

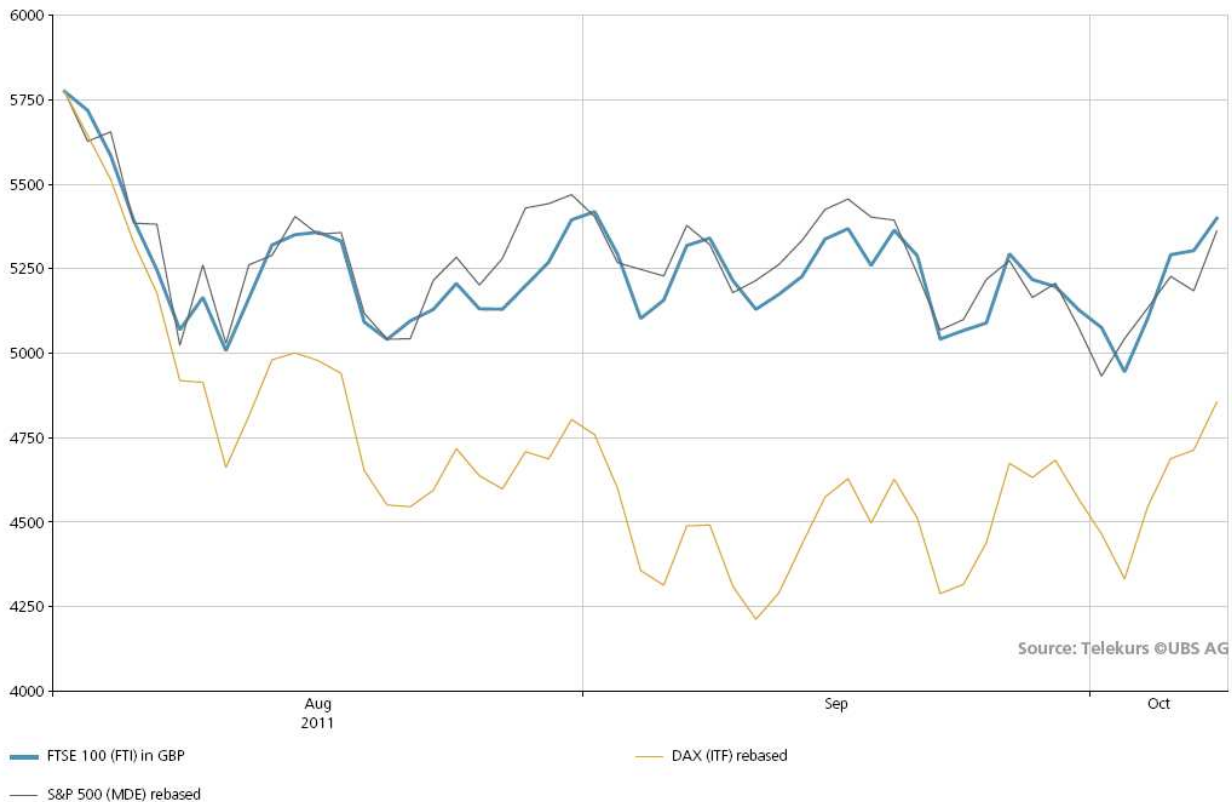


12th October 2011

Market Review

After the sharp falls seen in the first few days of August covered in our previous letter to you, as indicated in the chart below the FTSE 100 subsequently fell a further 449 points (8.32%) to 4,944 points from a level of 5,393 points at the time of the August letter.

**FTSE 100, the DAX and S&P 500
1st August – 10th October 2011**



To highlight further the continued high levels of volatility being seen in financial markets, at the close of business on 10th October, the FTSE 100 closed at a price of 5,399 points. This represented a swing of 904 points in total between the 4th August and the close of business on the 10th.

Continuing the slide in markets from the 4th August, the global financial system and the economy drove momentum further down. Leading economic manufacturing numbers from the United States teetering between expansion and contraction fostered further uncertainty as to whether the US and indeed the global economy was heading back into recession. This led to expectations in some quarters of the announcement of further quantitative easing by the US Federal Reserve.



The Fed subsequently launched “Operation Twist” with this statement: “To support a stronger economic recovery, by extending the average maturity of the Federal Reserve’s holdings of Treasury bond securities, purchasing (by the end of June 2012) an additional \$400 billion of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less”.

This program initially achieved what it set out to do, by putting downward pressure upon longer-term interest rates (yields on longer dated US Treasury bonds) in order primarily to make financial conditions easier for mortgagees in the US housing market. However, this statement was not received very well by participants in financial markets. Not only is this action merely a recycling of existing money in the US monetary system as opposed to any new form of stimulus, the Federal Reserve’s gloomy prognosis for the US economy was met with a negative reaction. Investors doubt that “Operation Twist” will provide much stimulus for US growth.

With the focus now turning again towards Europe, there are concerns at this point about the timing of a sixth tranche of EU/IMF funding for Greece; A downbeat IMF annual report warned that global financial stability, exacerbated by poor policy decision making, had worsened considerably and threatened growth, adding to negative sentiment. The downgrade by credit ratings agency Moody’s of a number of US financial institutions including Bank of America and Wells Fargo, and S&P’s downgrade of its long-term ratings on 15 Italian banks further pressured risk markets.

The lack of a concise plan to resolve the longer term problems associated with the European sovereign debt crisis and the ultimate impact of this lack upon the European financial system, were the overriding factors pushing markets downwards throughout September and into early October.

In the past week, we have seen a sharp recovery in global equity markets, triggered initially by positive manufacturing economic numbers in the US and the UK, which showed unexpected growth in some quarters resulting from a rundown in company order books.

A massive shot in the arm was given to global financial markets prior to the weekend, when the closely watched monthly US non-farm payroll jobs report showed that the world’s biggest economy added 103,000 jobs in September, far more than the anticipated 65,000 and a big rise from August’s increase of 42,000. This figure implied that there was little meaningful sign of a return to recession in the United States, although there is still a long way to go before the US economy recovers from the financial and economic crisis of 2008-09.

At the weekend German chancellor Angela Merkel said European leaders would do “everything necessary” to ensure banks have adequate capital. Merkel joined French president Nicolas Sarkozy in trying to convince investors that they can stamp out the debt crisis roiling global markets.

At a joint press conference in Berlin, Sarkozy set a deadline of the 3rd November ‘Group of 20’ summit to deliver a response that addresses the immediate debt crisis in Greece, and what he called the structural defects in the Eurozone. Markets surged the following Monday on the back of this news, buoyed by the feeling that European leaders have finally accepted the gravity of the problems facing the European Union and its single currency. We are of the opinion that it will be difficult for these leaders to draft a complete and concise plan to resolve this crisis in the next three weeks. Whilst they should be able to address some of the problems facing European financial institutions with remedies covering the shorter term, further disappointment may be experienced in the longer term.

Hence, we expect a continuation of the extreme periods of volatility we have seen in financial markets, as and when periodic debt payment obligations test the ongoing solvency of European sovereigns and companies within the financial sector in this region, and that of other sovereign nations and investors with exposure to Europe in these areas.



MPL Asset Allocation

With the recent pullback in markets affecting all asset classes excluding cash and conventional gilts, we have been utilising cash held on deposit resulting from profits taken upon emerging market debt prior to August in order to reduce equity risk in client portfolios. We have therefore increased gold, index-linked gilts and emerging market debt allocations in client portfolios, also reducing exposure to the UK banking sector through the sale of the Newton Income fund.

We stand by the comments made in our last letter regarding the US consumer, and also believe that the third quarter company earnings results season beginning this week will provide some surprises which could bolster market sentiment towards the end of this year. With the longer term sovereign and economic problems yet to be resolved, our recent purchases will offer some protection in a continued period of uncertainty and they have already provided positive returns to client portfolios.

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