

Premier Discretionary Team

Asset Allocation - For Professional Adviser Use - Not for Distribution to Retail Clients

21st March 2011

Minutes

Present:

Mike Jennings, Acting Chief Investment Officer
Fred Fulcher, Director Portfolio Management
Raj Hallen, Investment Specialist, Portfolio Manager
Nigel Sidebottom, Investment Director
Paul Smith, Senior Investment Manager
Rosamond Borer, Head of Risk
David Pendlebury, Portfolio Manager
Kyra Cushway, Assistant Portfolio Manager
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Equity Market Overview

Equity markets have used recent geo-political and geological issues as an excuse for a sell off. Similarly, bonds have used it as a reason to rally.

None of this is surprising and we predicted a pause for consolidation of recent strong gains at the last meeting. The underlying trends in each however, have not materially changed. Equities have had a new bout of risk aversion and have simply taken a breather after a strong run from last July's low. Global equities had risen 24% (Source: Bloomberg, 07.05.10 – 18.03.11) to their recent peak so this hiatus was no surprise. What is also unsurprising is the rise in volatility after it reached very low levels. In aggregate over the past month, equity returns have been negative across all global equity markets.

Libya

Libya and Japan have, understandably, grabbed the headlines of late. Libya has the largest oil reserves in Africa, and the ninth largest in the world. It currently produces approximately 2% of world production (source: BP Statistical Review of World Energy, June 2010). As tensions moved from Tunisia to Egypt to Libya, suddenly oil becomes a major issue. Current unrest in Bahrain and Yemen is edging worryingly close to Saudi which contributes 12% of global oil production and a far greater proportion of reserves.

Libya, with 2% of global production, is itself not as much of a concern as Saudi. Other OPEC members purport to have the spare capacity to meet demand should supply from Libya be seriously disrupted or halted. The direct problem is that oil is a classic product with inelastic demand whereby a small change in supply leads to a large change in price.

Typically, this is due to the price being the cost of the marginal supply – i.e. cheap Libyan oil is replaced by a more expensive source. In other words, the price rise is perfectly logical despite the relatively minor proportion of the world's oil that comes from Libya.

The implications of disruption in Saudi do not bear thinking about. We assume that their \$36 billion fiscal give away will appease the Saudi population as it specifically targets the poorest end of the population. In conclusion, it would seem that the rise in oil price that we have seen is justified. Assuming that we do not see material unrest in Saudi, we would expect it to remain high (above \$100) for the foreseeable future but not spike sharply from here (above \$140).

Although the recent rise is unpleasant and will dampen down consumer demand whilst simultaneously raising the cost of production, the year-on-year rise has been far less sharp than that witnessed in mid 2008 when Brent reached \$145. The ramifications for global economic growth would appear to be minor, although might be greater for individual companies. Poor Q4 results for the likes of P&G and Unilever might suggest rising input costs are squeezing margins.



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Japan

The terrible disaster in Japan is still too fresh to be able to make a truly accurate analysis of the economic effects. However, we expect that the disaster could cost Japan 2% - 3% in GDP growth. If this is extrapolated for the overall effect on global GDP growth, we estimate that the direct effect could reduce global GDP by c. 0.25%. What is more difficult is the "multiplier effect" or the knock on from component shortages and depressed Japanese consumption as a result.

Japanese GDP growth was negative in the last quarter and it seems likely that further negative quarters lie ahead, putting the economy back in recession. The huge infrastructure and rebuilding expenditure and the fiscal stimulus provided by the Bank of Japan will, however, be a substantial boost to GDP in 2012.

The funding for the stimulus programme should come from internal domestic and institutional investors which may have an impact on reducing the high Japanese savings ratios. Anecdotal evidence suggests that there has not been huge repatriation of funds from overseas back to Japan; in fact, speculative capital has been flowing in to Japan, seeking to take advantage of the opportunities which may arise from the huge building and reconstruction programmes that will need to begin immediately.

Whilst the earthquake and tsunami may not have a major long term knock on effect on global markets, the nuclear issue could be more of a global problem. The Japanese stock market only accounts for approx 7.6% of global stock market capitalisation. Also, non-Japanese global companies only derive 2% of their earnings from Japan, suggesting a limited negative effect.

Long term ramifications for the global nuclear industry are potentially huge and the attraction of new energy stocks has greatly increased. Although Japan does not manufacture many end market products, it is a major global manufacturer of high value components, particularly for the automobile and technology industries.

Summary

Risk aversion has been raised over the last month which was no surprise and global GDP growth may be slightly worse than initially forecast at the start of 2011 but the global economic recovery is still on track. Global earnings growth may well be revised down from 15% but if 13% is a more realistic estimate then this is still attractive and will be a driver for stock market valuations. Our thesis that equity markets are cheap in the long run and bonds do not offer attractive value given the outlook for interest rates and inflation, remains in tact.

Asset Allocation Changes

It was agreed that no changes to asset allocation were required within client portfolios.

Within the model strategies it was agreed that the following changes be made:

Premier Capital Builder Plus Portfolio;

- reduce the holding in the Premier Defensive Growth Fund by 5%
- increase the holding in the Premier Alternative Strategies Fund by 5%.

Premier Conservative Portfolio;

- reduce the holding in the Premier Alternative Strategies Fund by 10%
- add a new position in the Premier Conservative Growth Fund of 10%.

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