

March 2008

26th March 2008**Market Report**

The speed with which the volatile conditions in global credit markets can turn sharply from positive to negative, has been brought home to us. Last month we wrote to you having seen signs of improved liquidity in the UK money markets, with 3 month money market rates falling briefly below 5%.

Signs that the global credit turmoil is still very much with us were seen over the past two weeks, with 3 month money market rates moving swiftly back over 5% to a current level of 5.5%.

This sudden change was a very strong indicator of how liquidity in the global money markets had begun to dry up once more, putting a firm focus back upon the level of confidence and trust that participants in the financial banking sector have in transacting business with each other in the current market climate.

Indeed, this UK money market action reflected exactly what was happening in global money markets, and proved to be a primary factor culminating in the collapse of Bear Stearns Investment Bank.

Similar to the recent failings of Northern Rock in the UK, tightening liquidity conditions in the US financial money markets led to the ultimate sale of Bear Stearns to JP Morgan for \$10 per share.

In simplistic terms, Bear Stearns relied upon short term overnight funding in order to conduct its daily business, not from depositors, but from the wholesale money markets.

The overnight funding involved Bear Stearns' dealers selling securities (Repurchase Agreements or "Repos") to investors for cash and then repurchasing them the next day at the slightly higher price (the difference in price being the interest paid to the lender).

As conditions tightened once more, securing this funding became more difficult for the bank, with rumours beginning to circulate that other banks were refusing to enter into transactions with Bear Stearns dealers.

Upon the back of these rumours, Bear Stearns clients withdrew \$17 billion of funds from the bank within the space of two days last week, leaving the Bank in a position of being unable to secure funding to transact its daily business, effectively staring bankruptcy in the face.

Although the US Federal reserve stepped in with emergency funding using JP Morgan, (Bear Stearns clearing bank) as a conduit, it was clear that no one would want to do business with a bank reliant upon 28 day loans from the central bank. Hence JP Morgan stepped in to take over Bear Stearns for a paltry price of \$236 million.

The immediate market reaction to these events was, in our opinion, one of panic, the recent 'violent' market swings being driven by emotion rather than fundamentals. With the FTSE 100 currently on a Price to Earnings ratio (P/E) of 10.8 yielding 4%, if company earnings expectations for 2008 were to be cut by 30-35% this would put the FTSE on a P/E of 15, the level last seen in June 2007, just before the current credit problems began, hence it can be argued that potential earnings downgrades have now been priced into the market.

March 2008

Although we believe that these credit related problems will persist for the next few quarters, we continue to maintain a cautious stance having positioned ('Below Average Risk' and above) client portfolios in market areas which continue to weather the current financial storm and those which will benefit from any potential market bounce.

Although it is difficult to say whether the market has now reached a base, the key factor to watch will be potential signs of improvement in the US residential housing market and the (lagging) knock on effects of any positives here on the general US economy and the financial sector.

MPL Asset Allocation

Cash

We have continued to place 20% of new clients' portfolio holdings on to 3 month money market deposits, as interest rates here have moved up to 5.5%. We are wary of the fact that, although present fixed term deposit rates are attractive due to the current market turmoil, we are potentially heading towards an economic period of lower UK interest rates with moderate inflation. As the income generated by holding cash is variable, this means that holding cash will not be so attractive in this environment, and we will be looking to secure a greater percentage of income which is fixed in client portfolios.

Fixed Income

Last week we sold our remaining holding of UK Government Bonds, the Treasury 4% March 2009 Gilt. Owing to the very swift change of sentiment in equity markets and the resulting flight back to the quality of the UK Treasury bond market, the 4% March 2009 Gilt moved over its redemption value at par (100 pence). It is very rare for a short dated gilt to move to par a good year before its redemption date. Hence, we took the opportunity to lock in a capital gain of approximately 1.5% for clients, having also received an income coupon of 2.5%. In line with our comments regarding the cash element of our portfolios, we are currently looking at attractive opportunities in the corporate fixed income arena.

Equity

We have maintained an equity portfolio weighting of approximately 40-45% for 'Below Average Risk' (and above) portfolios, bringing newer client portfolio holdings in line with this weighting also. We reiterate that our stance is still one of caution in this area of the market, and if profit taking opportunities are presented to us in current rallying markets, we will take them.

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