

2nd Quarter Investment Briefing

What an interesting quarter it has been, the markets volatile, the FTSE 100 dropping by 14.5% between 01/04/2010 – 30/06/2010. The ongoing European crisis, BP crisis and Governments trying to cut costs mainly by increasing taxes, drawing back some of the growth that we had seen within the first quarter. However, with the use of quality investment managers we still remain in positive territory year to date.

Equity view

We have all heard how BP is affecting pensions via the media, however, this is not the case for the majority of pensions although large final salary schemes such as PECRS will have been affected. Although the underlying annuitants will not see this, but scheme actuaries will be clamoring for the Government (in the case of PECRS) to top up a new shortfall in pension funding created by two parts the capital value reduction of BP shares and zero dividend being paid this year. It is in fact an incredible buying opportunity, which will also be the case for many fund managers that we use.

At the start of this quarter BP was the 6th largest company in the FTSE 100 and generated a staggering 13% of total dividends from the FTSE 100. Then crisis struck a major leak on a deep water drilling rig in the Gulf of Mexico, the saga begins.

In May the oil giant BP finally seemed to be getting to grips with the oil spill in the Gulf of Mexico. The company said it is diverting about 3,000 barrels of oil a day into a drill-ship via a mile-long tube inserted into the broken MC252 oil well. The group has also skimmed some 187,000 barrels (7.8m gallons) of oily liquid from the surface of the water.

By mid June BP was trying to raise \$50bn to cover the cost of the Gulf of Mexico disaster, while the oil giant is also preparing to sue a partner in the Deepwater Horizon rig.

The Sunday Telegraph reported BP is readying to take legal action against US firm Anadarko, its main partner in the oil field, for its share of the clean-up costs.

A senior BP source said Anadarko was "shirking its responsibilities", with legal action in the United States is now likely to follow.

Meanwhile, the Sunday Times reported BP is working on a plan to raise \$50bn to cover the cost of the oil spill, which would start next week with a bond sale to raise \$10bn.

A further \$20bn would come from bank loans, with asset sales over the next two years would generate the additional funds.

In addition, the Observer said BP might sell its remaining North Sea interests, plus stakes in dozens of exploration and production projects where it does not have overall control.

At the beginning of this new quarter the US government is believed to have given oil giant Exxon the go ahead to launch a £100 billion takeover bid for [BP](#), as the British company continues talks to sell assets to Houston-based Apache. According to a report over this last weekend Exxon has been granted clearance by US president Barack Obama to bid for BP and create a company with a £265 billion stock market value. Strange how competition rules are brushed aside so swiftly when it suits? Similar to the recent news that BA can now merge with Iberia Airlines (previously declined by the competitions regulator).

Sources told *The Sunday Times* that although the company had been given the nod there was no certainty that Exxon would make the move.

Over the weekend BP made its latest attempt to contain the oil spill in the Gulf of Mexico. It removed a cap over the well in order to replace it with a tighter fitting container that should capture the escaping oil.

BP is also still believed to be in talks with Houston-based oil company Apache to sell up to £8 billion worth of assets and raise money to pay for the oil spill.

The *Wall Street Journal* reported yesterday that a sale could include stakes in BP's Alaskan oil fields.

Negotiations with Apache are thought to have been underway for a number of weeks.

This year European equity markets are down over -16%, Asia -13% with America the best of a bad lot down -4%. As you would expect, the Banks have been the biggest fallers followed by commodity sectors and utilities.

On the whole, economic and corporate news has been very good. The latest earnings reports saw a near record positive surprise in both sales and the bottom line. Dissecting economic data has also proved of little concern; activity on all levels is better than expected.

This fall has been peculiar for lack of data driven 'red flags'. Ordinarily, data indicates a waning economy by 'rolling over' before markets take fright – not today, economic data could hardly be better.

We know about Greece and the problems that certain countries are having; we know the European leaders are not united in a proposed solution to peripheral sovereigns indebtedness; we know about the problems in Thailand and today's 'news' that North Korea is preparing for combat is yet another worry. What importance should be attached to recent events? In our opinion the extent European banks are insolvent, the speed and willingness of European authorities to realise the problem and the impact this has on money supply, is the main concern. Unfortunately, banks are so opaque that to answer this question with confidence is impossible. Investors are selling first and asking questions later.

Emerging Markets

The darlings of the investment world at present and likely to be into the future, reversed growth slightly, certainly no colossal downturns as noted in the developed markets. The Chinese have finally broken the pegging of the Renminbi against the US \$ to allow for greater flexibility for its currency.

Weaker commodity prices and higher interest rates soured investor sentiment in Latin America with Brazilian stocks underperforming. Although overall this is still a very attractive area of investment.

Emerging Europe is struggling the most with investors fearful of the goings on in developed Europe. However, Russia continues to perform strongly with the economy still accelerating.

Fixed Interest

The UK's Monetary Policy Committee voted to keep interest rates unchanged at 0.5%. However, the minutes caused a surprise by revealing a 7-1 split in the vote after Andrew Sentence voted for a 25bp hike in the rate - the first vote for a hike seen since August 2008.

Investment grade bonds BBB and above have had positive performance over the last quarter with a rally towards quality due to the Greek disaster (bonds now graded as junk by Moodys, although stable). Surprisingly at a recent Spanish Government bond auction the sale was over subscribed!

Our preference in this area is quality and strategic bond management, from the likes of Invesco Perpetual, Aegon, Lloyds and M&G.

Commodities/Gold

We will fixate on Gold for this issue as I read the following article with some interest the other day and thought it would be good for everyone.

It takes a lot to spook the solid old gold market. But when it emerged last week that one or more banks had lent 380 tonnes of gold to the Bank of International Settlements in return for foreign currencies, there was widespread surprise and confusion

The news that a mystery bank has just pawned the family jewels gave traders a jolt, nervous about the sudden transfer of almost 20pc of the world's annual gold production and the possibility of a sell-off.

In a tiny footnote in its annual report, the bank disclosed its unusually large holding of gold, compared with nothing the year before. The disclosure was a large factor in the correction of the gold price this week, which fell below \$1,200 for the first time in more than a month.

Concerns hinged on whether the BIS could potentially sell on this vast cache of bullion in the event of a default, flooding the market with liquidity. It appears to have raised \$14bn for whoever's been doing the swapping small fry on the currency markets, but serious liquidity in the gold market.

Denominated in euros, gold has fallen 8pc since the beginning of the month and is now trading at a seven-week low of 937 per troy ounce.

The big gold exchange traded funds (ETFs) having peaked at record inflows in May have also been showing net outflows over the past few days.

Meanwhile, economists and gold market-watchers were determined to hunt down which bank is short of cash curious about who is using their stash of precious metal for what looks suspiciously like a secret bailout.

At first it looked like the BIS was swapping gold with a troubled central bank. After all, the institution is the central bankers' bank and its purpose to conduct transactions with national monetary authorities.

Central banks in the troubled southern zone of Europe were considered the most likely perpetrators.

According to the World Gold Council, central banks in Greece, Spain and Portugal held 112.2, 281.6 and 382.5 tons of gold respectively in June leading analysts to point fingers at Portugal, or a combination of the three.

But Edel Tully, an analyst from UBS (Virt-X: [UBSN.VX](#) - [news](#)) , noted that eurozone central banks would be severely limited with what they could do with the influx of extra cash unable to transfer it straight to governments or make use of the primary bond markets.

She then listed the only other potential monetary authorities with enough gold as the US, China, Switzerland, Japan, Russia, India and Taiwan and the International Monetary Fund.

This led to musings that the counterparty was the IMF, making sense because the lender of last resort is historically prone to cash shortages and has been quietly selling off gold in the first half of the year.

Renowned gold expert Jim Sinclair adopted this explanation. The panic came when people mistook a lease for a swap, he argues. Far from being a big release of gold into the market, it is simply a commercial arrangement between the IMF and BIS with a favourable rate of interest paid for the foreign currency.

"Gold swaps are usually undertaken by monetary authorities," he writes on his industry blog, MineSet. "The gold is exchanged for foreign exchange deposits with an agreement that the transaction be unwound at a future time at an agreed price."

"The IMF will pay interest on the foreign exchange received. Historically swaps occur when entities like the IMF have a need for foreign exchange, but do not wish to sell the gold. In this case, gold is a leveraging device for needed currency to meet requirements."

"The many reports that characterise the large IMF gold swap as a sale of gold into the markets do not understand the difference between a swap and a lease."

However, the day after original reports about the swaps, BIS emailed a statement saying that the swaps had not been conducted with monetary authorities but purely with commercial banks.

This did nothing to quell the sense of mystery surrounding the deal or deals. It is almost inconceivable that a single commercial bank could have accumulated so much gold alone. And cynics have suggested that the whole affair still looks like a secretive European bailout that a single country wants to keep quiet. ????

In this case, one or more of the so-called bullion banks which act as wholesale market-makers and include Goldman Sachs (NYSE: [GS](#) - [news](#)) , Deutsche Bank (Xetra: [514000](#) - [news](#)) , JP Morgan, HSBC (LSE: [HSBA.L](#) - [news](#)) , Barclays (LSE: [BARC.L](#) - [news](#)) , UBS, Societe Generale (Paris: [FR0000130809](#) - [news](#)) , Mitsui and the Bank of Nova Scotia would have agreed to act on behalf of a monetary authority.

This would add an extra layer of anonymity. "So the BIS swaps look like a tripartite transaction," writes Adrian Douglas of the Gold Anti-Trust Association. "The commercial bank or banks made a swap with a central bank or banks and then the commercial bank or banks made a swap with the BIS."

Analysts for Commerzbank (Xetra: [803200](#) - [news](#)) note that in the meantime, "The price of gold is tending weaker at present."

Outlook

On a personal basis I do not believe that we are heading for a double dip, admittedly there is continuing bad news which will keep markets relatively volatile and I do think it will be some time before we see massive reductions in the levels of volatility. However, in saying that I think that there are some great investment opportunities in the current markets and some very well priced (if not cheap) assets to be had and therefore do not think that this is a time to be out of the market.

Mortgages and Property

The Bank of England Monetary Policy Committee (MPC) voted to keep interest rates at 0.5% and maintain quantitative easing at £200bn.

A "dramatic turnaround" in the UK commercial property market saw real estate investment trust (REIT) Land Securities swing strongly back into the black. In the year to March, the value of Land Securities' investment properties increased by £863m or 10.3% with basic net asset value up 17% to 750p. (Read more: [Land Securities sees 'dramatic turnaround'](#))

British Land had a good year despite the challenging and volatile markets, lifting net asset value (NAV) by 27%, more than many analysts had predicted. The real estate giant revealed net asset value per share at 31 March 2010 was 504p, while the portfolio valuation grew 13.5%.

Property website Rightmove's house price index rose by 0.7% in May, down sharply from the 2.6% increase seen in April in a further sign that the recovery in house prices is easing. The total rise in average prices over the whole year was 4.3%, taking the average price to £237,134.

Jersey Home Loans (JHL) News

Many of you will remember the prolific lending JHL conducted in Jersey up to 2008, for a couple of years they were the biggest Jersey mortgage lender, (£200 million +) some achievement! However, with the credit crunch there lending rapidly dried up and in the midst of 2008 they stopped, they have started offering equity release but not at competitive rates. This recent press release may see JHL coming back as a Jersey lender?

Private equity firm JC Flowers is in talks to fund a £50 million rescue of mutual Kent Reliance, in the first step of a plan to consolidate struggling building societies.

The investment will see JC Flowers, run by Chris Flowers, take a 49% stake in a new holding company to allow Kent Reliance to retain its mutual status. The building society's 180,000 members will hold the controlling stake in the company.

According to *The Sunday Times*, Flowers is planning to use the deal as a launch pad for 10 similar deals. Former Financial Services Authority chairman Callum McCarthy will be chairman of the new, as yet unnamed, venture.

Kent Reliance chief executive Mike Lazenby will take the same role at the enlarged group and will be tasked with leading consolidation.

JC Flowers will invest £500 million into the plan in a radical overhaul of the sector which has seen a number of larger building societies taking over smaller players as they struggled to meet capital requirements.

Talks between Kent Reliance and JC Flowers are thought to have started nine months ago and the FSA is believed to be working closely with the companies on the structure of the deal.

Something different?

We have been reviewing the Stamp market makers Stanley Gibbons, for some time and recently agreed internally and with our regulators that we are happy to place investments through this group. I have gone on a lot in the briefing this time so, just to let you all know if you wish to have some more information regarding a stamp portfolio please do not hesitate to contact us. As with all investments it should only form part of a portfolio not the sole investment. Stanley Gibbons have for a number of years been offering other alternative investments such as autographs, clothing signed pictures, anything rare and unique in quality which is irreplaceable.

In a week that the ashes of the Coronation Street cat were sold for £844, who knows what is going to be ultimately valuable next? See the next page?

You can purchase a bra worn by Monroe for just £7,000.



The nude-coloured under-wire bra comes direct from Monroe's personal wardrobe, complete a certificate of authenticity confirming its pedigree.

In a world where X-rays, gowns and chairs are selling for record sums, £7,000 for an item of clothing **actually worn by Marilyn Monroe** is a wonderful opportunity. This is a special and classic piece – and what a talking point!

Where would you hang it????

Queries and questions

Should you have any questions please do not hesitate to contact one of our team, we hope our briefing has been of interest and finds you well.

We have also finally got around to launching our web site (only taken us four years) please have a look there may be useful items on there not just for you but another family member. We will be looking to continually improve upon it so if you would like to suggest anything please drop us an e-mail. www.hbfs.co.je