

12th December 2008

Market Report

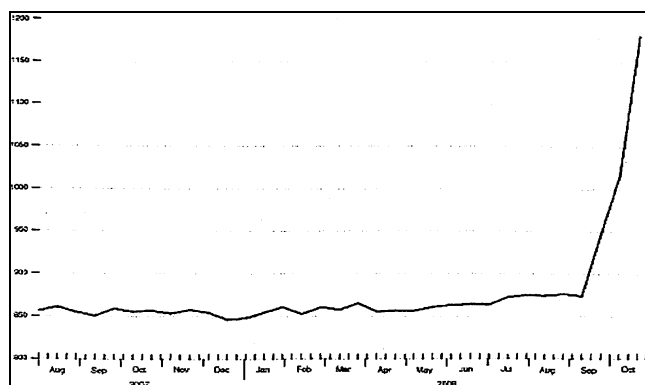
In recent weeks, further aggressive monetary policy stimulus has been seen from the Bank of England, in the fight against the global recession.

On the 4th December, the UK base rate was cut by a further percentage point, bringing the UK base rate down to 2%. Following the unexpected 150 basis point cut in November, a base rate at 2% (last seen in 1951) represents the lowest base rate since the Bank of England was founded in 1694.

The sharp deterioration in the economic outlook across Europe also prompted the European Central Bank to cut its base rate three-quarters of a percentage point to 2.5%, its largest reduction ever, with the base rate in the United States being cut in the same period to 1%, with a further cut being expected on 16th December.

Federal Reserve Increase in Money Supply

Adjusted Monetary Base Billions of Dollars



Federal Reserve Bank of St. Louis

The retrenchment in global financial markets seen over the past 18 months has encompassed all asset classes with the exception of cash deposits and the “Conventional” UK Government Treasury bond market. The recent bounce in financial markets has begun to unearth evidence of differentiation within all asset classes, with regard to the effects upon them of the economic outlook, the inflation cycle, and individual balance sheets.

Whilst we are in a period of falling inflation as a result of slow global economic growth, some asset classes which perform well in an inflationary environment cannot be ignored. Referring the chart above, the liquidity recently pumped into the global system by central governments through fiscal and monetary measures, in order to fight the current mixture of financial crisis and recession, will have an inflationary impact going forward.

The dramatic fall in commodities prices seen over the past three months, has given Central bankers more flexibility in battling the problems. However, in the shorter term, the reflation of the US economy through increased liquidity, coupled with the lower rates those dollars currently earn, could potentially weaken the currency relative to other currencies, leading to increased cost for US consumers purchasing goods and services abroad and hence price inflation.

Having briefly touched on commodity prices, the recent falls have resulted from reduced demand expectations due to a slowing global economy, rather than increased supply. Infrastructure, i.e., supply, storage capacity, processing etc., remains strained and will amongst other inflationary factors have an impact in improved economic conditions.

MPL Asset Allocation

Cash

The anomaly of the attractive money market rates we have seen over the past 18 months has now ended. There has been a significant downward effect upon fixed term deposit rates, resulting from the recent injections of liquidity by Central governments into the economic system.

One week rolling fixed term money market deposit rates have plummeted from a level of 3.899% per annum pro rata, at the time of our last investment department letter, to a current level of 1.580%.

With the above comments in mind, we have recently begun to shift a portion of funds invested in the money markets towards asset classes yielding greater income coupled with the potential of increased total return.

Fixed Income

UK Treasury Gilt Market

We have recently moved 20% of all client portfolios into the short-to-medium term end of the UK Treasury index-linked Gilt market, in line with our comments above.

The index-linked gilt market has been very quick to price in the current deflationary economic environment, falling dramatically since early October.

The current UK Treasury Index-linked break-even inflation rate on a four year Treasury stock (UK Treasury Index-Linked 2.5% August 2013) implies that the market is pricing in a level of inflation for the next four and a half years of -1.08%.

This very low to negative inflation expectation is indicative of the short-to-medium term index-linked gilt market at present. The price level attached to these expectations is probably an overshoot, as we do not believe that inflation will be negative for the next four years.

With a current “Net” Real yield of 3.286% for a 20% tax payer, the UK Treasury Stock Index-Linked 2.5% August 2013 for example, should initially provide capital appreciation for investors as this overshoot is corrected. Over the longer term, the inflationary factors discussed above will also benefit this asset class.

UK Corporate Bond Market

In the past month we have also added UK corporate debt to client portfolios, through the M&G Corporate Bond fund.

Along with the whole of the corporate debt market, the fund fell sharply in early October in line with the sharp falls seen in the equity market at that point. In the case of the M&G Corporate Bond fund, the fall was undeserved as the fund is weighted towards high quality Investment Grade corporate debt, heavily weighted in the utilities sector with very low exposure to the financial sector. The fund is very well placed to benefit in difficult economic conditions, and has performed since it was purchased.

There is compelling value in the corporate bond sector now in comparison to similar areas of the equity market. Indeed with dividend yield under threat in some sectors, attractive income is on offer for a more senior stake in many companies at present.

Equity

The recent bounce in global equity markets has been a positive in light of the violent moves seen in this asset class recently. The outlook remains unclear as to what will happen in the year ahead, however our client portfolios are well positioned to benefit when this position becomes clearer.

In what has been a very difficult year for investors and clients alike across the entire global financial landscape, we would like to thank you for your continued support in such unprecedented conditions.

May we wish you a Merry Christmas and a prosperous New Year.

Giles Rackham
Mark Kitson
Richard Dawes

Investment Director
Senior Investment Manager
Trainee Investment Manager

giles@mplltd.co.uk
mark@mplltd.co.uk
richard@mplltd.co.uk

MPL Wealth Management
45 Doughty Street
London
WC1N 2LR

0207 831 4711

www.mplwealthmanagement.co.uk