ECS Investment Newsletter July 2010

The long and winding road to a UK recovery!

With the FTSE 1000 sitting at around 5400 at the start of the year and a subsequent rise to 5800 you could have been forgiven for thinking we were well on the road to recovery. As the fall out from the credit crisis continues to make the headlines we continue to lurch from crisis to crisis and already nervous markets continue on a volatile track. The recent falls have taken the market back to 4800 but this is well above the 3500 we previously experienced. With the constant stream of bad news appearing in the media from the purveyors of doom and gloom it is easy to get depressed about the future and the underlying security of the investments you hold.

So how have UK markets performed during previous severe market falls?

Event	Great depression	Oil Crisis	Tech Bubble	Credit Crunch
	1929-1931	1972-1974	09/00 to 03/03	03/09 to 03/10
Market Fall	**- 40%**	**- 61%**	**- 48%**	**- 45%**
	1932-36	1975	03/03 to 06/07	03/09 to 03/10
Market Rally	**147%**	**145%**	**151%**	**69%**

Source: Dimson, Marsh and Staunton and JP Morgan

On this basis there still appears to be good value for people who are investing for the medium to longer term but as ever I should state that past performance is not necessarily a guide to future performance. Not all the recoveries were instant and never did they run a smooth course.

There is no doubt though that the world seems to be split into two distinct camps at the moment, the debt laden western developed worlds and the much more nimble emerging world economies. The latter seem to be making a stronger recovery probably due in no small part to the fact they have had a reluctance to borrow following the financial problems they experienced back in the 1990’s. In the west we simply have to take our medicine and bear the pain… and that includes the countries of the Euro zone.

In the UK, the government will have to tighten the belt quite hard ….. but not hard enough to squeeze the life out of the somewhat fragile recovery. On the face of it domestic markets look set to grow at a slower rate than overseas markets for some time. Current market sentiment is that global markets are likely to produce greater returns over the next few years. That said it is always worth remembering that over 70% of the income of the FTSE100 companies does actually originate from overseas. However you should consider the position of any fund holdings you have in UK Mid and Small Cap stocks, as these may do better in a flight to the larger “Blue Chip” stocks of the FTSE100.

Whilst the markets remain volatile there are always new buying opportunities for anybody with a reasonable time horizon. When markets fall there are always people ready to buy into the “improved value”. A number of fund managers are stating they are using the recent fall as an opportunity to selectively buy in rather than staying out of the market.

For those with portfolios already invested in the market there is little to do except continue to stick with your existing strategy and ride out the storm.

So what financial solutions are available in the market?

As ever a balanced spread of investment aligned to your current attitude to risk is likely to be the best policy for those with a long term buy and hold strategy. Second guessing an unpredictable market is fraught with danger and for every winner there is usually a loser.

Actively managed funds

There are a number of cautious managed funds where the manager is controlling the asset allocation dependant on the economic outlook and these funds can respond to changes in the market conditions. One fund that has done well during the recent turbulence is the Fidelity Multi Asset Strategic fund and is one worth considering if you are nervous about the market volatility

Absolute return Funds

What a clever idea these funds appear to be on the face of it. They aim to provide you with expectations for lower volatility and more consistent returns. They deliver this by utilising financial instruments to make money when markets are going down as well as when they rise. They do this through the use of derivatives and beneath the simple concept is quite a murky world of complicated financial instruments. And there lies the problem i.e. they can use a wide variety of techniques using many strategies, all with different levels of risk. There is also the additional risk of those who issue the financial trades being able to deliver them at a future date. Current 12 month returns range from 21.2% down to –10.8%. (Source: Trustnet 25/05/2010). The volatility of these funds has also been quite diverse. Interestingly one of the top selling funds of last year now seems to be seeing some pretty heavy outflows.

Whilst we are monitoring a small number of these funds we have generally avoided them and we would suggest some caution when considering this type of investment.

Taxation

As the coalition government tightens the domestic belt we all know that government cuts and increasing taxation is well on the way. With predicted changes to Capital Gains Tax (CGT), ISA fund holdings are even more attractive. At this stage we must await the full detail of the changes to CGT before we make any comments on this subject.

ISA Allowances

Remember the new ISA limit is **£10,200**. Up to £5,100 of the new ISA allowance can be saved in a cash ISA with one provider. The remainder of the £10,200 can be invested in a stocks and shares ISA with either the same or another provider. Alternatively, the full £10,200 can be invested in a stocks and shares ISA with one provider.

You can also reduce the risks of investing at the “wrong time” by drip feeding money into the market and undoubtedly that is why we are seeing a number of investors setting up regular contributions to the new maximum level of £850 per month. So if you want some additional safety why not feed your capital in this way? It is surprising how quickly now you can build up a substantial ISA’s holding using the new allowances.

And finally...................

I said in January that it would be a tough year, with continued volatility and that certainly seems to be the case. There will continue to be many challenges to face over the next few months and years but I still have faith that equity markets will deliver if you are prepared to stick it out through the tough times. Remember we have come along way since the FTSE 100 stood at a daunting 3500!!

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