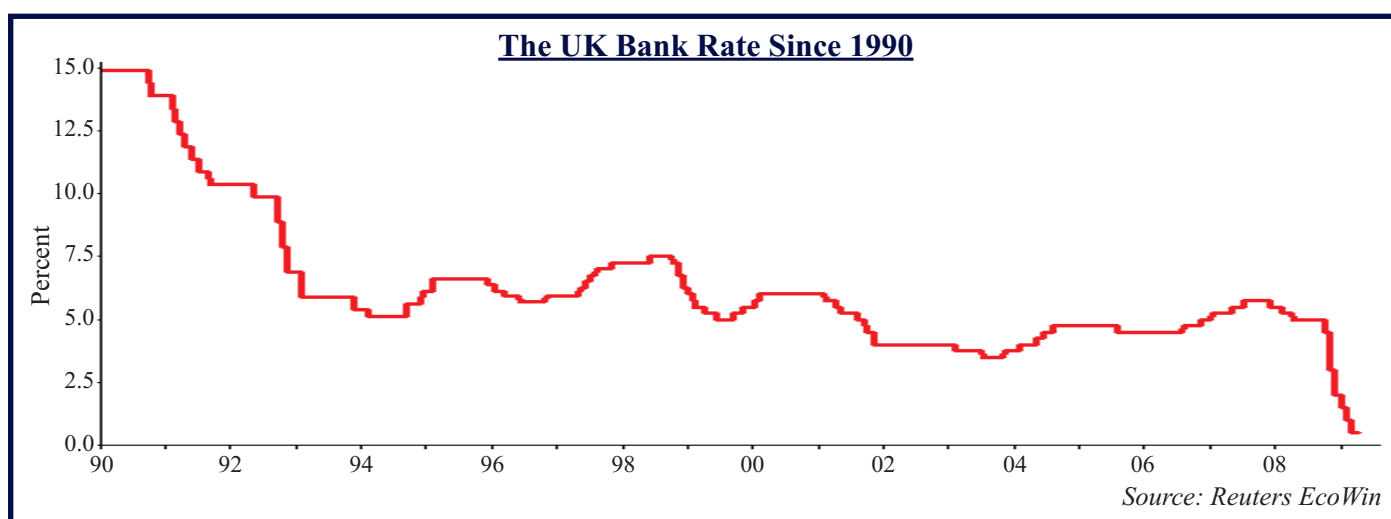


EMPTYING THE MEDICINE CABINET

If 2008 was the year in which economies and stock markets became very ill thanks to previous over-indulgence, 2009 has so far been the year in which the medicine cabinet has been emptied in search of a cure. The latest remedy to be tried is quantitative easing ("QE"). That its use has been authorised at all is a very clear indication that the patient is indeed very poorly; QE is a potent and largely untested treatment, but with little scope to reduce interest rates further (see chart) the medicine cabinet is looking bare. The question on the lips of all of us pacing up and down in the waiting room is: 'will quantitative easing work?'



QE involves the central banks creating new money, as if it were printing new bank notes, and using it to buy government and corporate bonds. This should drive bond prices up and yields down, thereby lowering the cost of borrowing for companies where the cost of debt is related to bond yields. The new money is paid to the banks, insurers and others from whom the central bank buys the bonds. From here, hopefully through new lending, the new money finds its way into the economy, thereby further easing the credit crunch, and saving us all from a prolonged and painful bout of depression. At least that's the theory.

In practice, it seems likely that QE, if administered too liberally, may have a nasty side-effect; inflation. Conversely, if the shock to the global economy from the credit crunch proves too great, QE may have no positive impact at all and economies may end up in a deflationary slump regardless. To all of us expectant onlookers one thing seems highly likely; that the dose is unlikely to be 'just right' - it is simply too early to tell how the patient will react.

As investment advisers, our challenge is that 'inflation proofing' a portfolio requires real assets: equities, commodities and property - but a deflationary slump demands quite the opposite: government bonds and cash. Our belief is that sooner or later the medicine will work - and inflation will ensue. However, it is much too early, and too risky, to dismiss the deflationary outcome. Our advice to clients, therefore, is that portfolios should be set up to favour a recovery, with accompanying inflation, but that healthy weightings to cash, despite very low interest rates, should also be held. The latter could be considered a health (or wealth) insurance premium to cover against further unpleasant surprises.

If you would like advice on any of the matters in this bulletin, please contact Nick Fletcher, Chief Executive, at nick.fletcher@saunderson-house.co.uk or on 020 7315 6504 (direct), who will either help you personally or guide you to an appropriate adviser.

This note is for general guidance only and represents our current understanding of law and HM Revenue & Customs practice as at 3 April 2009. We cannot assume legal liability for any errors or omissions and detailed advice should be taken before entering into any transaction. The value of investments and any income therefrom can go down as well as up and you may not get back the full amount you invested. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. Saunderson House Limited is authorised and regulated by the Financial Services Authority.