Investment Bulletin

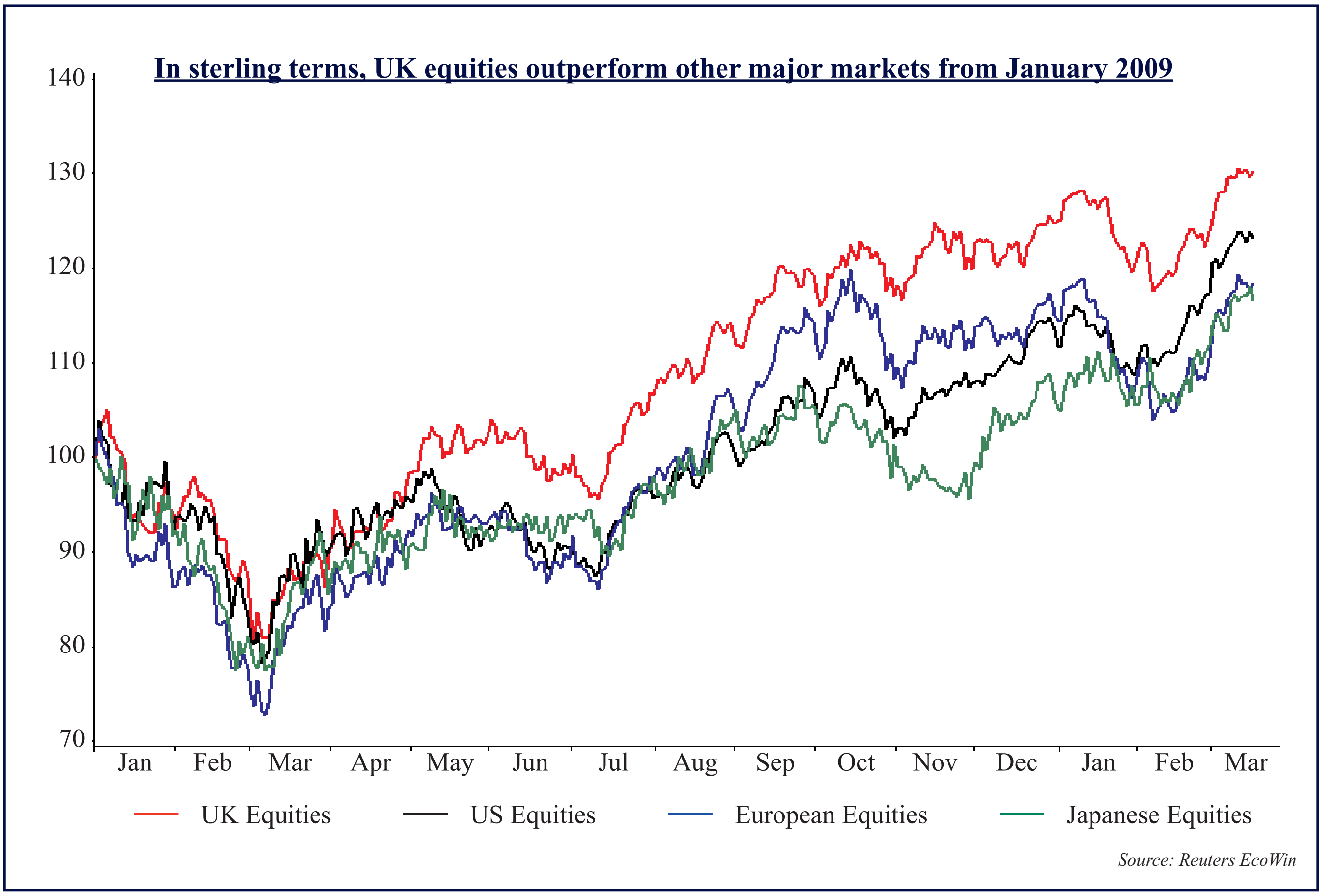
SAUNDERSON HOUSE

19 March 2010

CONFLICT-FREE FINANCIAL ADVICE

SEARCHING OVERSEAS FOR STRONGER EQUITY RETURNS

We are recommending a partial re-weighting of equity allocations away from the UK and towards the US, Asia Pacific and Emerging Markets. With many equity markets looking reasonably valued, we expect overseas equities to benefit from better economic growth characteristics and, potentially, currency appreciation. The re-allocation should also improve portfolio risk characteristics by reducing vulnerability to possible sterling weakness.



While the UK economy performed robustly up until 2008, its heavy reliance on financial services and household consumption meant that it suffered a deeper recession than most of its G7 counterparts and, likewise, has been slower to return to growth. Moreover, falling tax revenues, higher social security spending and the need to rescue its oversized banking sector have left the UK's public finances in a weak position. Tax increases have already been announced. Doubtless, more will follow in next week's Budget and after a general election, the timing of which is singularly unfortunate from an investor's perspective. In our view, while the UK economy is no worse than might have been expected given the severity of the financial crisis, it now looks set for a prolonged period of painful restructuring as households save more despite higher taxes, the public sector shrinks and financial services suffer greater regulation.

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With regard to the attraction of overseas markets, several factors convince us that the time is now right to re-weight equity allocations:

- The resilience of global equity markets, in spite of the ending of several policy support measures, has given us greater conviction in the durability of the recovery in equities. This encourages us to look for stronger returns in equity markets where economies face fewer obstacles to growth.

- Better economic data from the US is signalling that the recovery there is gaining traction. We ascribe this to the flexibility of the US economy which, among other things, has allowed businesses to cut costs aggressively. The benefit of this is now becoming evident in strong earnings reports from US companies.

- Considering Asia Pacific and Emerging Markets equities, these markets suffered sharp corrections through the bear market, which ended in late 2008. Since then they have recovered well, up until the recent policy tightening by the Chinese central bank. Our view is that growth will remain strong in the emerging economies, particularly those in the Asia Pacific region. Subject to valuation, this should lead to better equity market returns.

- Stronger growth and generally healthier trade balance and government finances should mean that the currencies of many developing and emerging economies can strengthen against sterling over the long term.

Finally, returning to UK specific issues, the general election, set to be called imminently, markedly increases sterling-related risks. Although we expect to see an overall majority for David Cameron's Conservatives, this is far from assured. The possibility of an inconclusive outcome or the re-election of Gordon Brown, combined with the schedule of heavy gilt issuance and burgeoning public sector deficit, could combine to cause difficulties for sterling on foreign exchange markets. Sterling is, at present, trading at close to fair value on a purchasing power parity basis versus the dollar. This, in our view, gives us the opportunity to side-step sterling-related risks by increasing allocations to US dollar and US dollar-linked currencies, such as those of Hong Kong and Singapore, through an equity re-weighting.