

8th December 2009



Reaffirmation of the MPL Discretionary Investment Process

In the current prolonged environment of volatility in global equity markets, the MPL investment team have taken the opportunity over the last few weeks to carry out a 'bench test' of all our clients' existing portfolio compositions.

In this test, we annually review all the parameters which we set to govern our choice of investment assets within clients' differing risk profiles. The bench test is conducted in order that (a) we continue to have a good indicative idea of what to expect from client portfolios in terms of total return (income and capital growth) and (b) we can identify the associated potential levels of risk (as measured by volatility) associated with a given level of return.

This process has also helped us to reaffirm our investment process as one of asset allocation within the context of a minimum five year view, which ties in with a typical business cycle span of 5-8 years. This has also aided us in planning for the impending early stage of the next complete business cycle, which we are now beginning to see unfold in different global economies.

Most importantly, this process helps us to manage our clients' expectations and meet their investment objectives within their own personal risk framework and investment timeframe.

The key factor to emerge from the recent bench test is that in trying to achieve an expected total return of say 7-8% for a balanced medium risk portfolio, we all now have to accept, due to the events of the past two and a half years, that the risk level associated with aiming for this balanced return has increased markedly (by approximately 5%) over this period.

To put this in context, two and a half years ago we could expect, in trying to achieve a target return of 7-8% per annum, that in 95% of cases the total annual return of the portfolio could range within a band of 20.4% from a worst case scenario of -2.5% to a best case of +17.90%. In the current financial climate, the bench test reveals that this range of total return (and risk) is now expanded to a band of 29.8% from -7.9% to +21.9%. Thus volatility is up by almost half.

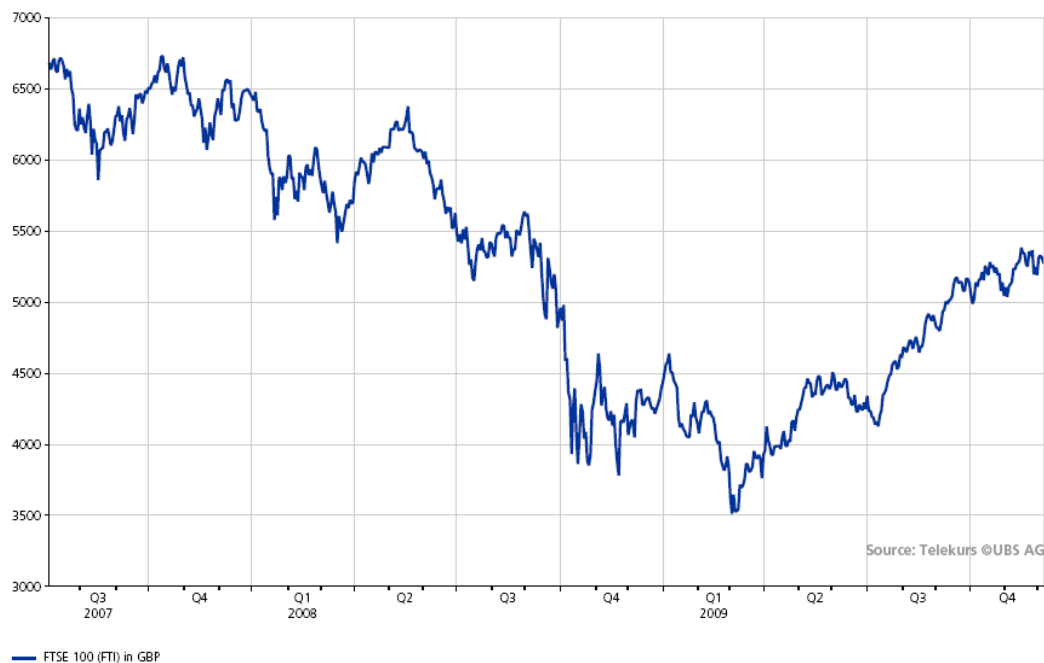
The above highlights that, now more than ever, we need to be alert to the risks that are still inherent in the broken global system which is slowly being repaired.

Hence we continue to be very cautious and selective about the assets we use to achieve our clients' investment objectives over the longer term. Our discretionary clients' portfolios are built, not overnight, but over a course of time, through a process of thorough research and due diligence in order to make good investment decisions on clients' behalf in the course of the business cycle.

This also helps us to be prepared for any 'outliers' which may fall outside our expected risk range for assets that have been selected for inclusion in client portfolios.

For example, whilst we do not benchmark our portfolios against any particular index or set of indices, an active MPL medium risk unnamed client portfolio, comprising diversified assets including UK gilts, global equities and UK commercial property, has returned 6.28% in the period since the MPL discretionary management service began in earnest in June 2007, in comparison with a return of -12.2% for the FTSE Actuaries All Share Total Return index as a whole.

FTSE 100 Index – June 2007 - Present



Whilst some damage has been caused by the portfolio weighting that has been invested in global equities from September 2008 to the present, some of this risk has been mitigated through diversified investments in the portfolio, such as UK gilts, corporate debt, property and money market instruments.

Hence we continue to have full faith in the knowledge that, through diversification of our clients' portfolios in different asset classes, we can achieve their investment objectives at comparatively low risk and avoiding violent fluctuations in portfolio values over the longer term.

As a result, we remain cautious in the face of the unusual and, we believe, unsustainable circumstance of a UK equity market rally of over 25% in a single three month period when considered against our five year view.

For these reasons, we think it is preferable to accept a perceived short term portfolio underperformance over a quarter rather than over-commit portfolios to an asset class that has returned -12.2% (with the risks associated with this exposure) over the past two and a half years, against a portfolio consisting of diversified assets which has returned 6.28% in the same period.

Market Report

In the past week, we have begun to see the level of volume of shares traded per day in the FTSE 100 index increase from the low levels seen over the past eight or more months to a daily volume in a range between 1.2 to 1.5 billion shares traded. Whilst this level of trade is still low in comparison to a usual daily trade level of 4 billion shares, we take this as a positive sign that more participants are returning to the UK equity market. Some risk aversion remains (highlighted by the recent acute –albeit temporary - falls in global equity markets, following the events in Dubai), but selective scope for investment in global financial markets is increasingly visible.

In the UK and many other western economies in Continental Europe and the United States, companies and consumers continue to reduce high debt levels. Continuing de-leveraging, housing concerns, lagging unemployment, potential monetary policy blunders and the possibly underestimated impact of troubled state finances (prompting fears of a double-dip recession) will continue to keep consumption and capital expenditure in these economies subdued for some time yet. Hence with 60% of the earnings of companies in the FTSE 100 coming from overseas, our focus remains upon large, defensive, well capitalised companies with a global reach into economies showing good growth prospects.

Mindful of the fact that global government stimuli have supported the recent rally we have seen, we continue to focus on investments which will not suffer at the point when these stimuli are removed.

In line with the above comments, Continental Europe exhibits many of the traits seen in the UK at present, with sluggish growth and highly indebted companies and consumers. However, whilst these areas are a cause for concern, signs of export-led growth are being seen in two of continental Europe's biggest economies, France and Germany. Also, attractive and sustainable dividend yields are available at present and our focus here at present is upon companies with low exposure to the Continental European consumer, which should benefit from this export-led growth whilst paying attractive yields.

On a global bond perspective, sovereign and corporate debt looks attractive in some of the more developed emerging countries with strong economic fundamentals and healthy current account balances and public sector finances, as compared with the western world. Attractive yields are also available here and we will shortly be pursuing opportunities in this area, as a hedge against our global equity exposure, which has participated in the powerful rally we have experienced over the past few months.

MPL Asset Allocation

Cash

Fixed term deposit rates are little changed from the point at which we wrote our last investment letter to you. The UK Government has succeeded in forcing investors to remove their money from deposits into asset classes which are offering better rates of return (albeit at an increased risk).

For clients who are totally risk-averse, the only current option they have in achieving higher deposit rates per annum (circa 3-4%+) is to tie funds into a longer term deposit in excess of 3-4 years. Whilst some banks such as Santander are offering rates of up to 3% on a one year basis, these rates are only available to private investors with raw cash and not to investors who are holding cash within a pension fund, for whom deposit rates offered by the bank over this period are far lower.

The concern that these risk-averse clients should have over the next 3-4 years is that with the onset of inflationary pressure in this period, the purchasing power of their deposit income may well be eroded.

Fixed Income

UK Treasury Gilt Market

Concerns remain in the conventional gilt market regarding increased quantitative easing through increased supply of conventional gilts, as to when it will end and when the base rate will increase. We believe that, in line with the United States, the base rate will remain low for some time yet as companies and the consumer in these economies continue to struggle.

Inflation should not be a major problem over the next year to 18 months, but in the immediate 3-6 months factors such as the recent weakness of sterling against import prices, the forthcoming reversal of last year's VAT rate cut and the increase in energy and fuel costs will all have an impact upon RPI inflation over this period. This should favour our clients' index-linked inflation-protected gilt holdings.

Briefly touching upon another external factor/risk, which could potentially cause problems in the UK Treasury and UK equity markets over the next 6 months, the UK general election looms large with the prospect of the first 'hung' parliament (where no single party has control of the House of Commons after an election) since 1974.

A possible effect of this could be that the lack of a strong government may stall plans to reduce the UK's record budget deficit and lead to a sell-off in the British currency and bond markets. However, whilst we will be prepared for the eventuality of this happening, we have taken note of the workings of a 'hung' parliament in countries such as Denmark, where no party has had a majority since 1909, and more recently Scotland.

UK Corporate Bond Market

Whilst the opportunities which were available in the UK corporate debt market back in June are no longer available, investment grade yields are still attractive in comparison with UK government gilt yields. Corporate bond fund managers have to be very selective regarding the corporate debt in which they invest.

Very much in the vein of conventional UK government gilts and long term deposit cash, rising inflation is a concern here, as yield income could have less purchasing power. However, we are still of the belief that as company fundamentals improve, many companies, whose debt was downgraded at the height of the financial crisis, could potentially be in line for an upward re-rating of their debt, with a resultant capital upside for this debt, possibly mitigating the risk of inflation initially.

Equity/Alternative Assets

In the past few weeks, we have invested approximately 4% of all institutional discretionary client portfolios into global Public/Private Finance Initiative infrastructure projects, through a holding in the International Public Partnerships infrastructure fund, which is quoted on the London Stock Exchange.

The fund focuses upon global government-backed infrastructure projects such as schools, hospitals and prisons in countries including the UK, Canada and Australia.

99% of the infrastructure assets within the portfolio are backed by governments, with 70% of the revenue from the portfolio assets protected against inflation.

With a yield of approximately 4.8% initially, which is anticipated to grow at 3% per annum (that is 3% of 4.8%), the attraction of this fund is that 70% of the assets within the portfolio are actually generating the revenue at present, with 30% of the assets in the construction phase. These assets should become operational within the next 5 years, which should enhance the Net Asset Value of the fund and result in capital gains for investors in the fund.



The typical government concession term for the 50 assets within the fund is 25 years. Thus with government backing over this period, a large element of inflation protection, a growing yield, a prospect of capital growth and a good pipeline of investment opportunities, this holding is a good, stable alternative to UK equity and bond investments, which will help us to achieve our clients' investment objectives over the longer term.

On behalf of the MPL Discretionary Investment Management team, we thank you for your continued support throughout a rather turbulent and traumatic 2009.

May we take this opportunity to wish you a Merry Christmas and a prosperous 2010.

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