KILSBY WILLIAMS & GOULD

FINANCIAL BULLETIN

"Helping our clients to achieve their personal financial objectives through our integrity, skill, diligence and experience"

August 2011

Welcome to our Autumn financial bulletin where we will aim to provide you with useful information and insight into the current marketplace. This issue will provide you with an updated in-house economic commentary, an article from Pictet Asset Management on thematic, investment mega-trends over the next decade, and a smaller companies investments piece from Hargreave Hale. We hope you find it of interest.

We would also like to extend an invitation to our annual client investment seminar to be held at St. Mellons Golf Club on Tuesday 13 September. We are delighted to announce that Alastair Mundy, one of the UK's top performing and outspoken fund managers, will be giving a talk on "Dispelling Investment Myths", in which he will outline his personal and hugely successful style of investing. Alastair manages over £3billion for Investec Asset Management across a range of multiple award winning funds and is rated highly by both his peers and independent agencies. If you are interested in attending, please email myself or Andy, or alternatively contact Oliver Stone: oliver.stone@kilsbywilliams.com or 01633 654 155.

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Why thematic investing makes sense

Thematic investing is not new, but how does one distinguish a profitable theme from a fad. We all remember, some of us painfully, the dot com boom and bust at the turn of the century or even the rather bizarre clamour to become ostrich farmers in the 1990's. But, some themes are here to stay.

The basis for successful theme investment lies in the identification of long-term structural changes in social, environmental and demographics factors such as ageing and population growth. We call these long-term changes "megatrends".

Pictet has identified nine megatrends, each of which has identifiable long-term drivers which we believe will yield investment opportunities: agriculture, biotechnology, clean energy, digital communication, generic drug production, premium brands, security, timber and water.

The themes can be grouped into three broad categories: environmental; (timber, clean energy, water and agriculture) social; (premium brands, security and digital communication) and demographic (generics, biotechnology and once again water and agriculture).

The external environment is one of the most important factors influencing share price. Structural changes in the macro economic environment have implications for all industries and individual stocks.

Consider water as an investment theme. Population growth is the increasing demand for clean water worldwide, particularly in emerging markets. Investment opportunities exist across the entire water cycle from water sourcing to water distribution, waste-water collection and treatment. Investors provide vital capital to these industries which are striving to deliver this vital resource. Demand will only increase over time.

The rising global population also means a higher demand for food and the need for the agricultural sector to sufficiently increase output to feed the global population. In addition, a greater prosperity in emerging countries is leading to more meat consumption, which means land resources is needed to provide the necessary feed-stock for animals. Investors can select companies who help increase professionalization in farming and help to ensure that the world is able to feed the growing population.

There is a significant difference between the dot com boom and bust in 2001 and the new digital era. My own eight year old daughter can navigate across the internet with ease, while my youngest daughter asked for an iPad for her sixth birthday. Much to her disappointment she received a shiny new scooter. Generation Y are immersed in technology. Digital media is the forum for communication - have you ever tried to part a teenager from their mobile phone!

With the digital revolution also comes the risk of information passing too easily across cyberspace. Corporations now spend billions of pounds in new technology to protect themselves and their customers from cyber attack. The result is an emerging security industry, which is seeking solutions to protect companies and individuals. But security extends beyond cyberspace, in an increasingly risk averse society people want to feel safer and protect their families from physical and emotional harm.

In conclusion in volatile markets where share prices move violently it pays not to focus on what is happening in the short-term, or investing in "get rich quick" fads, but to seek longer-term trends that will provide investment opportunities for the mid to long-term investor.

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*This article was written by **Mr. Stephen Gunkel - Investment Writer at Pictet Asset Management***

PICTET 1805

ECONOMIC COMMENTARY AUGUST 2011

Stealing money from our children!

I write to you in the midst of the latest bout of market turmoil, caused this time by the perennial issue of sovereign debt. The FTSE 100 has so far fallen in value by 15% in the past four weeks over these fears and could well fall further along with other global stock markets, despite the best efforts of reassurance from policy makers.

American politicians squabbled amongst one another to the point at which Standard & Poor's lost patience and downgraded both their foreign and domestic credit rating, whilst European commentators now seem convinced that Italy and Spain are next in line for a hand-out.

Despite austerity measures being implemented, governments are still spending more than they have and as a result they still run an annual deficit and their debts are increasing. Economic growth will continue to be slow, and in a zero growth world, corporate profits are in danger of becoming increasingly dented.

Worryingly, the interest bills payable on sovereign debt are also increasing. For example, the UK pays some £44 billion a year in interest costs currently, but over the course of this parliament (until 2015) interest payments are set to eclipse defence spending and exceed more than half of the education budget. And this assumes that we, in the UK, do not lose access to cheap money in the manner of Greece, Portugal, Italy and Spain

In the US, interest rate payments are currently greater than federal-level education spending, but by 2015, will eclipse their welfare budget, coming in at an estimated $500 billion a year. Even with the recently agreed debt reduction deal, S&P's US downgrade note estimated that general government debt to GDP will continue to rise, with a pessimistic assumption giving a figure of 100% by 2021; it is clear that not enough is yet being done, and the political wrangling will no doubt continue through the upcoming election period.

This is money that is effectively being stolen from our children. They will have to pick up the pieces and suffer. Our generation has engaged in profligate spending at a personal, corporate and supranational level, run up unimaginably large debts, and it is the next generation that will have to bear the pain of reduced government spending, fewer jobs, higher taxes and less favourable retirement contracts in order to rectify the situation.

This is the background for this review.

Debts; The British public continues to reduce personal debt levels, both in terms of reduced spending and mortgage repayments. The government is now following suit. We still take the view that debts and mortgages should be repaid. After all, debt reduction is another form of saving – and one that leaves you less at the mercy of the banks.
Verdict: Repay Debts.

Cash; With lower than expected economic growth, interest rates are now no longer likely to rise in 2011, but we still expect an increase within 12 months – especially if the markets force governments to pay more to borrow. With inflation still running at 4.4% as at July, cash is still unattractive.

Verdict: cash will offer short term protection but, steer clear of fixed rate accounts of more than twelve months.

Other Defensive Assets: With worries over global stock markets and certain developed world sovereign debt, a flight to quality has once again taken place, with the value of UK government debt seeing a sharp increase recently, pushing yields ever lower - the same applying to investment grade corporate bonds. Fixed interest fund managers are being forced to purchase ever more risky corporate bonds to provide both capital growth and a decent yield, whilst several of our preferred 'savvy' fund managers have been running 'short' positions in developed world government debt for some time.

We remain convinced that when interest rates inevitably rise, and with inflationary pressures continuing, fixed interest government and corporate bond prices will fall.

We are still positive on index linked bonds which we believe can protect the value of your investments in real terms, though care must be taken as demand may be outstripping supply, pushing prices unnaturally high.

Verdict: Do not hold corporate and fixed interest government bonds, and continue to hold index linked government stock.

Commercial property: UK Commercial Property will be an excellent diversifier during the market turmoil, and whilst we will not continue to see the significant gains made through autumn 2009 and 2010, we still expect more modest returns of between 4-6% through 2011 and 2012. It will be important to prudently pick the correct funds to capture these returns and as such we will look to shortlist funds that are large, well diversified in both property type and geographically, relatively cash rich and with low vacancy rates.

Verdict: Neutral – continue to invest in funds as described above

UK Equity: As I write this the FTSE 100 stands at 5,120 in the latest intra-day figure, primarily over Eurozone and US economic fears. However, before these events, the FTSE 100 price/earnings ratio at around 11.5 was still low in historical terms, and today it stands even lower at 8.75.

Mega-cap companies look the most attractive prospect at the moment, and funds that primarily invest in this space take up some of the top positions on our shortlist. Mid-cap and smaller companies have outstripped larger company returns over the past 2 years and even taking into account the current blip, might have been in danger of becoming slightly overheated. We would still recommend investments in smaller and micro-cap companies, but only if inheritance or other tax benefits are available.

Verdict: Overweight – concentrate on larger cap companies with strong dividend streams to provide stability in volatile times.

Alternative Investments; This asset class covers many different investments, all designed to produce growth, but with varying degrees of capital protection. Unregulated products occupy this space, and these investments do not enjoy the same level of government backed protection as the regulated investments.

Verdict: Overweight: Concentrate on regulated funds; the top Absolute return investments and Cautious & Balanced managed fund managers with proven track records and prudent portfolios. Only invest in unregulated funds where they genuinely add to the diversification of the portfolio.

Overseas Equity: As with the UK, we believe overseas equity markets also look good value**.** We still hold the view that the emerging markets and commodity funds play an essential long-term part in building a balanced and diversified portfolio, however these funds have seen a reduction in their value as investors have taken profits after 2 years of stellar growth.

The US, Europe and Japan all have their macro economic woes, but the general consensus is that they are in good shape at a corporate level, with companies still enjoying high cash balances and historically low valuations.

There will be winners and losers through this decade, and we will only be looking for funds with a long track record of good performance, and manager stability. Again as in the UK, larger-cap companies with a strong dividend stream and good brand image are likely to provide stable growth in these times, and our shortlists show a bias towards this.

Verdict: Overweight – concentrate on larger-cap, global and regional equity income funds to provide more stable returns.

Risk Warning

Whilst we have mentioned a variety of market opportunities; investment or encashment in any area is very much dependent on client needs, objectives and attitude to risk. We encourage all readers to take advice before acting on the content of this publication. This publication is not intended to represent personal financial advice.

As is clearly evident from the above, past performance cannot be used as a guide to future returns and capital loss may occur in some of the sectors outlined earlier.

INVESTING IN SMALLER COMPANIES

Investing in equities always entails a certain degree of risk, as many will know having experienced the recent gyrations in the market. However, market risk is to some extent short term risk and a challenge for traders. At Hargreave Hale we prefer to invest for the medium to longer term in fundamentally strong businesses which have a track record of growing their earnings throughout the economic cycle.

Smaller companies are viewed by most asset allocators as higher risk than their larger brethren; this is because they are less liquid, have less diversified revenue streams, less international exposure, weaker management, and weaker balance sheets. However, whilst this view is technically correct, it is a generalisation. From a stock picker's view this perspective is nonsense as of the numerous listed smaller company stocks there are clearly some which defy these characteristics, and there are enough of them to construct a diversified portfolio. In addition, many smaller companies have the opportunity for substantial growth which more than compensates for additional risk.

As an asset class, smaller companies have over the longer term outperformed larger companies. This is because they are more geared to economic growth. Also, as Giles Hargreave (the CEO of Hargreave Hale) would say, 'Elephants don't fly'. What he means by that is that, it is clearly easier for a smaller company to grow its earnings by a multiple of its current size over several years, than a large multinational more mature company.

Examples of our successful investments include ASOS, a global on-line retailer of high street fast fashion, with a single warehouse in Barnsley. In 2007 the company had turnover of £42m, profits of £3m and a share price of approximately 120p. Scroll forward to 2011 and the company is looking at forecast turnover of £500m, profits of £38m and recently had a share price of £24. Importantly, due to its niche positioning, a first mover advantage, and flexible business model, the company continued to outperform expectations throughout the difficult market conditions of 2008 and 09.

Identifying these kinds of niche growth businesses is what our investment team is about. Our fund management team has nine full time executives, who typically meet 3 to 4 companies a day, assessing their prospects and cross-referencing findings with other stocks in the market. We screen companies, looking at the strength of cash flows and the vulnerability of earnings.

Whilst there are investment merits of a small company portfolio, there are also additional tax benefits. Many shares listed on the AIM market benefit from what is called 'business property relief'. Qualifying shares effectively fall outside one's estate for death duties if held for two years or longer at the date of death. Hargreave Hale manages a successful Inheritance Tax portfolio service for clients who want to invest part of their assets in the AIM market, as part of their IHT planning strategy. Careful selection of 20-30 lower risk Aim listed securities has proven over many years to be an effective investment strategy, irrespective of the additional tax perks.

Successful stock selection is never guaranteed, however careful portfolio construction, continued due diligence, an experienced team and a longer term horizon stack the odds in your favour. The Marlborough Special Situations Fund, a smaller company unit trust managed by Hargreave Hale, is the best performing UK equity fund since inception over ten years ago. In addition, over the last five years the Hargreave Hale IHT portfolios have risen by approximately 40%, in the face of a sharply declining AIM index (-26%) and also a decline in the FTSE100 (-9%).

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*This article was written by **Mr Richard Hallett - Investment manager for the Hargreave Hale Inheritance Tax Portfolio Service**.*

Hargreave Hale is one of the UK's leading investors in small and micro-capitalised companies, with a consistently excellent track record. They are our preferred Inheritance Tax stockbrokers and the Marlborough Special Situations fund is on our buy list within the UK Smaller Companies sector.

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