



Second Quarter 2011

An overview of the second quarter and views going forward

30/06/2011

1st April to 30th June 2011 Overview

2011 continues in a state of flux with weakness in the US, inflation in emerging markets and the return of Greek woes have weighed on risky assets with equities experiencing a run of eight consecutive weekly declines.

We expect some recovery in global activity in the second half of the year accompanied by low interest rates. In other words a soft patch, not a double dip. Against a backdrop of on-going corporate strength, we also see a recovery in Japan combining with lower oil prices to support growth.

To highlight how the main markets have fared in the last three months see the table below:

Index	30/31/ Dec/2010	31/03/2011	June 30 th 2011
FTSE 100	5,899	5,908	5938
Dow Jones	11,577	12,319	12415
Nikkei - Japan	10,228	9,755	9820
DAX - Europe	6,914	7,041	7372
Hang Seng – China	23,035	23,527	22046
Nifty 50 - India	6,134	5,833	5634
IBOVESPA - Brazil	69,305	68,587	62214

A further retreat from the Asian and Latin American stock markets over the last quarter, however this does not send shivers down the proverbial spine as we believe that these markets are financially well positioned, with strong, healthy balance sheets in comparison to the over-indebted developed world. Although the Emerging and Asian markets have their own concerns in relating to inflation, plus these markets are also now trying to judge their own interest rates, whereas previously they judged them in relation to the developed world.

Overview

The world economy remains split between the strongly recovering, fast growing emerging economies of Asia and Latin America, and the slow growing, crisis plagued economies of Western Europe and North America. The only major central bank to raise rates in response to recent commodity based increases was the ECB, which briefly strengthened the Euro to a point in late June where exchange for minutes hit GBP £0.90 = 1 euro! (During June).

April

On April 18, 2011, Standard & Poor's Ratings Services affirmed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the United States of America and revised its outlook on the long-term rating to negative from stable.

The reason: Because the U.S. has, relative to its 'AAA' peers, what S&P consider to be very large budget deficits and rising government indebtedness and the path to addressing these is not clear to us, S&P have revised our outlook on the long-term rating to negative from stable.

S&P believe there is a material risk that U.S. policymakers might not reach an agreement on how to address medium- and long-term budgetary challenges by 2013; if an agreement is not reached and

meaningful implementation does not begin by then, this would in S&P's view render the U.S. fiscal profile meaningfully weaker than that of peer 'AAA' sovereigns.

Outlook: The negative outlook from S&P rating on the U.S. sovereign signals that they believe there is at least a one-in-three likelihood that they could lower their long-term rating on the U.S. within two years. The outlook reflects their view of the increased risk that the political negotiations over when and how to address both the medium- and long-term fiscal challenges will persist until at least after national elections in 2012.

However, other indicators show the potential of reasonable growth into the future from the USA.

In China in an effort to reduce the widening wealth gap (estimates show the richest of Chinese households control between 40 and 60% of household wealth) the Chinese authorities plan to lift income threshold for personal tax payments, increasing from Rmb 2,000 (£193) to Rmb 3,000 (£289) per month. This will reduce the number of taxpayers by 50 million and reduce Government tax by Rmb 15bn.

Other measures include a promise to raise average wages by 15% per annum, doubling the average wage 2015, It also plans to build 35 million low income homes over the next 5 years.

The two most notable responses to the change by S&P rating agency on the outlook for the US credit rating were from the largest holders of US debt, guess who? China \$1.2 trillion (according to US data) and Japan \$890 billion. Japan played down concerns about US credibility but Chinese Government had the following to say; "We hope the US government will take responsible policies and measures to safeguard investors' interest".

May

The on-going saga of excitement (volatility) in the markets continued unfortunately with most indices recording losses. Stressing over the implications of another chapter in the peripheral European debt crisis. In addition the US debt crisis was never far from the mind.

Commodity prices were generally weaker; silver declining by 20.6%, oil 7.3%, nickel 12.8%, aluminium 4.3%, with major commodity indices declining by 5 – 7%.

US data was not good this month, whether retail sales, the housing market or the labour market (where 45 million US citizens now receive food stamps!) Bearing in mind that one of easiest ways for the US to resolve its massive debt problems is to grow its way out of trouble, so a slowdown is something the US can least afford at present.

The Chinese government in response to continuing inflation (although slowed) increased the bank reserve requirement yet again to 21%. This means that large banks have to hold 21% of their deposits with the Central bank.

Indian financial stocks are already on attractive valuations, but the government's plan to issue all 1.2 billion citizens with biometric identification cards will transform the banking system and create a surge in domestic consumption. The programme will give every citizen an individual bank account, which will be a massive driver of banking penetration.

The majority of domestic savings are kept under the bed at present, not in banks. The country has a very high and rising savings ratio, but a remarkably low loan-to-GDP ratio.

Did you Know?

Amazon announced recently that the sale of e-books (books in electronic format for Kindles and other electronic devices) had surpassed the number of sale of printed books for the first time. It also announced that it has sold more than three times the number of e-books so far this year as it had over the same period last year.

June

2011 has continued on its relentless drive to prove challenging and unpredictable and June was no exception. Without doubt the biggest source of volatility has been the Greek debt crisis. Now Greece is not a major global economy but threads of it weave into banks in general and in particular European banks, into the future of the Euro and the European community. The likelihood of this is that Greece will in the end, leave the euro. It is only a matter of when and how (orderly or disorderly exit).

Markets were weak during mid-month but rallied towards the month end. The S&P 500 was down 5.9% at its lowest but finished 1.6% down for the month; it posted a remarkable recovery of 4.1% in the last four days of trading.

The other major feature of the month was the decision of the International Energy Agency (IEA) to release 60 million barrels of oil from their strategic reserves. The effect was swift oil prices dropped by 10%, but the Greek/Eurozone crisis soon overtook the IEA's decision and the oil price started to tick up again.

In comparison to other developed markets the British coalition government's plans to close the deficit by 2015 carries some credibility, so Britain is not facing a similar debt crisis.

China raised banking reserve ratios yet again hitting 21.5% (and thus cannot lend the assets out). Emerging markets continue to struggle with rising inflation, consequently many raising interest rates in response. During the past month India raised their official interest rates by 0.25% to 7.50% (the tenth increase in 15 months).

Unfortunately the coalition government does not seem to be able to stand as firm as the likes of Maggie Thatcher are the Unions going to break them? Strikes are no good for the economy or its fragile recovery, why do the unions not realise that their members are not only lucky to still be employed but minor changes to an absolutely fabulous pension scheme for civil servants will still provide them considerably more than any of us can expect in retirement!

Did you know?

The price of Orange juice hit a 4.5 year record on the news of poor citrus crop in Florida

Commercial Property

Rental will continue to provide most of the returns for 2011, although activity in our London centric property fund Henderson has been quite interesting to watch with rental yields firming and demand for office space increasing, thus pushing the value of property up in London.

Furthermore, a shortage of new properties and the limited availability of development finance should be beneficial over the medium term as tenant demand improves in line with the economy.

This is an added bonus of the banks not lending in that we are not in an era of oversupply and is another good reason for the expectation of increased capital values, in the not distant future.

Capital values across the UK will start to tick up more so as we move into 2012 – 2013 whilst remaining relatively low risk (little downside) with the funds we are utilising averaging 10 years + average lease expiration.

Jersey

Housing Market

The spark that started in the first quarter hasn't quite fizzled out but certainly has not started any forest fires, with a high number of properties available on the market they are holding capital values down.

We have seen continuing increase in new mortgage applications and it is pleasing to note a number of them are first time buyers, this trend is indicative of higher loan to value (LTV) being available from one or two mortgage providers.

The relentless building of flats in Jersey does concern me and it may not be now or even in the next few years that my fears really come to fruition, but ten years or more from now what is Jersey going to look like? Interestingly the planning minister has just resigned, but kept his role in external affairs! Well I presume a jolly to China was a dam sight better than he could have achieved through planning, but as pointed out his legacy of flats will remain in the eyes of every Islander (born here or not, if you love it you're an Islander) every time they head into the harbour.

Best mortgage rates available in the market	
---	--

2 year discounted standard variable rate	1.99%
Base rate tracker	2.49%
2 year fixed rate	3.49%
5 year fixed rate	4.49%
All rates correct at time of printing and subject to lenders terms & conditions	

Ashburton, Orchard and Spearpoint

Ashburton and Orchard have provided positive returns year to date, although nothing too exciting but expected. The Ashburton Chindia fund has stabilised somewhat over this last quarter recording no further losses since the end of March.

The Orchard strategy has been holding a reasonable weighting of cash but this has not affected the performance and Richard Harwood (fund manager) believes there will be some great opportunities to come.

The Spearpoint fund which is a little more aggressive than the above is marginally negative year to date, but not scarily so and again matching its investment perspective at this point in time.

Looking forward

Yes the world has problems, but they are not insurmountable, a level of volatility will continue, but the risks are relatively low and in normal cyclical terms the time is right for risk assets (equities).

Therefore despite all the financial problems that the World faces, I remain of the opinion that over the next two/three years there is going to be some substantial growth opportunities and only those who participate will reap the benefits.

Unfortunately, it won't all be plain sailing, as market volatility is here to stay. However, I do not see this as a bad thing, as rebalancing of portfolios and drip feeding funds into existing portfolios will benefit from £ cost averaging, maximising potential gains.

Finally

We wish you all a good summer hope you enjoy holidays, etc, and look forward to reviewing your investment with you soon.

Should you wish to discuss any of the enclosed comment please feel free to contact your adviser.

Kind regards

A handwritten signature in black ink that reads "David". The letters are cursive and slightly slanted to the right.

David C Troy
Managing Director