

Premier Discretionary Team

Asset Allocation - For Professional Adviser Use

14th June 2010

Minutes

Present: F. Fulcher, M. Jennings, I. Rees, N. Kelsall, K. Cushway, D. Pendlebury, N. Sidebottom, R. Hallen.

Overview

Since the last meeting and outside of Europe, the overall global macro economic picture is little changed. Merrill's has upgraded 2010 global GDP from 4.4% to 4.5% and downgraded 2011 from 4.5% to 4.4%.

In the US, Bloomberg consensus expectations are for 3.2% real GDP growth in 2010 with 3.0% in 2011. CPI is forecast to be 1.8% in both years with the budget deficit falling from a peak of -10.2% of GDP in 2009, to -9.1% in 2010 and -7.5% in 2011. If these forecasts come to pass then this is a satisfactory and stable resolution to the "noughties" indebtedness being bailed out by growth.

Recent retail sales fell -1.2% for May versus an expected rise of 0.2%. Non-farm payrolls also rose far less than expected recently to worry the bears but unemployment does continue to drift lower at 9.7%, versus a high of 10.1%.

Outside of Europe, the other major worry has been the ability of China to maintain its growth rate, again. Bloomberg consensus numbers suggest real GDP growth is expected to accelerate from +8.7% in 2009 to +10.1% in 2010. Looking at specific data releases there has been a mixed picture; PMI manufacturing data for May was weaker than expected, but import and export data for May rose 48.3% and 48.5% respectively, indicating decent global activity. Retail sales growing at 18.7% in the year to May, again does not look like an economy running out of steam.

The big worry currently is, of course, that Europe derails the Global economy, although the evidence for this so far would appear to be slim. Looking at Merrill's numbers; Euro area GDP has been cut in 2010 from 2.0% to 1.0% and in 2011 from 3.0% to 2.25%. Interestingly, reported data from France and Germany has generally exceeded expectations of late and German unemployment, for example is continuing to drift lower (at 7.7%). The worry is in the periphery where, with the more slowly released macro numbers, we have little evidence as yet.

We know that budget deficits are high as is total debt but what really matters is a country's ability to pay its interest. It is easy to see why Greece has needed to be bailed out, however, Italy clearly has a very large interest bill and is therefore vulnerable to higher cost of its debt but its budget deficit suggests that it is not spiralling higher from here. Spain, on the other hand, has got a high budget deficit at the moment but it does not have the burden of excessive total debt. The UK, although a scary budget deficit also, does not have the extreme total debt number, and does not have a refunding cliff ahead thanks to long dated issuance.

The €750m bail out is larger than the US TARP scheme, and the equivalent to 60% of the combined GDP of Spain, Portugal and Greece and 77% of their debt. To argue that it is insufficient is, we think, difficult. Also, don't forget that German GDP is 50% larger than that of the entire peripheral Europe.

Within the fixed income markets, credit spreads have widened prior to the fall in equities and European banks now have to pay higher rates to borrow money. At the start of 2010, we estimated interest rates to be 1% by the year end but this has been revised to early / mid 2011 before the current emergency rates are lifted.

Equities are not looking pretty so far this calendar year. Greece is down -30.6% YTD, Spain down -19.2% Italy down -13.9% and, interestingly, China is also down -21.6% in local currency. In addition to worries about Southern European debt contagion, Merkel and Sarkozy seem to have fallen out. Middle Eastern tensions are rising, BP (and oil service stocks globally) has fallen precipitously, and the Prudential has failed in its AIA bid which is all negative for sentiment.

When sentiment in markets goes wild, it is usually helpful to revert back to fundamentals. The Eurostoxx is currently trading on a PE of 8.9x 2011 expected earnings, FTSE on 8.8x, and the US on 11.4x. The broader FTSE All Share is 8.9x and the Stoxx 600 is 9.7x. The historic 40 year average is 17.7x.

In Europe either equity markets have become extremely cheap on fundamentals or earnings estimates are wildly over optimistic. Citigroup has tried to stress test this vulnerability, their base case is for a weak economic recovery

Assets:

Equities ► HOLD

Bonds ► HOLD

Property ► HOLD

Alternative Assets ► HOLD

Cash ► HOLD

Structured Products ► HOLD

Commodity ► HOLD

Equities (Geographic):

UK ► HOLD

US ► HOLD

Europe ► HOLD

Japan ► HOLD

Pacific Basin ► HOLD

Emerging Markets ► HOLD

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Contact Us:

Investment Relations Team
0845 203 9033

Chris Warren

Telephone:
01483 400 466

Email:
chriswarren
@premierfunds.co.uk

Jonathan Lewis

Telephone:
01483 400 437

Email:
jonathanlewis
@premierfunds.co.uk

where Global nominal GDP grows by 5.6%, 6.3% and 6.4% respectively in 2010, 2011 and 2012. Their calculations show 35% global earnings growth in 2010, falling to 20% growth in 2011, and 15% in 2012. The reason that earnings holds up so well in this scenario is that costs have already been cut sharply. Investors seem to have priced in a fairly ferocious outcome to growth ahead which we believe is misplaced.

CSFB estimate that at €/\$ of 1.20, 13% is added to European earnings (with a 9 month time lag). Anecdotally, US companies are beginning to guide down due to a strong Dollar. Usually, on a hedged basis, stocks with a weak base currency outperform.

Doing an unusual Price-Earnings analysis of asset classes, equities are cheap relative to 10 yr Sovereign bonds, and cash is unbelievably expensive and a dreadful investment unless a deflationary spiral is imminent, in which case you would prefer bonds anyway.

At the start of the year we said that equities would have multi-week periods of euphoria followed by panic and this thesis remains intact. The big and unresolved long term risk is that the heart of the problem has not been addressed; mainly that debt is excessive and has, so far, been simply passed from private sector to public sector and from core Europe to the periphery.

The good news is that we cannot see tightening by monetary authorities for the foreseeable future so, for now, we have ample liquidity, cheap valuation, and good earnings growth which should be positive for equities.

Portfolio Specific Issues

The Premier Capital Builder Portfolio has seen a contraction in value recently due mainly to the spike in volatility rather than falls in equity markets but due also to sellers of zeros in anticipation of changes to capital gains tax in the budget. GRY's have risen by around 1% over the last few months. The duration has been shortened recently and this has proved to be a good move and protected the portfolio.

The Premier Dynamic Growth strategy has seen a reduction in cash which has been held for while, mainly through the purchase of Templeton Emerging Markets. The discount to NAV has come back to 10% and it was deemed to be a good buying opportunity.

All the individual structured products held within the Premier Conservative, Premier Balanced and Premier Growth strategies were reviewed and discussed in great length and each stock was assessed on its own merit. As a result, certain stocks were reclassified from equity to alternative.

The performance of the portfolios over recent months has been dampened by the widening of bond spreads of the banks that provide the MTN's. Whilst there is the potential for certain banks to have capital ratios tested at some stage, we remain comfortable with the outlook for the senior debt of the banks we have exposure to.

It was agreed not to change the current asset allocation.

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Tel: 0845 230 9033 Email: marketing@premierfunds.co.uk Web: www.premierassetmanagement.co.uk