

During 2009, we witnessed the end of the longest and deepest recession in most western economies since the Second World War

Market and Portfolio Overview – Fourth Quarter 2009

It is hoped that the major economies will recover to some extent in 2010, the general consensus being that such economies will bounce back from recession over the year. The US recovery is expected to be greater than that of Western economies, despite having experienced a shallower down- turn in 2009.

The UK economy is still under scrutiny and a downgrade from AAA rating would be a blow both in psychological and monetary terms. The UK Treasury now owns circa 22% of the Gilt market, and in 2009 the Bank of England bought 96% of all new Gilts issued. This has engendered significant uncertainty over the outcome of a Treasury and Bank of England mass sale of Gilts. It is therefore unwise to be 'bullish' on Government bonds.

Tough fiscal policy will be required from the political party in charge after the next general election. A hung Parliament would delay the implementation of such policy. It is highly possible that UK interest rates will not stay on hold for the majority of 2010. In theory, tight fiscal policy and loose monetary policy result in a weak currency; it is difficult to gauge whether this is already taken into account, or whether Sterling could weaken further.

On balance, we feel that, for most economies, the recovery may be better than markets expect. Although the UK may lag behind the US and the Euro zone in raising interest rates, once the 'short rate' rising cycle begins it could be sharp and, assuming no credit downgrade, UK Gilt yields will rise slowly over the year.

With regard to the 'three stage equity cycle' we are now in the third, synchronised recovery phase. The massive rebound from March 2009 to mid October 2009 is over and we are back to more normal equity market conditions with lower risk and return characteristics.

We remain positive on commercial property and expect this asset class to be supported by the tight supply and by weaker Sterling creating foreign demand. We also expect the sector to continue to benefit from low interest rates.

There are numerous potential negative effects on the market that we will be monitoring in 2010, not least the lack of an outright winner in UK general election. This could create 'policy paralysis' and therefore Gilts, equities and Sterling could all fall sharply. We would expect equities to recover first after any such initial fall.

The amount of fiscal stimulus in most major economies is unprecedented in peace-time history; therefore the probability of 'policy error' is high. If inflation is ignited because policy stays too loose this will be very bearish for bonds and moderately unattractive for equities. Equally, if rates rise too soon, this will pose a significant threat to markets in the short term (although we do not think this is likely).

Portfolio Activity—The Conservative, Balanced and Growth strategies

Where appropriate, we bought the Baillie Gifford Emerging Markets Growth fund. The fund aims to maximise the total return through investments primarily in emerging markets around the world. The fund was launched in March 1997 and is managed by both Richard Sneller and William Sutcliffe. The stock selection process begins with a thorough analysis of four company factors; attractive industry background, strong competitive position, sound financial characteristics and positive management attitude towards shareholders. The fund was added to portfolios underweight in Emerging Markets.

Where held, we sold the Morgan Stanley FTSE 100 Accumulated Growth Shares. This stock offered investors a maximum return of 137p per share over a 3 year period (launched at 100p per share). The product matures at the end of December 2011. The product was approximately 10 months in to its 3-year life and was pricing at 124p per share. Given that investors would receive a maximum return of 137p and would have to wait a further 26 months for this, we felt it was an opportune time to lock-in the 24% profit and sold the product on 5th October at 124p.

Over the period, we also sold our holding in the (Citi) Symphony Structures FTSE Auto-call 23%. Provided the FTSE was equal to or above the strike level of 4063.01 on the first anniversary (19th October 2009) the product would return the capital invested + 23%. With the FTSE well above 5000 approaching the first anniversary it looked almost certain that the product would mature on its first anniversary and pay 123p. We took the decision to sell at 122p per share on 5th October.

For clients holding the (Citi) Symphony Structures FTSE Gilt Backed Auto-call 10.5%; we received 110.5p per share (issued at 100p per share in October 2008) when the product auto called on its first anniversary in October. The product had capital protection collateralised against a basket of gilt edged securities and was triggered by the FTSE100 being above 4167 on the anniversary date.

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