

# EQ Investment Bulletin

## April 2011

### Equity Markets

Last month we told you how we were reacting to falls in the equity markets by increasing equity exposure.

Following the Japanese tsunami, markets fell sharply. At the time we felt that this would be a short term dip and reacted by switching out of two "absolute return" funds to a FTSE Allshare tracker and a Japanese equity tracker fund.

We were pleased to see that markets then rallied. The FTSE 100, after falling to 5,598 at close on 16 March, gained over 8% to close at 6,055 on 8 April.

In the last few days markets have fallen back due to concerns about US debt, as Standard & Poor's warned that America may lose its 'AAA' credit rating. Many commentators put the chance of this happening at about one in three.

America's debt problem is no secret, though to date its position as the world's largest economy had allowed it some leniency from markets and credit agencies. We were surprised to see the market react so sharply to something that most investors already knew about!

We still believe that market falls will be short term and will therefore continue to hold the tracker funds until we feel the time is right to move back into the "absolute return" funds.

We feel the UK market could get back to its February levels relatively quickly. If it does, we could switch back out of the UK tracker fairly soon.

We would expect our purchase of the Japanese tracker to take longer to pay off. The Japanese market is up fairly significantly since the disaster but has recently been going sideways. Currency movements have reduced market gains for investors outside Japan, with the Yen falling from its record highs in the immediate aftermath of the tsunami.

We will continue monitoring this position and will move to a more defensive position when we feel the time is right.



## Inflation

The latest inflation numbers have been released and CPI (Consumer Prices Index) inflation has fallen from 4.4% last month to 4% this month.

This is a welcome fall and inflation is likely to fall further over the summer as the impact of some of the previous price rises lessens.

However, the Bank of England believes that inflation will fall back to within its target range of 2% to 3%. They may well be right, but the oil price has now risen to over \$120 a barrel. This not only puts up petrol prices but indirectly puts up the price of most goods which of course need to be transported somehow. Inflation may therefore not fall as far as the Bank has forecast.

Many economists believe that if oil remains above \$120 a barrel this could have a significant impact on global economic growth. The oil price should fall back if the situation in the Middle East becomes more stable, but there is no telling what will happen in the region or how long the uncertainty will last.

We are concerned that any falls in inflation figures will be temporary and that inflation will then go back to being significantly above the Bank's target.

## Income Units

When we invest your money via a wrap platform such as Nucleus, we tend to buy income units rather than accumulation units.

We have had a number of queries recently about how the two types of units differ and why we buy income units even if you are investing for growth.

With accumulation units, the return that you receive is reflected solely in the price of each unit. The fund will receive dividends from the shares that it holds, but rather than pay these out to investors, they are reinvested within the fund and the price of each unit increases to reflect the income received.

With income units, the dividends received from the underlying holdings are periodically paid out to investors. Most commonly, funds pay dividends on a 6 monthly basis.

This means that, over time, the price of each accumulation unit will increase more than the price of each income unit. However, of course those investors holding income units will also have received cash dividends which can then be reinvested.

When we buy income units within your wrap account, dividends are paid out by the funds but they are held in the cash account within your wrap. There are several reasons why we do this rather than simply using accumulation units.

Firstly, whereas with accumulation units the dividends are automatically reinvested into the same fund, we may prefer the income to be reinvested into a different fund or even an entirely different asset class. This process gives us the flexibility to do so.

Another reason is that the cash received in the form of dividends can be used to pay charges. This means we don't need to sell units when charges are due at what might not be an optimal time.

Whether or not we choose income or accumulation units, the tax treatment is the same.

If you are closely following your performance via the online valuations, you need to keep this process in mind.

Take the example of a property fund, where returns come principally from income rather than capital gains. If you simply look at the price you paid for buying that fund and compare it to what it is worth now, this will not accurately reflect performance.

You could have received substantial income from that fund but this may have been reinvested in another asset class. The capital value of the property fund may therefore not have moved but you have still made a return from the income.

We normally only keep 2% to 3% in cash at any one time within a wrap, but there are times when the cash levels can increase due to this process. Where you see more cash than this it is simply because we have not yet reinvested back into the market.

## New Email Addresses

Following feedback, we've decided to make our email addresses a bit easier to spell!

Our new email addresses will shortly all end @eqasset.co.uk rather than @equilibriumam.co.uk. The old addresses will still work but please update your contact details to reflect the new domain.



## Half Yearly Investment Review

We are just finalising our half yearly investment review and aim to have this issued to all clients by the end of April.

As usual it will give you an update on performance and provide details of the changes made to portfolios since the last issue in October 2010.

We hope you enjoy it and would appreciate your feedback.

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# Market Views | April 2011

## General Economic Overview

GDP growth is expected to remain muted but will recover from last quarter's negative result. Inflation may remain well above the Bank of England target for some time. It may fall back this year, but not as far as some have predicted due to continuing oil price rises. This could impact on global growth if sustained.

Interest rates will rise this year, most likely to 1% by the end of the year. However, this will have little impact on inflation, driven by external factors. We think inflation could be an issue for some time.

If our scores below turned out to be correct, our balanced asset allocation could return around 7.5% over the next 18 months compared to our long term assumption of 7.6% pa.

### Asset class key

+ positive	+5 strongly positive
- negative	-5 strongly negative
= neutral (normal behaviour)	

Equity Markets	Outlook
<p>Equities have recovered from their mid March dip which made them look very cheap. They now look reasonable value based on current earnings. However, the consensus is for some decent earnings growth this year and based on earnings estimates there is the potential for some good growth.</p> <p>We believe that high quality, well capitalised companies should outperform, as they have not seen the same growth as poorer quality stocks.</p>	+1
<p><b>Fixed Interest</b></p> <p>We are concerned about the risks of investing in pure fixed interest. Given our views on inflation and interest rates, returns on fixed rate bonds are likely to be much lower than they have been of late whilst the risk of losses is increased.</p> <p>However, we believe there is value in inflation linked, variable interest rate, and some high yield bonds.</p>	-4
<p><b>Commercial Property</b></p> <p>The rental yield on the commercial property index remains very attractive relative to other asset classes. However, we are expecting little capital movement and possibly some small capital losses over 18 months.</p> <p>Property funds are gradually reducing their high cash levels, which has been a drag on returns. This should improve total returns in the long run but in the meantime we are expected lower than average returns.</p>	-4
<p><b>Residential Property</b></p> <p>We believe prices could fall or remain flat over 18 months, well below our 5% pa average assumption.</p>	-5
<p><b>Cash</b></p> <p>With interest rates remaining at record lows, returns on cash are as low as they have ever been. Rates will remain below average for some time.</p>	-5

These represent Equilibrium's collective views. There are no guarantees, although we hope to be right more often than wrong. We usually recommend holding at least some funds in all asset classes at all times and adjust weightings to reflect the above views. These are not personal recommendations so please do not take action without speaking to your adviser.