29th October 2013

Our Ref: MK/RD/Q313

Mr & Mrs A N Other
123 ACB Street
London
NE1 2BA

Dear Mr & Mrs Other

Re: MPL Portfolio Valuation – 123456789.1

Market Review

For the past five months global financial markets have been besieged by the anticipation of the "tapering" of the United States Federal Reserve's ("the Fed") third Quantitative Easing economic stimulus program (QE3). As discussed in previous correspondence, this focus had a negative impact upon all asset classes (with the exception of commercial property and global infrastructure) prior to and especially after comments made by Ben Bernanke, Chairman of the Federal Reserve.

On 9th June 2013, Mr. Bernanke announced a "tapering" of some of the Fed's QE policies contingent upon continued positive economic data, also hinting that this would involve scaling back its monthly bond purchases from $85 billion to $65 billion after the Fed's September policy meeting. He also commented that QE3 could end by mid-2014 and suggested that if inflation follows a 2% target rate and unemployment decreases to 6.5%, the Fed would likely start raising rates.

Following a strongly negative market reaction, Mr. Bernanke backtracked from these comments somewhat, indicating in July that the near-zero interest rate policy would remain in place indefinitely. Equity market participants took these comments regarding the delay in taper of QE3 as a major positive. Buying pressure caused equity markets to rebound from the losses suffered in May and June 2013. Sovereign bond markets in the UK had a more muted response to these events, as the prospect of increased interest rates (which will depress bond prices) going forward is now a real possibility over the shorter term of around 1-2 years.

FTSE 100 Index (yellow) performance vs. S&P 500 Index (green) and UK 10 Year Treasury Gilt (white) <u>April 2013 to October 2013</u>

Source: Bloomberg

The recent political stand-off in Washington between the Republican and Democrat parties, which for the most part has now been deferred until March 2014, has had a further impact upon the delay in the Fed tapering decision. The temporary shutdown of many parts of the US public sector in October will have a slightly negative impact upon US economic growth in the fourth quarter of this year. This has probably delayed any decision on taper until 2014 at the earliest.

Putting taper to one side, and looking at economic and corporate fundamentals in the UK at present, economic expansion continues to be seen in leading UK economic indicators covering the construction, manufacturing, and services industries. To give an overview, construction companies have witnessed increased overall output levels and further improvement in order books within both residential and commercial construction. The UK manufacturing sector meanwhile continues to expand, along with the labour market in this area. Again new order volumes have increased markedly in this industry sector, with the domestic market remaining the prime source of new contract wins.

At the same time, strong activity growth in the UK services sector has also continued, rounding off the best quarterly performance for this sector since the second quarter of 1997. Growth was supported by incoming new business in this area, led by financial services (in part linked to increasing housing market activity) and the business sector, whilst employment levels have also picked up in these areas. Consumer-facing services however continue to struggle, this reflecting an ongoing squeeze on incomes due to an unfortunate combination of very weak pay growth and consistently high inflation - especially in non-discretionary consumer items such as food and utilities.

With these comments in mind, mortgage approvals as reported by the British Bankers Association for new home purchases, have breached 60,000 per month for the first time since July 2009, in part due to the widespread interest in the Government-backed Right To Buy Scheme. Meanwhile the Markit/YouGov Household Finance Index indicates that although household finances remained under pressure during October, the survey also suggests improving trends in the labour market at the start of the fourth quarter of this year, with incomes rising slightly and the average number of hours worked increasing further.

Putting these pieces of information together, there are indications that we are at the early to mid stage of the economic cycle within the UK. With this in mind, our focus at this stage of the UK economic and business cycle now tilts more towards cyclical growth. Defensive assets such as sovereign fixed interest holdings are being reduced in favour of assets that are more sensitive to the economic cycle and growth, such as equity holdings with a bias towards the financial services, industrial and consumer services industries.

Taking a brief look at the one to two year composite forecasts, analysts' forward earnings growth projections for companies in cyclical sectors such as homebuilding and wider industrials, indicate double-digit earnings growth expectations, which should thereafter be tracked by stock market prices in the year ahead.

Whilst US party-political and sovereign debt / budgetary concerns have been put aside for the moment at least, a fundamental earnings-led approach is being followed by the MPL investment team as we head into 2014. Whilst the US economic recovery is at a somewhat more advanced stage than that of the UK, similar opportunities still present themselves within US markets. As such, we are retaining an overweight investment stance within US equity markets.

MPL Asset Allocation

Gold

Following on from comments made in our previous letter, we have now disposed of our clients' holdings in the SPDR Gold Trust. Whilst gold will continue to be an ultimate hedge against inflation, the anticipation of increased interest rates in the UK and indeed the USA suggests from past experience that spot gold prices will not perform as well as other inflation-hedged assets, such as global equities, in periods of rising interest rates.

Fixed Interest

In consideration of the potential for increased interest rates in the US and the UK, which would have a further negative effect upon sovereign bond prices, we have sold client holdings in Australian Index Linked Bonds, and reduced exposure to UK Index-Linked Gilts as well as emerging market bonds – the latter due mainly to concerns that tapering by the US Federal Reserve will reduce US Dollar liquidity within emerging market economies.

Global Equity Growth

Proceeds from these disposals were reinvested into the global equity sector through the M&G Global Dividend and Rathbone Global Opportunities Funds. These funds give us exposure not only to global equity growth positions through cyclically biased companies with good prospects for future earnings growth, but also to a range of dividend paying, staple global stocks. This twin-pronged approach should serve to reduce the risk associated with increased equity exposure, by locking in solid income streams together with wide global diversification.

UK Equity Growth.

In line with our thoughts on UK economic and corporate fundamentals, we have recently reduced our exposure to larger-capitalised companies within the FTSE 100 index, as we feel these are nearing a fully-valued state; this reduction has been achieved via the sale of the iShares FTSE-100 Exchange Traded Fund. To replace this equity exposure, we have acquired on your behalf exposure to companies with a UK cyclical bias and found predominantly within the FTSE-250 Index. Through the Old Mutual UK Mid-Cap Fund and the Schroder UK Mid-250 Fund (in the case of the Schroder fund, for medium-to-high-risk clients), we have taken on an overweight exposure to the earnings growth prospects of medium-sized companies within the UK industrial, financial, and consumer services industries - as mentioned above.

With kind regards

AIDAN VAUGHAN
MANAGING DIRECTOR
aidan@mplltd.co.uk

MARK KITSON
INVESTMENT DIRECTOR
mark@mplltd.co.uk

RICHARD DAWES
INVESTMENT MANAGER
richard@mplltd.co.uk

*Figures courtesy of Bloomberg