

## Investment Bulletin – April 2011

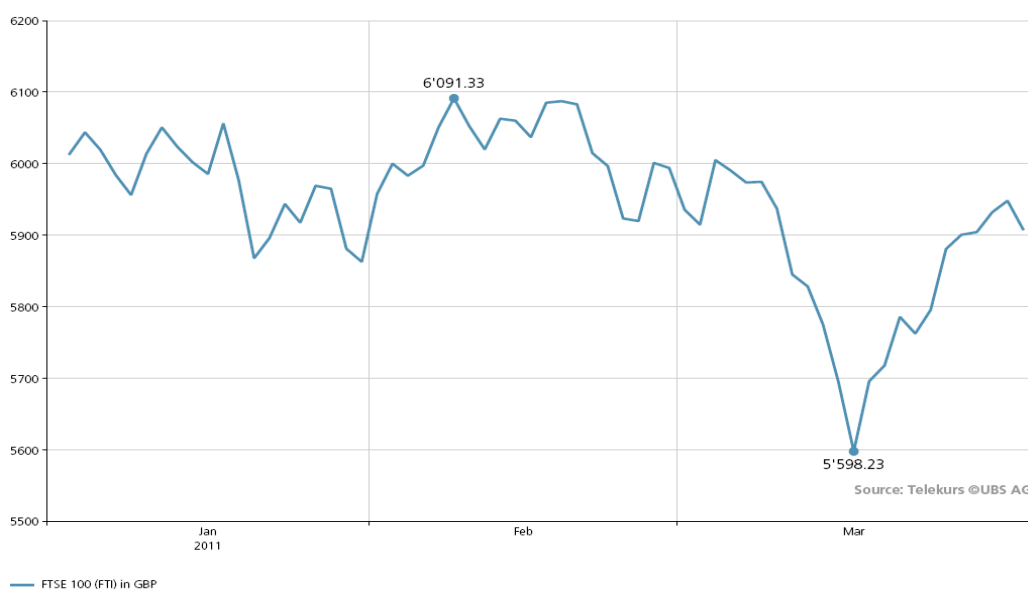
27<sup>th</sup> April 2011**Market Report**

At the beginning of the first quarter of 2011, we had experienced an appreciation in the UK equity market of over 7% in the five week period preceding the New Year. Against a backdrop at that point of an improving corporate picture and continued economic problems in indebted developed nation's world wide, numerous MPL investment department debates focused upon what possible "future" events, could potentially cause the UK equity market to deviate from this positive course.

The vast magnitude of events which occurred over the subsequent quarter not only highlight the continued volatile nature of financial markets at this point (which have presented us with good opportunities), but also just how resilient the UK equity market in particular is proving to be.

The negative headwinds which occurred include geopolitical tensions in North Africa which had spread to the Middle East and was partially responsible for the recent spike in crude oil prices (a possibly negative factor when considering prospects for the continuance of the global recovery); continued pressures in the euro zone capital markets exacerbated by ratings agency downgrades for both Portugal and Spain; Concerns about radiation risk at the Fukushima Daiichi nuclear power plant, following the horrific natural disaster which occurred off the eastern coast of Japan in March; as well as the possible end of quantitative easing (QE) in the US and further monetary tightening (increased interest rates) in China which again are negatives factors when considering global growth.

**FTSE 100 – 1st Quarter 2011**



Considering the multitude of negative events above, the resultant effect was the FTSE 100 equity index corrected by just over 8% as a result, from its high to low point. Making a comparison to the same period in 2010 when the first concerns regarding the sovereign debt problems in Greece were brought to public attention, the main UK market index fell by over 8.60% from its high point to its low point on this event alone. This market action highlights the resilience of equity markets at present. Not only has the FTSE 100 fallen less in value as result from the multiple events mentioned above in comparison to the singular event which occurred in 2010, the index has also recovered over ninety percent of this fall (at the time of writing the FTSE 100 index had a value of 6059 points).

There could be many reasons for this resilience, but to name a few we do know that there is still a wall of money in investment accounts at various institutions which as yet has not been invested in financial markets. This probably highlights the nervousness which remains in investor's minds in relation to the events which have beset equity markets over the past three years.

Considering the current problems faced across all of the asset classes that our investment team use to achieve our clients objectives; the nominal returns on annual cash investments remain below the real returns needed to preserve purchasing power in the current inflationary environment; short to medium term index-linked gilts (5-10 years to maturity) also have low returns excluding inflation ((however there may be investment opportunities in conventional gilts (non inflation protected) going forward); The corporate bond market excluding the financial sector can now be largely viewed as an asset class which will produce income at this point in time. The capital gains which have been achieved in the fixed income asset class over the last 3 years will probably not be repeated; Un-g geared commercial property in prime locations with good A grade tenants, still has the potential to benefit from increased rental yields, which will be the main driver of any further capital appreciation;

This leaves global equity markets which have all had a significant correction in the first quarter of 2011, presenting us with good opportunities in increase our clients exposure (below average risk and above) to this asset class.

In line with the comments made in our last investment letter quote *"in order to maintain a positive store of wealth or purchasing power, investments made within client portfolios going forward will have to produce a total return (income and capital growth) equal to or in excess of inflation, through capital growth, inflation protection, or a mixture of both components"* in increasing exposure equity exposure in client portfolios recently, we have done so with an international focus, hoping to take advantage of the structural change (which should result in growth) now in evidence in various regions worldwide.

Whilst there continues to be a high level of nervousness surrounding global equity markets at present, the resilience of these markets continues to support our view that a higher level of risk has to be taken in portfolios at this juncture, in order to avoid an erosion of capital (purchasing power) in all portfolios resulting from cost push inflation.

## **MPL Asset Allocation**

### *Cash*

With the prospect of monetary tightening being debated in the UK, fixed term deposit rates will benefit from any increase in interest rates here. However, we believe that over the course of the next few years, any rate increases will not reach the levels seen in the period up-to September 2008 (when interest rates hit 5.75%) as the UK consumer remains embattled. Hence fixed term deposits rates will continue to pay relatively low levels of yield. As a result, we have largely been reducing the levels of cash holdings that are held in portfolios.

### *Fixed Income*

In line with comments made in our last investment letter, we have trimmed our holdings of UK Treasury Gilts and UK Corporate Debt ahead of the potentially negative effects of a tightening in UK monetary policy by the Bank of England. Holdings in emerging market sovereign debt have been increased owing to the additional demand we expect to see for this fixed income asset class over time. The demand growth should be a result of the demographic and structural changes occurring in developed nations at present.

### *Equity*

Equity market holdings have been increased this quarter in the UK (due to the factors above) and globally (resulting from a move from emerging markets to developed markets by some investors) taking advantage of the weak market conditions which resulted from these events.

Corporate earnings continue to improve, with some multi-national companies in a position where they have lots of cash to invest and operational margins to exploit. We are wary of the effects that the potential end of quantitative easing may have on global equity markets in the short term, but this should be seen as a positive. Indeed the international focus that we have taken in increasing the equity allocation in client portfolios, should help in negate the effects of any weakness that this event could present in the short term, indeed these holdings may well benefit from the perception of a stronger US economy and stronger US dollar, that could result from this event in the longer term.

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