound has already fallen to a record low against the euro, energy prices are soaring both for the consumer and manufacturers, and inflation generally appears to be heading north.

Some difficult decisions therefore lie ahead for policymakers, but we expect to see further substantial cuts in rates around the world over the remainder of this year.

"...the US Federal Reserve's general monetary policy gradually seems to have been losing some of its potency"

A RE-EMERGENCE OF DISCOUNTS TO REAL VALUE


Mike Browning
Director


Neil Kennedy
Director


Colin McInnes
Director

To add to our worries, it has been frustrating to see the weakness and volatility in stockmarkets lead to certain closed-ended investment companies, including several structured investment funds and funds of hedge funds, being priced below either their true asset values or their protection levels.

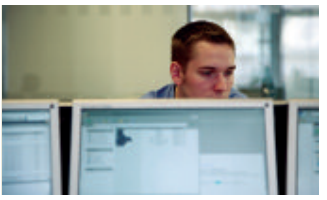
It is a valuable feature of many of these investments that they can be bought or sold on a daily basis, but the counter to this liquidity characteristic is that their share prices do not, particularly during volatile periods, necessarily reflect 'fair' value. We expect some of these pricing anomalies to iron themselves out as markets pick up, volatility subsides and some confidence returns, but for the moment the 'latent' value in some of these investments is being overshadowed by market forces, which in turn is having a negative impact on short-term performance in portfolios. However, provided we remain calm, understand what we own, and keep a close eye on any additional risks that could be building, we expect the passage of time to release the value in many of these investment vehicles.

The side-show that is the current preoccupation with short term trading and exploitation must give way to fundamental value at some point. It is frustrating to see the value in cheap shares of companies with strong balance sheets, good cash flow, healthy dividend cover and a positive outlook on earnings being overlooked in favour of the continued appetite for somewhat expensive growth stocks, particularly those in the mining sector. Sooner or later, some of the current market imbalances will start to unravel and turn back in favour of the over-sold sectors. Indeed, at the end of March there was a very sharp recovery in financial shares at the expense of the mining sector, bringing a much needed boost to those UK Equity Income funds laden with higher-yielding shares.

The reputation of many talented fund managers with solid long term track records is being tested severely by the short-termism pervading through markets. But their strategies, which at present may not be in vogue, should be seen in the context of a full market cycle. At some point, markets will start to re-focus on fundamentals and raw talent will prevail again.

"We expect some of these pricing anomalies to iron themselves out as markets pick up..."

EQUITIES – NOW WHAT?

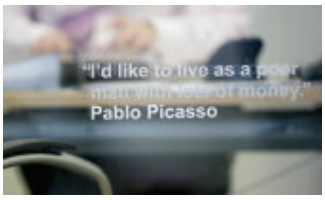


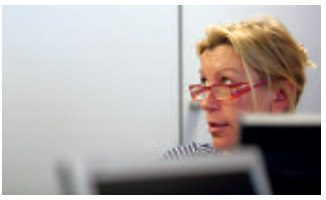
"The journey to full recovery is likely to be slower than we would all like..."

Whilst global stockmarkets are still below their levels seen at the start of the year, it has been encouraging to see them bounce quite strongly in the run up to the end of the quarter.

Just seeing the FTSE 100 Index nudge through 6,000 on the first day of the new tax year has given further encouragement, particularly since this seemed such a distant prospect in early March. Whether we can build much more onto this momentum in the near term is hard to tell, but just regaining this level has in itself provided a much needed boost to overall confidence. The recent rally does illustrate the capacity of markets to rebound quite strongly after significant falls, and also the potential dangers of being out of stockmarkets completely when markets do recover. We know, for instance, that the timing of moves into and out of stockmarkets is a difficult and risky strategy – getting the exit side of the strategy right is one thing, but getting the re-entry point right without missing the recovery is possibly even harder.

The journey to full recovery is likely to be slower than we would all like, and punctuated with further unsettling periods, but part of any sustained recovery phase will have its foundations in a gradual restoration of confidence. There is, however, a growing belief that the substantial financing facilities put in place by central banks in recent weeks will avert a more long-lasting liquidity crisis and will create the boost in confidence that markets currently lack.





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