



**Alan Boswell & Company Ltd  
Market Update – 25 June 2010**

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## **Outlook**

So much has happened since our last update that there is frankly not enough room to discuss in this missive. However, what has become clear since earlier this year is that investors would appear to have become much less confident about markets moving forward from current levels.

The causes are various and diverse: from the Greek debt issue (did they hide it or was it just not noticed?) to BP (did they not have a plan B before starting the drilling process?) to a new coalition government in the UK (will they hide it, or blame it on someone else?). In between we have seen markets suffering the effects of Dubai World and the debt bubble there, along with continued massive support from the ECB and IMF to secure the so called 'Olive Belt' countries from potential default of their external debt. Whether we will get part 2 of the great quantitative easing experiment is an open question. Markets naturally have returned to a state of frenzy with moves either way tending to be large and not always based on true fundamentals. The Vix index (a measure of market volatility) has been back to levels not seen since late 2008 at times.

The irrationality continues but many of the best long term investors have already made their point in holding assets with some level of defensive quality combined with an income to keep things ticking over whilst global economies rebalance their debt and trade levels. What is clear is that money remains tight and credit (unless you are a clean risk) is not all that simple to come by either personally or as a corporate borrower.

Underlying all of this however is the fact that, anecdotally, many companies have shown strong improvements in cash flow and balance sheet strength recently as they took early action to tie down costs and shut non-profitable activities. Having seen dividend levels fall during the latter stages of 2008 there is every reason to suppose dividends will rise over the next 12 month or so which will be supportive to those defensive type holdings already noted above.

What may be seen as a positive most recently is that the Chinese attitude has been softening towards their currency peg with the US\$, often cited by the press and americans particularly as the reason why there is no balance in world trade and why the US trade deficit is so wide. It will be some time before any currency flexibility makes a practical difference to the rest of the world but China is now taking a much larger role on the world stage and can afford some largesse whilst protecting it's own interests.

In our last update we mentioned the game of two halves where momentum faded after the first two quarters and returns were much more volatile heading into Q3 2010. This appears to have begun to play out although it is by no means certain where markets will go from here. We remain of the view that volatility can be your friend if your investment managers have the ability to exploit it for you. Patience will be rewarded by quality managers.

## **Inflation**

Politics has played a considerably larger part in this group of statistics in recent weeks and months. Due to pressures on debt management in some european countries and the ability of some governments to print money to get their problems under control it is not always clear who are the real winners of any recessionary phase in the global economy. On balance those countries exporting commodities and having significant base mineral assets seem to have advantage with most having to raise interest rates (Brazil, Israel, Canada,

Australia, Malaysia) or using increased bank deposits (China) to control money supply and prevent an inflationary credit bubble.

UK inflation numbers have surprised on the upside with Mervyn King continuing to write letters to the Treasury explaining why the numbers remain above the CPI target of 2%pa. The main reasons appear to be inflationary items such as oil products, foodstuffs and the importing of inflation from overseas markets. Many commentators feel that this period of higher inflation will pass and the slack inherent in many Western economies suggests a period of sub trend inflation in the not too distant future. In truth, with the budget cuts announced recently by George Osborne and in the wake of similar messages from Ireland, Spain and Greece, most governments would rather see a mild inflationary period than a deflationary one. The debt will seem less problematic then.

UK numbers for May 2010 were 3.4% for CPI, and 5.1% for RPI. The Office for National Statistics noted on 15 June that the average level in the European Union for May 2010 was 2%. Interest rates have remained at 0.5% in the UK for 15 months now and look unlikely to rise in the short term to support a particular target level of inflation.

## **Commodities & Property**

Gold continues to take the headlines having reached previous highs, and currently holding around the \$1240<sup>1</sup> mark but other metals have crept up too. Silver, palladium and other metals used in high value added products have been gaining value. Hard to trade, difficult to store and no income means that buying into the story requires you to hold an asset in the hope of capital gain. Many investors continue to favour buying the people who mine these fairly rare assets, or the people who turn them into value added goods. If markets fall heavily expect gold to move significantly higher on fears for the global economy.

For those holding property assets, a similar demand/supply story exists. Better quality property/higher quality tenants has meant higher asking prices for managers recently. The income stream paid by these tenants has been bid up by buyers with cash on their balance sheets. For most of the remaining property assets, the picture is less rosy. Nonetheless, investors should still hold the asset as a diversifier in their portfolio. We may have seen the best of any recovery bounce in capital terms at present, but if income continues to come through, the asset class could well see more money allocated here again. Bank lending has been restricted and any release of capital into this market could see a positive 'money multiplier' effect for investors.

Two areas that might bear some medium term fruit are the student accommodation and local GP markets. Both have government backed income streams, with fixed term leases and a ready supply of occupants. Although a specialised area, we do know managers offering such options to retail investors and the income is certainly competitive, considering that we are talking about UK only property assets.

Investors should be careful and understand that a 'bricks and mortar' fund is a completely different animal to a 'REIT' which is effectively a share traded in the usual way and subject to the same market forces that all shares are. Both have value, and we would be pleased to help in allocating any capital to the asset class where clients are keen to be involved.

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<sup>1</sup> [http://newsvote.bbc.co.uk/news/business/market\\_data/commodities/default.stm](http://newsvote.bbc.co.uk/news/business/market_data/commodities/default.stm) - 25 June 2010

## Summary

With the recent UK budget, it is apparent that we are now primed for more austere times. From a financial advice perspective that is why clients seek our advice. The central tenets of protecting your life, your health, your income and your future remain as they always were. For most people, the changes in capital gains tax (to 28% for higher rate taxpayers from 22 June) and the restrictions on pension contributions receiving higher rate relief (those earning £130k+) make little difference. Regular savings using either a pension plan, ISA or other wrapper along with some cash for short terms needs whilst protecting those close to you with some type of insurance arrangement are mere good common sense.

If clients are not sure of investing a lump sum (perhaps an inheritance) then monthly averaging of the sum is worthwhile and at this time markets look fair value with a longer term view. If you are looking at protecting your retirement income we can provide a solution which mitigates market risk whilst providing the option to take a flexible income for the short term or longer as necessary. For income investors a global approach needs consideration. With so many of the best dividend payers now located outside of the UK and Europe, one should consider Asia, Latin America and even the US for such rewards as well.

With our preference for a multi asset approach to client investments, and the close contact we have maintained with our preferred managers, we hope our clients have been able to see through the volatility and understand the positioning these managers have used to protect or enhance client portfolios where possible. With cash offering so little in terms of return it will unfortunately be necessary to accept some risk is required to make a return approaching inflation or above in the present climate.

***Please feel free to contact your financial advisor if any of the points mentioned here could add value to your own portfolio, or if you feel a review would be useful at this time.***