

## Money Marketing Awards

**We mentioned in our recent briefing that we had been shortlisted for Best Investment Adviser at the Money Marketing Awards.**

We are delighted to announce that we finished runner up, behind joint winners Hargreaves Lansdown and Paradigm Norton. We feel that this is a fair result as our investment process is quite specialised and the winners have a more generalist approach.

It is also very rare for a firm to win on their first entry, but following the launch of some new services (watch this space) we believe we can win it next year!

The list of awards that we have either won or made the shortlist is growing longer, and we hope you find this reassuring in these difficult times.

The markets continue to be against us and getting the balance right between mitigating losses and gaining the maximum benefit from any recovery is a difficult one. We believe our "active" service provides the best route to achieve these aims.

## The Applewood Active Service

As many of you know, our discretionary service is now up and running for clients on the Nucleus platform.

We have just agreed to use a second platform for this service, provided by Seven Investment Management.

We feel that Seven Investment Management have a similar philosophy to ours, and in many ways the relationship is a good fit.

When a client signs up for our discretionary service, we make sure that their investment is re-balanced to fit our current selection of funds. We have refined most of our portfolios in the last few months and so here are the changes you may have already seen if you have become a discretionary client:

### Fixed Interest

- Switched out of Index Linked Gilts due to concerns over deflation.
- Reduced Dimensional Global Short Dated Bond to 20% of the portfolio and increased investment grade Corporate Bond holdings to 60%, to take advantage of recent falls.

### UK Large Companies

Taken a higher conviction approach by selling Rathbone Income, switching to our other preferred funds.

### Global Established

Again, we've taken a higher conviction approach by selling:

- Fidelity European
- Threadneedle American
- Societe Generale Japan Core Alpha
- Newton Global Higher Income



The funds have been switched to our other approved Global Established funds, the aim is to get the maximum diversification without reducing returns. It can be important not to over-diversify - we call this "di-worse-ification".

### Global Speculative

We took the decision to only use Global Emerging Markets funds. We feel that we should leave the decision regarding which emerging market countries to invest into with specialist fund managers. We rebalanced to the following split:

- 40% Dimensional Emerging Markets Core Equity
- 30% Allianz RCM BRIC Stars
- 30% JPM Emerging Markets Equity

### Alternative Equity

Again, went for a higher conviction approach by reducing the number of funds. We sold Newton Phoenix Multi Asset switching into our other preferred funds.

## Improved Performance

We believe we can add significant value by making short term adjustments to our portfolios.

Our Fixed Interest portfolio has already seen a positive effect from our decision to drop Index Linked Gilts for standard Gilts. We anticipate reversing this switch at some point soon as fears change from deflation to the return of inflation.

Once the decision is made we need to act very quickly. A few days delay can make all the difference. The main benefit of our discretionary service is that if we make a decision at 11 am we can secure the prices at 12pm.

If you hold an account on Nucleus and have not yet signed up to our discretionary service, you will receive an invitation to do so very shortly. For more information, please contact your adviser.

## Quantitative Easing

The phrase currently on everyone's lips (but which nobody can say) is quantitative easing (which has quickly been dubbed "queasing"). This is a very simple concept which has complicated repercussions.

This is the modern version of printing money. The Bank of England is buying Gilts (and later will buy corporate bonds) from banks and other institutions. The Bank of England pays for the gilts or bonds by crediting the institution's account with newly created digital money.



This is designed to increase the amount of money in the system, which the government hopes will stimulate the economy. It can be difficult to get your head around, but the amount of money in the economy changes all the time. The amount that is out there has been reducing fairly dramatically since the onset of the credit crunch.

Say a bank lends a person £200,000 to buy a house on a 100% mortgage. If that person then loses their job and can't pay the money back, the bank will repossess the house. However, if house prices have fallen and it can only be sold for £160,000, the bank makes a £40,000 loss. That £40,000 the bank has lost has just gone. Nobody else has got it, it no longer exists.

Quantitative easing is designed to offset the reduction of the money supply, to get people spending again and banks lending again. It is also designed to reduce the cost of borrowing, by driving up the price of gilts and corporate bonds, and therefore reduce the yields.

Interestingly, using all this newly created money to buy gilts also reduces the cost of borrowing for the UK government. This is effectively robbing Peter to pay Paul. The Bank of England may lose on the deal but the government will be better off in other ways.

There is the danger that quantitative easing will go too far and inflation will return in a big way. After some potential short term deflation, we could be looking at rising prices once again. Our new discretionary service should allow us to react to this type of event with quick and decisive changes.

***If you have any queries or feedback, please do not hesitate to contact your usual adviser or the investment team. The investment team are:***

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
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## General Economic Overview

Recession is now likely to last for the best part of 2009. Inflation will remain low in the near term and we may see a short period of deflation. However, inflationary pressures remain and we will see a return to inflation at some point, probably later this year. We believe interest rates will remain at record lows for some time.

Asset Class	Applewood View
<p><b>Equity Markets</b></p> <p>Markets remain cheap on a number of indicators, with the FTSE Allshare having a Price/Earnings ratio of only around 7 (a long term average is 14) and yields far in excess of gilts.</p> <p>If the economic outlook is expected to improve in late 2009, based on the normal forward looking behaviour of equity markets there could be a significant rally in the middle of this year. Once confidence returns, we could see some excellent returns, particularly from large, profitable multi national companies.</p>	
<p><b>Fixed Interest</b></p> <p>We are very positive for long term returns on fixed interest, particularly corporate bonds from strong companies. However, liquidity in the markets and nervousness over the financial system continues to hamper the recovery.</p> <p>There is debate about the merits of continuing to hold Gilts vs. corporate bonds or inflation linked bonds vs. standard bonds. This all hinges around opinions on when/whether we will see inflation or deflation. We are holding some standard Gilts as we expect short term deflation, but with the expectation of a return to inflation later in the year. We plan to move back into Index Linked when we feel the time is right.</p>	
<p><b>Commercial Property</b></p> <p>No real change, in that we expect further falls in commercial property prices of maybe 10% to 20%. This market may begin to recover towards the end of 2009. We believe property shares are likely to reach a point where they look very undervalued in the near future with yields on the underlying shares of over 7%, and large discounts to net asset value.</p>	
<p><b>Residential Property</b></p> <p>We have seen perhaps the first tentative signs that falls in the residential property market are at least beginning to slow. Estate agents are reporting a large increase in enquiries, auction houses are reporting record turn outs, and a number of banks are planning to increase mortgage lending. However, we believe the market still has the potential for further substantial falls as the effect of redundancies kicks in.</p>	

### Key:

Positive Outlook		+1 is slightly positive, +5 is extremely positive
Negative Outlook		-1 is slightly negative, -5 is extremely negative
Neutral Outlook		Asset class expected to behave normally

These represent Applewood'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.