

## The correlation is broken...

I have just returned from my usual one week per quarter holiday and I am delighted that finally the correlation of my holidays to the market's dire performance has finally been broken! Of course, if I had returned to falling markets then I would have claimed to have been off sick for the last week!

At the time of dictating the FTSE 100 Index is hovering around the 4,400 mark, a rise from 9 March to 7 May of around 25% in less than two months.

During this time global property shares (historically our most disappointing investment) have risen almost 30%. Many of you who have been uncomfortable with global property may now wish to significantly reduce your holdings. If you do, please contact your paraplanner or adviser.

There are many people (including the financial press) that appear to be getting more and more optimistic, and almost as the weather gets better so do their expectations. There is an old stockmarket adage that you should sell in May and go away. This is born out in the statistics to some extent, particularly in bear markets, and I am beginning to believe that we should do so this year.



The steep rise in markets has made me very nervous in the short term. I have mentioned in many of my client meetings over the last six months that I wanted stability and flat markets, and I was discussing this while markets were veering from 4000 to 4500. I wanted markets to remain flat at 4000, but since then they have been on a rollercoaster from 3,500 back to 4,400.

I felt for some time that so much has changed in the world that we need a period of stability to allow us all to digest it. When markets are swinging wildly then fear and greed take over

in major ways and can lead investors to make irrational decisions. Fear can push people into selling assets at 3500 and buying them back again at 4500!

### Selling into Recovery

Over the past few weeks and months we have been recommending clients invest up to their maximum tolerance in equities.

If you have taken this action there is a good chance your portfolio now has more equity than your tolerance due to the recent growth. If this applies to you, we recommend you bank those gains and reduce equities back down to a more comfortable level.

For example, if we agreed 40% of your portfolio in equities was right two months ago, there is a good chance this has grown to 45% or even 50% depending on the date of any switches into equity.

We want to bank those 5% or 10% gains and go back to 40%. We want to dictate risk to your portfolio, rather than allowing your portfolio to dictate risk to you. This is primarily about sticking to strategy, rather than trying to predict market direction.

However, as equities rise in value, so too does the risk. The risk of a setback in markets has certainly increased and even if this is the start of a recovery we are likely to see at least a hiccup along the way. That's why you'll see from our asset class views we've reduced our equity outlook from +4 to +3. We still think equities will do very well in the medium term, but in the short term there is a real chance that there could be some further shocks.

If that doesn't occur and this is a bull market, we will have missed out on some growth but at least we have reduced risk to guard against potential falls.

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## Bull or Bear?

Whether this is the start of a bull market or merely a short term bear market rally is unknown. However it's important that we stick to strategy regardless. Rebalancing is vital as it smoothes returns and protects against the downside risks.

Many of those who have recently increased equity holdings will have set trigger levels at which we will switch out. We will start to use these increasingly, so when you next have a review your adviser will work out at what market levels we should look to reduce, or increase equities.

Perhaps you can also give this some thought before the review so we can take your views into account.

If you have assets on one of our chosen wrap platforms it is easy to do these switches with some accuracy, as we can place a trade at 10.00am and

be out of the market in time to get the 12.00pm price.

In contrast, most insurance companies still require a signed switch form and that can obviously lead to delays. This can be particularly significant if we need to send a form out to you before then sending it on to the insurance company.

If you haven't yet moved your assets (as least in part) to Nucleus or 7IM and would like to do so, please let us know.

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## Market predictions vs opinions

I had a debate with a client recently about whether we predicted markets or just offered our opinion. Clearly, what we would like to do is to predict the sector of the market that is going to rise the most over the time period that you are going to invest in it, and for those predictions to be proved correct the majority of the time.

That is incredibly difficult (impossible even?) to do and it is why we believe in a balanced approach. It is why we refer to assets being undervalued or over valued and whether we believe that investing in them now will be right over the medium and long term. Medium to long term is anything from 3, 5 to 10 years, but mainly we are looking at 3 to 5.

We will never make a prediction as to where the market will be in the short term, but we are always prepared to offer our opinion.

It is my opinion that once markets get past 4,500 or so I believe that the reality and the implications of rising unemployment will return to the fore. House price falls will continue and dent confidence again leading to the markets falling back to 4,000. I think it is likely that the March lows will be the bottom of the market, but I also know that they could go lower.

I believe that almost all markets will be significantly higher in three years time than they are today. I believe that the low interest rates available on cash deposits will spark a search for "yields" and this is likely to come through in a major way in the last quarter of this year when many of the fixed rates people are enjoying on their deposits come to end. Until then I am confident that markets will remain very volatile, and I urge you to pay little attention to this volatility other than trying to take advantage of it with some sensible switches in and out of the market.

### Equilibrium

I am pleased that the rebrand to Equilibrium has gone well and we have received some positive feedback on both the name and the "branding" style. Our new website ([www.equilibriumam.co.uk](http://www.equilibriumam.co.uk)) should be live on Monday 25 May 2009 and I would urge you all to have a look at that and to regularly review our blog which will provide you with our snapshot views and allow you to post your own comments in between these briefings.

And finally, I would like to thank all of our clients for their politeness, patience and in many cases good humour during these challenging times.

**Colin Lawson, Managing Partner**

Equilibrium Asset Management LLP  
Brooke Court, Lower Meadow Road,  
Handforth Dean, Wilmslow, Cheshire SK9 3ND

t 0161 486 2250 f 0161 488 4598  
e [askus@equilibriumam.co.uk](mailto:askus@equilibriumam.co.uk)  
[www.equilibriumam.co.uk](http://www.equilibriumam.co.uk)





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## General economic overview

Most people agree that recession is likely to last for the remainder of 2009 but opinions are mixed about when we will see a recovery and how strong it will be.

We are currently seeing deflation if RPI is taken as the main measure of inflation, although CPI remains positive. We believe deflation will be here for some months, but that inflationary pressures remain under the surface. We will see a return to inflation at some point, possibly later this year or some time next year. We believe interest rates will remain at record lows for some time, probably remaining at current levels for most of this year.

### Asset Class Views

<p><b>Equity Markets</b></p> <p>While there remains a real divide of opinion about whether we are seeing the start of a bull market or a short term bear market rally, there is consensus that there are pockets of real value in certain areas of the stock market. Even many of those who are pessimistic about the market as a whole believe there is money to be made in the right stocks. This could suggest that active management could outperform passive management in the short term.</p> <p>We believe that large multinational companies, those with strong balance sheets and low amounts of debt, should do well.</p>	
<p><b>Fixed Interest</b></p> <p>We remain very positive for long term returns on fixed interest, particularly corporate bonds from strong companies. Liquidity in the markets continues to hamper the recovery, but we are now starting to see some positive short term results. There is debate about the merits of continuing to hold gilts vs. corporate bonds or inflation linked bonds vs. standard bonds. This mainly hinges around opinions on when/whether we will see inflation or deflation.</p> <p>We are continuing to hold some standard gilts as we believe quantitative easing could still have an impact, and as we expect short term deflation. However, we expect inflation to return and anticipate we may move back into Index Linked when we feel the time is right, although we are concerned about government debt levels and may prefer high quality corporate bonds instead.</p>	
<p><b>Commercial Property</b></p> <p>No real change, in that we expect further falls in commercial property prices. Property shares are starting to show some real value due to the discounts available to net asset value. Forecasts for prices in commercial property markets remain negative, but falls are slowing and some other indicators may hint at the beginnings of a recovery towards the end of the year.</p>	
<p><b>Residential Property</b></p> <p>There is a variety of "less bad" data being published, with estate agents reporting an increase in enquiries, and mortgage approval data and house price data being less pessimistic. This points to a slowing in the rate of decline. We are cautious as we expect some further falls. We have not yet felt the effects of redundancies.</p>	

Key:

 means we are positive about an asset class

 means we are negative about an asset class

 means we are neutral about an asset class - we expect it to behave normally

 is most strongly positive,  is most strongly negative.

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.