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"STABILISING THE PATIENT"

It is both easy and difficult to predict the outlook for 2009 and into 2010. The easy part is to say that the full effect of the financial crisis in 2008 will translate into a severe economic downturn, the worst in a generation. Global growth, as measured by GDP this year will likely contract for the first time since the 1930s with the maximum pain expected in the first half of this year. Moreover, 2010 will likely see only a modest improvement as the de-leveraging process continues to play out, with potentially devastating economic and corporate consequences in the meantime. Clearly the debate right now is focused on whether the policymakers will succeed in preventing the recession turning into a depression and put in place the foundations for an improvement in 2010.

Over indebted households and under capitalised banks are adjusting their balance sheets, building up savings in the first instance and restricting lending in the latter. There is little chance of a sustained recovery until this process is well on the way to completion and we are some way from this point. Indeed, the consensus view is that we are only half way through the de-leveraging process. The good news however is that this is underway and much adjustment will have taken place by the early part of 2010. A catastrophic deflationary scenario can be avoided, if the aggressive, unprecedented policy interventions that have and will be seen over the coming months are targeted correctly. Precipitous falls in interest rates towards zero, combined with widespread fiscal stimulus packages globally, including the latest from the US, as well as the help from the substantial fall in oil prices are all important factors in helping to deal with this crisis. Finding a solution that finally underpins asset prices and at the same time, allows for a longer term solution to the debt problem, is crucial to moving the current crisis into the recovery phase. In other words, "stabilising the patient" after a severe cardiac arrest is crucial to avoiding complete organ failure.

We should not underestimate the scale of the likely stimulus that will be thrown at the problem on a global basis. Governments are now resorting to quantitative easing, which in layman terms means printing money to buy assets to re-liquefy the system and the quicker the better. Printing money to buy assets should create inflation under normal circumstances and some inflation would be desirable. However, these are not normal circumstances and with the scale of wealth destruction that has already occurred dwarfing the size of the stimuli. As a consequence, we believe that the global deflationary forces will be with us for some considerable time but eventually we will see some pricing pressure return, as production capacity is taken out of the economy and the benefits of policy actions start to feed through.

Undoubtedly, some value is emerging in equities, however to see a prolonged recovery in equities, we need to see the credit markets stabilise and begin to function again properly. A recovery without this is inconceivable. There are considerable amounts of cash being held on the sidelines by institutional investors which will need to be invested at some point, inevitably leading to quite powerful moves in some asset prices, once there is a sign of improvement.

It is our view that financial markets have been damaged by Government inaction over the insolvency of some banks. Essentially, Governments either need to nationalise the necessary banks or over-capitalise them which would then allow investors to participate in the equity market with renewed confidence. It is our view that we are closer to some form of resolution than many might think, but the process of getting to this point could be quite choppy.

As always, it is important to maintain diversification across the primary asset classes for portfolios. Equity investors will be rewarded over the longer term, and the market will be susceptible to further short-term volatility, albeit valuations for high quality global blue chip equities are compelling, when considering their relative attractiveness to other asset classes such as Government bonds and cash. High quality corporate bonds, in our view, look a very attractive option with income yields between 5% and 7%, with the opportunity for capital appreciation once liquidity feeds through into the credit markets. Commercial property rental yields are also beginning to look very attractive, but will need the credit markets to be functioning properly before valuations improve.

This is in my view an environment for investors to generate very attractive levels of income through a combination of very high quality blue chip equities and corporate bonds and should be considered against an environment where interest rates are, and will remain close to zero for some time to come.

I have enclosed the Spring 2009 bulletin which I sincerely hope you will find of interest.

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(NB: Past performance provides no guarantee of future returns and any views expressed by us do not constitute advice as each client's circumstances differ)