insight
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Where are we now?

These have been and are unusual times. How unusual is exemplified by the fact that the decline in stock market values this year has only been exceeded once before, in 1931. Why has this happened? Is it Armageddon? Should we sell everything and keep cash; and if so where should cash be held? Will things ever be the same again? Most of us have had some of these thoughts recently. This letter is designed to put the situation in context and to see towards the next two years and beyond.

What has happened?

All asset classes, except government securities, have fallen in value this year. This is a world crisis on top of a UK crisis. Economies have cycles as do stock markets. It is the aim of economic policies to manage these cycles, but they cannot eliminate them. On top of a natural downturn has been the effect of an ending of enormous credit growth. You will know well enough about silly loans being given in the U.S. to people who had little or no collateral and no real way of ever repaying these loans. To a lesser extent this also happened in the U.K. and some banks have paid a heavy, but deserved, price for it.

You could ask where did this money come from for all these loans which have now turned near worthless? The Banks themselves created it by packaging loans up and selling them for cash, and then using that cash to make a multiple of loans. Lehman Brothers going bankrupt meant some loans would not be repaid and the rush for cash became serious. Hedge funds had to sell assets at any price to meet redemptions. At the same time the world's economies were slowing down, meaning companies would make smaller profits and this led to a rational reduction in the price of shares.

However has this so-called "correction" now been overdone? The cause of the selling has been both the reduction in credit and the anticipation of lower profits, but what investors should now look at is whether at this price shares look good value?

It is not very helpful using the traditional method of valuing shares which looks at the price of the shares relative to the profits they are making (the price/earnings ratio). The reason for this is that we don't know what the average reduction in profits is likely to be. However, even if we assume an average reduction of 20%, the price of many equities looks very good value indeed and a good fund manager should still find those companies which won't cut dividends even in a bad time.

With the property market, it went too far up, and has now come down, but the prospect of an economic slowdown makes it hard for investors, who themselves may have difficulties in financing property purchases at this time. However a solid portfolio of properties which may now yield over 6% in the U.K. should be a good long term bet, but it will probably take some time before capital values start to rise gain.

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Should we have foreseen it?

The problems in the housing market in the States we did foresee, and we were certain of a significant downturn there. What we did not foresee was the huge amount of selling of assets to pay off debts that subsequently took place, which led to a serious confidence crisis in banks. Nor did we foresee how Governments would deal with this crisis (some good, some bad). We also certainly did not foresee such a big drop in the values of a whole range of assets, especially shares. We believe that this fall has been overdone on any long term basis, and we have now seen some recovery from the lows.

Is it over?

Have equity prices stabilised? We don't know. Western economies have yet to feel the full impact of the recession or downturn, certainly worse is to come. There is still a lot of debt to be paid off which could mean more massive selling of assets. In making investment decisions though it is best to look at long term value and here there are bargains to be had. In particular Far Eastern markets, which defied the downward trend for some time, were dramatic fallers in September and October. We believe on a long term basis that this is where great economic growth will occur and that this will find its way to those stock markets and to the companies which trade there.

Last year's investors

Those who invested in markets in 2007 will feel particularly disgruntled, because despite our relatively cautious approach, values have fallen. It will take some time for these values to recover, and our guess would be about two years before we see any significant sustained strong trend upwards.

Looking ahead

Events have moved so fast that even for expert analysts, it has been difficult to obtain some degree of perspective. The rescue package for the major banks was the essential first step to arresting the panic in financial markets. The next requirement was for substantial monetary easing which has just started and will accelerate into next year. Now that these have happened we feel we can make some reasoned judgements about the future prospects for our clients' portfolios.

The inherent productive potential of the global capitalist system will mean that at some time, economies will return to an upward growth trend. Stock markets tend to move some 18 months to 2 years prior to that uptrend. At the moment, certain shares look very good value and long term this will be considered to be a very good time to invest.

That does not mean to say that there won't be any more major falls, and when markets improve, they definitely won't be rising in anything approaching a straight line. However, professional investors, like Warren Buffet, tend to invest when everybody else is fearful, and that has always been a route to long term investment success.

We will naturally discuss these issues as they apply to you personally when we next review your situation in order to determine what action, if any, you ought or need to take.

With kind regards

Yours faithfully

ANDREW ROBERTS
CHAIRMAN