

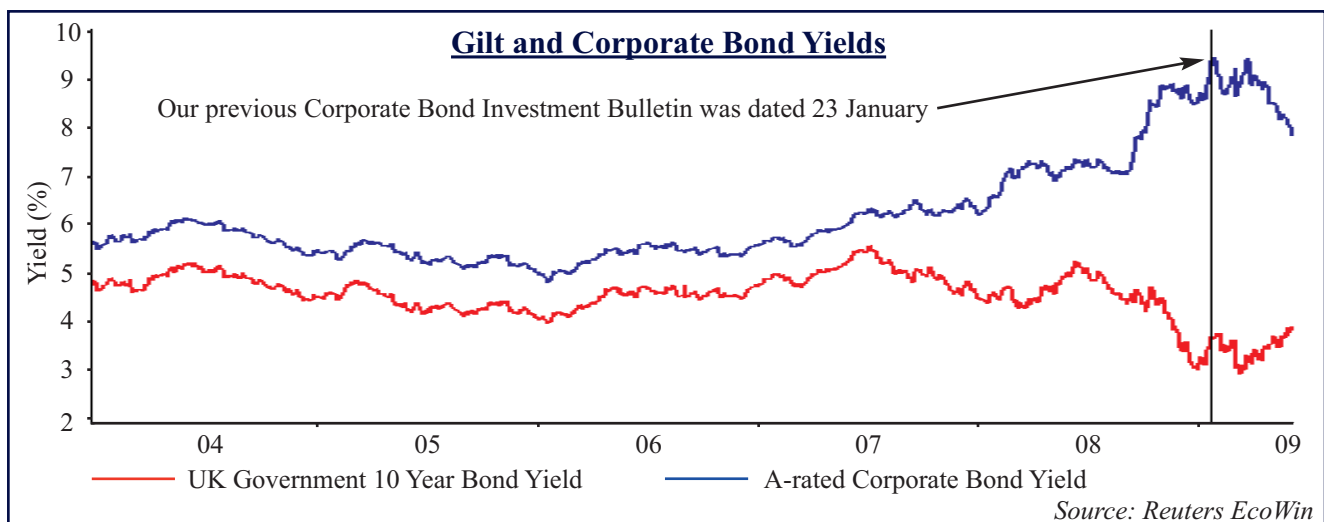
12 June 2009

FOCUSED FINANCIAL ADVICE

### FIXED INTEREST: A FURTHER ALLOCATION TO CORPORATE BONDS

In our last update we mentioned our then forthcoming ‘Bull, Bear or Balance?’ seminar which took place on 4 June featuring guest speakers Anthony Bolton, President of Investments at Fidelity International, and Jonathan Ruffer, Chief Executive of Ruffer LLP. Both speakers agreed on several major points, particularly the medium term threat of resurgent inflation. Anthony Bolton expressed the view that the current environment presented a good opportunity to buy equities, while Jonathan Ruffer highlighted the attractions of long-dated index-linked government bonds. A recording will be sent to clients in the near future.

Our recent research, supported by some of the conclusions reached at the seminar, is that the risk of deflation has now receded somewhat and that this should be reflected in portfolios through a reduction of cash assets, where appropriate. Earlier this year, we advised many clients to replace the conventional gilts in their portfolios with corporate bonds and cash. In recent months, the yield on the benchmark UK 10 year gilt has risen (i.e. the price has fallen) indicating that the extreme risk aversion - the ‘flight to safety’ that drove investors to seek shelter in government bonds - has eased (see chart below). We are therefore recommending a further increase in corporate bond weightings funded from cash, where applicable. We believe this will provide a reasonable return on capital without assuming direct equity risk.



In reaching this conclusion we have considered many forward-looking indicators including the surveys of consumer and business confidence, which are now showing signs of improvement. Lagging indicators, such as unemployment statistics, are also proving slightly better than forecast earlier in the year. Financial markets, meanwhile, are signalling that the worst of the financial crisis may be over. For example, commodity and equity prices have risen since the low points reached in the first quarter of this year. The market for government bonds is telling a similar story.

These developments in economies and financial markets lead us to conclude that governments and central banks seem increasingly likely to win the battle against the deflationary forces of the credit crisis. We therefore believe it is appropriate to reduce cash weightings, retain index-linked gilt investments and increase allocations to corporate bonds. With the threat of deflation receding, the protection offered by cash in this scenario is becoming less valuable, particularly as easy-access cash investments are currently earning very little interest. Corporate bond yields, meanwhile, have fallen from the very high levels reached earlier in the year, though they remain elevated (as shown in the chart above). Our judgement is that they will continue to fall, thereby generating capital gains in response to the improving economic backdrop while providing portfolios with a healthy income stream.

As in January, we are recommending that increased allocations are achieved through well diversified and expertly managed corporate bond funds. These still offer attractive yields which means portfolios should benefit from a healthy income stream. We will be analysing individual portfolios and will write with any specific recommendations.

This note is for general guidance only and represents our current understanding of law and HM Revenue and Customs practice as at 12 June 2009. We cannot assume legal liability for any errors or omissions and detailed advice should be taken before entering into any transaction. The value of investments and any income therefrom can go down as well as up and you may not get back the full amount you invested. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. Saunderson House Limited is authorised and regulated by the Financial Services Authority.