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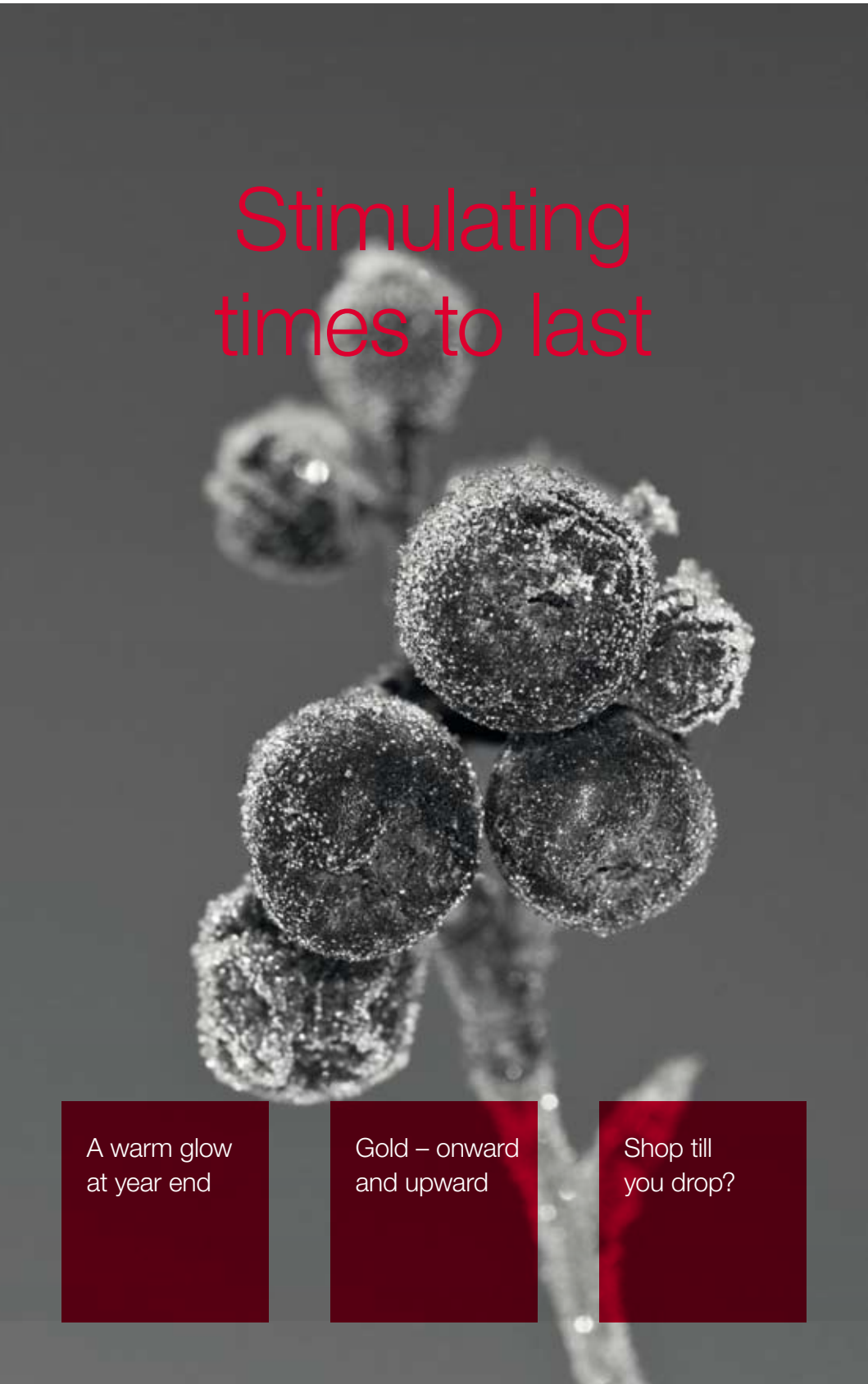
ASSET MANAGEMENT

Investment Update

Winter 2011

Stimulating times to last



A warm glow at year end

Gold – onward and upward

Shop till you drop?

A warm glow at year end

Global equity markets have ended the year on a high note and have exceeded most commentators' year-end predictions of this time last year. The winter may have been pretty cold so far but seeing investment barometers such as the FTSE 100 Index briefly above 6,000 points recently has given most investments a warm glow for the year end.

Mark Robinson
Director
Head of Investment

Can this phase of optimism for stockmarkets continue? Well, for a start the massive stimulus that has enabled us to get where we are today is unlikely to be removed soon, so one leg of the stool is still very firmly in place and likely to remain so for the majority of 2011. Whilst the UK financial authorities possibly should be looking carefully at altering monetary policy, particularly in the light of higher inflation, we do not expect interest rates to be changed until the end of the year at the earliest – monetary authorities are likely to be reluctant to move early for fear of killing off the recovery, even though it is probably right for them to be doing something. As Andrew Sentance, one of the UK MPC's members, has voiced, doing nothing now runs the risk of even larger moves in interest rates later on, which could be far more damaging to the economy. We have some sympathy with this view, but believe that the MPC is likely to dig its heels in over potential policy change. This means that investors are likely to continue to divert savings away from cash in a quest for more decent investment returns.

We have cautioned for some time that the unwinding of the current global monetary and fiscal stimulus will not be straightforward and could become more of a challenge sometime during 2011. We have not changed this view, but in the near term the more positive economic and market momentum seems likely to continue - stockmarkets have generally moved ahead in line with rising company earnings, so valuations are not particularly elevated in most developed markets, providing scope for further progress in the early part of 2011. A healthier corporate dividend outlook should also provide good market support. Of course, there are still several things that may interrupt the positive mood for markets, most notably further stresses in the eurozone, an escalation of tensions in Korea or a more overt trade spat between the US and China. For this reason it remains important to us to maintain both geographic and asset diversification and to build, where appropriate, a little more defensiveness into client portfolios in recognition of perhaps more challenging times later this year.

Mark Robinson
4 January 2011

Gold - onward and upward

Our investments in gold have been restrained somewhat by a generally weak dollar in 2010, but this has recently turned around against a backdrop of a stronger US currency in the last weeks of the year.

The gold price has now moved above $1400/oz, with some previously bearish commentators turning very bullish. Increased Chinese demand is one key factor, with the country effectively diversifying its foreign exchange reserves into a more internationally recognised currency, namely gold. Chinese imports of gold are likely to be at least five times greater in 2010 than they were in 2009, despite China being the world's largest gold producer. Although precise and timely data from China is difficult to obtain, there is a strong suggestion that the majority of their imports are being converted into mini-gold bars, to sate the appetite of individual investors. Furthermore, the recent launch of a savings account allowing Chinese to invest from £1 a day in gold has had a phenomenal start, with over 1m accounts opened and over £500m invested in gold so far. If this demand continues, then the recent momentum in the gold price is likely to continue, and remain somewhat dislocated from trends in the wider commodity cycle. We do not want to get completely carried away with gold as an investment theme – after all it provides no income – but its characteristics as a truly alternative asset class with a straight ten-year record of gains are hard to ignore. We are therefore happy to maintain our commitment in most client portfolios, but are mindful that it may not look so attractive when cash starts to pay some decent interest again, as it surely will do one day.

Asset allocation remains key

For sterling investors, having had little or no commitment to continental European markets has been the right call in the past year. So much for the internationalisation and close correlation of stockmarkets – a near 10% gap opened up during 2010 between the UK and continental European stockmarkets. And that is not because the UK stockmarket has provided the best return of all developed markets. The surprising joint winners were Japan and the US, which saw returns of almost 20% in sterling terms as measured by the S&P 500 and Topix Indices. Admittedly, returns were boosted by some currency gains, but however the returns have come about, having international exposure in portfolios (outside continental Europe) has worked well in the past year. Seeing Japan towards the top of the leaderboard is a rare but particularly welcome sight and may be a sign that this investment pariah of the past 20 years is finally coming to terms with its political problems and can see some way out of its deflationary spiral. We are not getting overly excited about the prospects in Japan, but what exposure we do have is performing well and contributing to overall portfolio returns.

Whilst there are some encouraging signs of a more self-sustained global recovery, there are still plenty of potential obstacles for markets to deal with. The future of eurozone, the structure of which was designed to be irreversible, is by no means clear, and the current approach of applying large sticking plasters, rather than embarking upon some major surgery, is losing its potency. There is still a risk that the bloc will not survive in its present format in the medium term, but at least there is a stronger political will for survival, which may be sufficient to prevent the real worry, that of contagion with other economies, from permeating through financial markets. We still see little reason to venture back into continental European markets for the time being.

Shop till you drop?

For UK consumers and retailers the arrival of 2011 brings with it a number of headwinds. Early indications show that shoppers were out in force in the post-Christmas sales, but it remains to be seen whether this was just a dash for pre-VAT-hike bargains or something demonstrating greater consumer confidence.

We know that retailers are facing tough conditions from higher input prices, and will be faced with the challenge of either absorbing or passing on some of the significant increases in raw materials prices, in particular wheat and cotton which impact both food and clothing sectors. All this comes at a time when consumers have yet to feel the full brunt of tax increases and government spending cuts. If sales figures are weak, expect the excuse of December's snow and ice to be thrown into corporate trading statements. Separating the wheat from the chaff, so to speak, may be difficult, and it could therefore be a slightly jumpy time for stockmarkets as they grapple to get a clear picture of consumers' spending habits in the early part of the new year.

"shoppers out in force, but it's not yet clear whether this is simply VAT beating or sustainable renewed confidence"

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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
Email: enquiries@berry.co.uk
Website: www.berry.co.uk

Bordier & Cie

Rue de Hollande 16
CH-1204 Genève
Case postale 5515
CH-1211 Genève 11

Telephone: + 41 22 317 1212
Facsimile: + 41 22 311 2973
Website: www.bordier.com

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