

September 2009

18th September 2009**Market Report**

In the period over the summer break, markets globally have continued to rally higher with particular emphasis on rises in the financial and other cyclical sectors hit hardest by the recent weakness in the global economy. Note however that this has occurred in conditions characterised by the low trading volumes associated with the summer months. Speculators trading over ultra-short time frames (some of whom were forced by the rally to close their short positions) have also boosted markets.

There has been a very positive response to second quarter company results, many of which exceeded analysts' expectations. The temporary one-off benefits of cost cutting measures carried out by many organisations worldwide increased their market value. The initial drivers of this response have been the failings of competitors in their individual sectors, the rapid recovery in many areas of the credit market (reducing their attractiveness somewhat) and continued central bank/government support in global financial markets - with leading economic indicators providing further impetus.

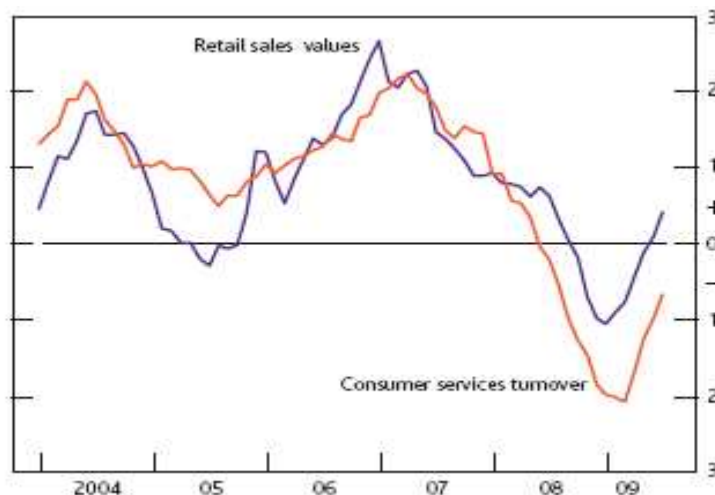
The pace of decline has begun to stabilise in leading UK economic indicators such as the expected volume of output, the order book volume for manufacturing companies (partially due to restocking), the operating surplus of corporations (a proxy for total pre-tax profit income generated from production of new output by companies within the UK) and consumer confidence figures. However, these figures remain negative in terms of growth.

All of these factors have been embraced wholeheartedly by financial markets in recent weeks as early signs of economic recovery. However, concern remains as UK unemployment continues to rise, real money supply growth (M2) and wage growth remain moderate at best and credit conditions continue to remain difficult for all but the best of organisations/individuals.

The net effect is that, whilst the effects of government stimuli have been a major influence in averting a slide into economic depression and propping up many institutions which natural market forces would have doomed to failure, the consumer remains a key factor who has been missing from the economic recovery story so far (especially within the UK and the US).

Comprising nearly 60% of Gross Domestic Product (GDP) and key to its recovery, growth in household consumer spending within the UK remains negative. The outlook for consumers is tough, with economic activity remaining weak, unemployment continuing to rise and household savings ratios (aided by low interest rates and falling inflation boosting real incomes) increasing. Until this situation improves significantly, we cannot expect household expenditure to improve markedly and it is anticipated that consumer spending will remain weak going into 2010. This does not bode well for UK GDP growth, which will remain lacklustre at best.

UK Household Expenditure



Bank of England Agents summary of business conditions (August 2009)

In the immediate term as market volumes continue to rise after the summer break, the market may well find temporary support from continued government stimuli, along with the emergence of consolidations (takeovers/mergers) of large capitalised companies within the UK. As the end of the third quarter approaches, the focus should now turn to whether or not companies achieve their sales forecasts. As the one-off effects of cost cutting measures and increased market shares gained from the failings of competitors have now been priced into earnings forecasts, the fundamental growth drivers of businesses going forward should now be examined more closely.

Surprisingly, collective gross profit margins (currently at approximately 35%) remain at levels higher than the historical average margin of 28%. These margins have tended to lag changes in household expenditure, which implies that these margins will fall back again, impacting upon company earnings and ultimately upon future equity market valuations.

Mindful of the fact that developed economies face a prolonged period of sub-par economic growth, we continue to focus upon large capitalised companies with strong cash flow which will continue to weather the economic recession. With approximately 60% of the earnings of quoted UK companies in the FTSE 100 coming from overseas, our search is very much focused upon those organisations worldwide with exposure to countries at a slightly advanced stage of the business cycle. This will include countries whose consumers, as a result of economic stimuli, are beginning to participate in the economy again via increased spending, or those countries who from past experience have successfully weathered the global financial crisis to an extent that consumers within these economies are now driving these economies forward.

MPL Asset Allocation

Cash

As credit conditions have continued to improve, LIBOR has fallen further and fixed term deposit rates have continued to remain at low levels.

September 2009

On a short three month deposit basis, we have recently taken advantage of a technical anomaly which continues to exist between high street retail banking institutions and building societies. Larger building societies such as Skipton and Nationwide, who have been responsible for mopping up troubled mortgage lenders (such as the Scarborough Building Society) have to offer higher deposit rates than banks, as they are having to price in the risk perception of the sector. This is good news for senior debt holders who invest with these institutions, as they will achieve a better deposit rate and - as Alistair Darling recently pointed out - structures such as that of Skipton are the new model for mortgage banking going forward, so these building societies will continue to be looked after by the regulators and the government.

Fixed Income

UK Treasury Gilt Market

After an initial fall in our 5 year conventional Treasury gilt position, our holdings have appreciated back to their purchase position as the Bank of England has pledged further support to the quantitative easing programme, adding a further £50 billion of funds to the existing stimulus measures. Further support has come from a continued rise in unemployment, which will restrict the level of wage growth in the short term and ultimately keep inflation in check over the short term, safeguarding the income produced by these securities.

UK Corporate Bond Market

Our corporate bond holdings have continued to appreciate in value in line with easing credit conditions in this area. Our decision to take on more risk to benefit from an over-estimation of default rates by the market appears to have been justified. Prices have further benefited as Moody's Investors Service has sharply lowered its peak default rate forecasts for speculative-grade companies thanks to a sharp narrowing in spreads and a re-opening of the high-yield bond market.

The rating agency no longer expects the default rate to be worse in Europe than in the United States, a scenario that it had been predicting for several months, while the global rate is likely to match levels last seen in 1991.

Moody's now predicts the European speculative-grade default rates will peak at 12 percent in the first quarter of 2010, while the U.S. and global default rates will peak in the fourth quarter of this year at 12.7 and 12.2 percent, respectively.

In a forecast a month earlier, the rating agency had forecast peak default rates of 15 percent in Europe, 12.9 percent in the U.S. and 12.8 percent globally, and back in April it had predicted Europe's default rate would peak above 21 percent.

Equity

In line with our comments above, we will be looking to marginally increase our weightings in global equity markets, taking advantage of economies at a slightly advanced stage of the business cycle and areas which will benefit from an improving economic environment. However, wary of the fact that volatility and indeed risk remain within equity markets globally, we will still attempt to do so in a defensive manner.

Brian Pay
Mark Kitson
Richard Dawes

Managing Director
Senior Investment Manager
Trainee Investment Manager

enquiries@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