

Monthly Update

March 2010

Markets Overview

World Markets

Cash

Sterling:

UK interest rates were kept on hold at 0.50% following the March meeting of the Monetary Policy Committee. Sterling has continued to weaken ahead of the forthcoming general election based on fears a hung parliament will hamper the political process, and potentially dilute or delay firm plans to repay the deficit. Being short on sterling has become the favoured position for many investors, however, some commentators are beginning to voice concerns this is a crowded trade with limited upside. Improving economic conditions and a decisive election victory for one of the main parties could trigger a rebound for sterling, leaving investors overly exposed.

US Dollar:

Economic recovery in the US is underway evidenced by a raft of positive data releases. The world's largest economy has responded strongly to being awash with liquidity and very low interest rates, and corporate earnings for quarter one, 2010 are expected to be strong. Notwithstanding this positive backdrop, longer-term structural issues remain firmly entrenched such as high unemployment, falling real wages and rising taxes, all of which suggest US consumers will not return to their spending ways to the extent they have in the recent past. That said, the strength of retail sales has surprised and this, coupled with strong manufacturing numbers, suggests the core market uncertainty in the near term will remain the question of when the Fed signals a shift in interest rate policy.

Bonds

Sterling:

The perceptions of UK fiscal risk have caused gilts to be volatile in the lead up to the general election, albeit this is expected to subside once the outcome is known. The rush, by some, to avoid UK government debt may, like the currency, be overdone and buyers could return with renewed appetite. Corporate debt has outperformed as improving fundamentals have boosted demand for not only investment grade corporate issues, but also for paper issued by companies further down the credit spectrum. Overly pessimistic forecast default rates have prompted analysts to target sub-investment grade debt where perceived value remains despite the contraction in spreads seen through 2009.

US Dollar:

The favourable macro-economic environment - a sustained recovery, benign inflation, high levels of liquidity and robust corporate performance - has boosted demand for corporate debt with spreads narrowing over Treasuries during the first quarter of 2010. Like the UK, the volatility in US Treasury prices is a consequence of the growing perception that risk is elevating around the challenges faced by the administration in managing its fiscal position. The bond market will be quick to punish what it thinks are policy errors.

Property (Sterling and US dollar):

Yields on prime commercial property in the City of London have fallen from 7.5% to less than 6% over the last 12 months according to Savills, the property agent. Rumours of a deal which could complete with a yield close to 5% has fuelled concerns the market has moved far too far, far too fast and investors should expect prices to drift again as supply grows to take advantage of elevated prices. Previously mothballed projects have recently been restarted by developers driven by evidence that City space fell by a third over the year and demand is likely to surge due to this acute shortage. Further afield, real estate in Asia, despite strong recent performance, is expected to continue to deliver attractive returns supported by strong economic growth in the region.

Index	Price	Up/Down on month
FTSE 100	5,679.64	↑
DJ Ind. Average	10,856.63	↑
S&P Comp	1,169.43	↑
NASDAQ	1,958.34	↑
Nikkei	11,089.94	↑
£/\$	1.5184	↓
€/£	0.88982	↓
€/\$	1.351	↓
£Base Rate	0.50%	↔
Brent Crude	82.7	↑
Gold	1,113.25	↓

Prices quoted as at 31/03/10

Source: Bloomberg

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Equities (Sterling and US dollar):

Global equity markets have posted robust returns during the first quarter of 2010 as investors priced in a continuation of the economic recovery, supported by upgrades in corporate earnings and profitability. UK investors will be interested to note the FTSE 100 returned 4.9% during the quarter and the FTSE 250 9.2%, boosted by rising merger and acquisition activity over the period. Equities are no longer cheap based on standard valuation metrics, however, expanding economic activity has justified higher prices with current levels at, or around, fair value appearing to be the consensus view. Nevertheless, risks abound from sovereign default in Euroland through to monetary tightening in China and asset allocators are justifiably cautious towards equities given the strong rally investors have enjoyed over the last 12 months. An uninterrupted flow of corporate good news is priced into equity valuations and there is a sense disappointments will prompt a bout of profit taking and a rise in risk aversion.

Alternative Investments (Sterling and US dollar):

Hedge Funds:

The industry benchmark HFRX index delivered returns of +1.63% (US dollar terms) for the year to 31 March, which lagged many underlying asset classes including global equities that gained 2.74% by comparison (MSCI World, US dollar terms). While the hedge fund industry has never been marketed on the basis of keeping track of equity bull markets, many investors need convincing of hedge funds' ongoing role in portfolio construction given the negative experiences of 2008 - both from performance and liquidity perspectives. It is nevertheless interesting to note relative value strategies, such as those exploiting market inefficiencies (arbitrage), have performed relatively well in recent times suggesting such opportunities exist for skilled managers and, most importantly, they have the means of exploiting them.

Commodities:

Fears of monetary tightening in China was a headwind to commodity prices early in the first quarter of 2010 but a view Chinese economic growth will only endure a mild and short-lived deceleration has prompted base metal traders to become more upbeat about the remainder of 2010. Gold has had a quiet start to the year as inflationary fears have faded and confidence in the economic recovery and financial system has returned. The extremely cold weather endured by the northern hemisphere, coupled with rising demand from a growing economy, has resulted in Brent Crude rising by 5.3% for the three months ending March.

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Andrew Bates

Tel: 0207 002 3600

Fax: 0207 002 3612 or email on
andrew.bates@fairbairnpb.com

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