

### A Volatile Quarter

It is three months since we issued our last briefing note and since then the market has continued to be incredibly volatile. You will find enclosed a copy of this briefing as our views are largely unchanged.

At the time of dictating (Monday 23rd of June 2008 at 11.15 am) the FTSE 100 index is at 5640, a level we last saw towards the end of March.

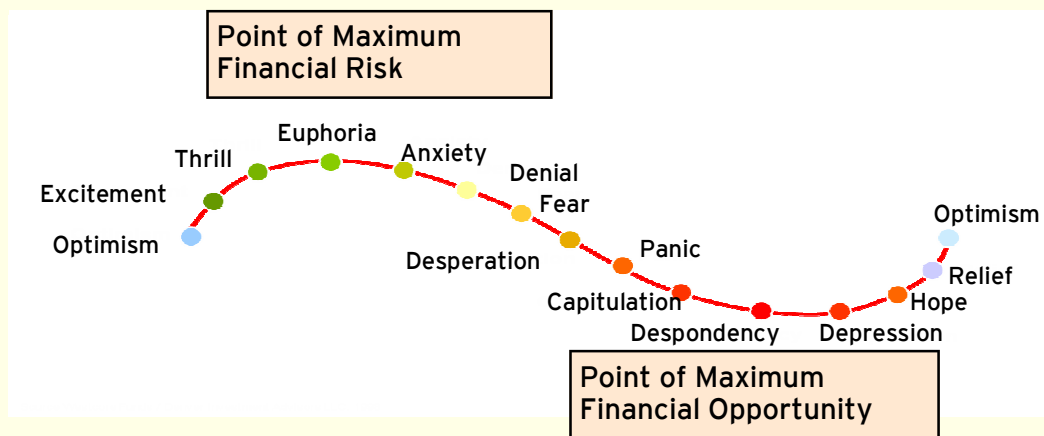
However, unlike in March it has not breached our 5600 trigger point. We have agreed with many clients to top up their equity holdings if the index closes below 5600 for two consecutive days, and whilst we have come close it hasn't happened yet.

There is always the risk that the market could fall further before recovering however we believe when looking at a five year view, that buying equities at this level represents a great opportunity.

### A Barrage of Bad News

The last time I can personally remember such negative sentiment towards the stockmarket was in 2003 when the market hit its low point of 3500.

Bad news, as always, is a best seller and the easiest way to get your name into the financial pages is with dire predictions. Times of greatest euphoria can represent the greatest risk and, at the point of despondency, the greatest opportunity, as highlighted below:



Since our last briefing the FTSE rose from 5700 to nearly 6400 increasing by 13% and has then given up all of those gains to reach the current low levels.

### A Bear Market

If you define a bear market as a 20% drop in the level of the stockmarket then we are currently experiencing the 9th bear market in the last 40 years. When you look at the duration of bear markets, (in other words the length of time stockmarkets fall for) of the last nine:

- Six have been fairly short lasting a year or less
- One has lasted less than two years
- Two have lasted for nearly three years, being the periods May 1972 until December 1974 and September 2000 to March 2003.

The most recent market peak was on 15 June 2007 and so we are already 12 months into the latest bear market.

### **Bear Markets and Recessions**

Whilst there have been nine bear markets over the last 40 years there have only been four recessions. The stockmarket tends to be forward thinking and therefore is more likely to fall before a recession and rise during one. Indeed, the UK stockmarket has risen during three out of the last four recessions.

### **Residential and Commercial Property**

A number of commentators have stated the belief that residential property will fall on average by 30% over the next three years and that commercial property has a further 10% to fall from its current low levels.

As with all averages there will be pockets of above and below average performance, which means that some sectors of the property market may be looking at falls of 50% or more from their peak. If this happens, we believe that this could cause the end of the false feel good factor that many households have enjoyed over the last decade.

We have been in the unusual and irregular situation that as house prices have been rising, families have been getting into ever increasing debt and yet feeling wealthier and wealthier as the value of their home increases.

The credit crunch has brought this to a brutal end and there is the potential that this could drive the UK into recession as people quickly adapt their behaviour accordingly.

### **Inflation**

There are now so many different levels of inflation with three official versions of the Consumer Prices Index, the Retail Price Index and core inflation all remaining relatively low in real terms. However, we now have inflation being measured differently by financial journalists, for example with the introduction of the Daily Telegraph's "Real Cost of Living Index". They calculate that inflation is running in excess of 9% per annum.

Whichever figure you chose to believe it is clear that prices are increasing more rapidly primarily due to the huge increase we have seen in energy costs. These increases can not be put down just to increasing demand. There are many that believe it is a speculative bubble that will shortly burst and bring inflation tumbling down with it.

There is the chance that have we seen a long term shift in energy prices and that \$100 per barrel of oil will become the new low rather than the old high! However, if the energy price just stabilises from here then its effect on inflation will disappear as goods have already increased, but they will not necessarily continue to do so.

### **Summary**

These are clearly turbulent times and the safest way to navigate through them is to stick to the originally agreed strategy. We still believe that anything below 5600 is a very strong buying opportunity and 6500 would be a strong selling opportunity.

It is important that we don't crystallise losses by selling equities at market lows but instead use them as an opportunity to top up holdings where it is sensible to do so. We believe that when everyone around you is being fearful it is time to be greedy, and when everyone is being greedy it is time to be fearful.

In other words we want to invest against the herd, buying in assets at a relative lows and selling them at relative highs.

The stockmarket rises, it falls and then it rises again. Investing takes discipline and it takes patience. It punishes knee jerk reactions and rewards logical long term strategies.