Investment Bulletin

SAUNDERSON HOUSE

3 OCTOBER 2008 FOCUSED FINANCIAL ADVICE

FINANCIAL MARKETS AND PORTFOLIOS UPDATE

These are extraordinary times in financial markets. The share prices of financial companies are falling sharply and credit markets are in effect closed. Money markets and interbank lending are paralysed by concerns over counterparty risk. These events are without modern precedent. They may also have a broader impact, as a properly functioning banking system is vital for any developed economy. This note comments on the general (i.e. not specific to every client) positioning of portfolios and provides our view of the future.

Portfolios

1 Recommended portfolios are cautiously invested; our mid-range balanced risk model has circa 45% in low risk cash and fixed interest. Apart from a small allocation to commercial property, the remainder is in high quality, value-orientated equity funds, focused predominantly on developed markets. We have arrived at our current asset allocation through successive moves to de-risk portfolios over the past two years. While, with perfect foresight, we would have taken the de-risking further, we believe that the recommended changes have served to provide a large degree of capital protection, from an already cautious starting point.

The steps taken to reduce exposure to risk assets began in April 2006 with a reduction in Far Eastern and Emerging Markets equities, followed in October 2006 by a halving in your commercial property allocations. In 2007, reductions to what we saw as over-valued UK smaller companies were made and, subsequently, equity weightings in Europe were halved. These proved to be well timed moves.

2 Your Saunderson House advised assets are visible and liquid. There are no suspect "cash plus" investments, opaque hedge funds or structured products, where there is often counterparty risk and little liquidity. We have also discouraged investment into the Indian and Chinese equity markets, which have fallen very sharply - the latter by more than half. Instead, we have favoured UK sovereign debt, particularly index-linked gilts, thereby protecting capital from commercial credit risk and higher levels of inflation, while also maintaining perfect liquidity. These, together with cash held in the most secure liquidity funds, have formed the bulwark of portfolios. We have concentrated our equity fund selections predominantly on value managers, which, despite some falls over the last year, are proving their worth in these turbulent times, with a number outperforming of late thanks to their positioning away from banks and resources stocks.

The Future

Equity markets, in our view have already discounted a great deal of bad news. There may be more to come but we do not believe that the world has changed completely; interest rate cuts and more systemic government support for troubled institutions are likely to trigger a recovery in due course. It is not our view that we are faced with long term, structural problems as experienced by the Japanese from 1990. Now is therefore not the time to sell out of the equity market.

On a five year time horizon equity markets are likely to be much higher. By contrast, UK government bonds, which are much favoured by investors at present, are unlikely to provide attractive returns over the same timescale. Reasons for this include greater gilt issuance in future to meet higher deficits and the likelihood of slightly higher inflation rates through the next cycle. As you would expect, we are monitoring developments very closely and will advise clients on further recommended asset allocation changes as appropriate.

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.

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