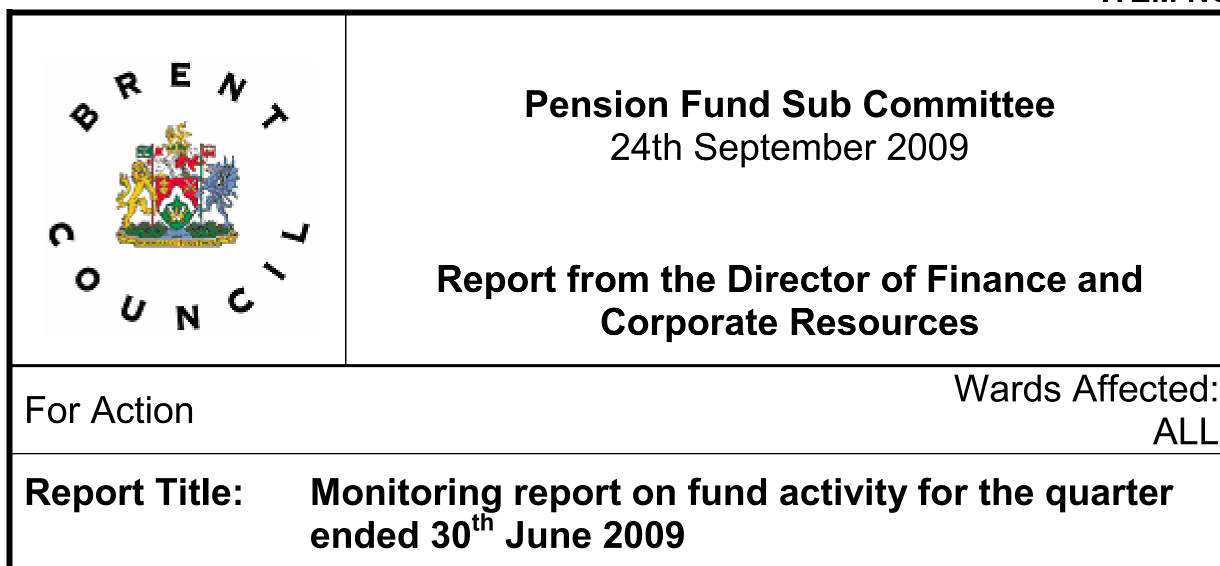
ITEM NO:8



Pension Fund Sub Committee
24th September 2009

Report from the Director of Finance and Corporate Resources

For Action	Wards Affected: ALL

Report Title: Monitoring report on fund activity for the quarter ended 30th June 2009

1. SUMMARY

This report provides a summary of fund activity during the quarter ended 30th June 2009. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:

a) Public equity and credit markets rose during the quarter, while private equity and property fell in value. Markets have continued to rise strongly during July and August.

b) Although performance is positive, the Fund has underperformed its benchmark over the quarter (2.7%) mainly as a result of underperformance in global equities and private equity, and asset allocation. The Fund also underperformed the average local authority fund (1.2%), again mainly as a result of poor performance in private equity . Over one year, the Fund has underperformed its benchmark (-7.7%) and the average fund (-7.8%) as a result of poor manager performance in fixed interest, global equities, currency and GTAA.

2. RECOMMENDATIONS

Members are asked to note this report.

3 DETAIL

ECONOMIC AND MARKET BACKGROUND - QUARTER ENDED 30TH JUNE 2009

3.1 All equity markets rose strongly during the quarter in the belief that the worst of the recession was passed. The UK rose by 8%, USA 15%, Germany 30%, and Japan by 23% . The UK economic background was:

- UK base rates remained at 0.5% as recession continued. Medium and long-term interest rates rose. However, credit markets have improved – LIBOR and LIBID have moved closer to bank rate. The Bank of England has increased its

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programme of Quantitative Easing (QE) to increase the money supply and credit.

- Headline inflation (RPI) fell by 1.6% in the year to June (-1.2% April), and the Index of Consumer Prices (CPI) rose by 1.8% (2.3% April). It is expected that RPI inflation will fall by around 1.1% in 2009 to reflect lower oil, commodity, and food prices.
- Average earnings growth (including bonuses) was 2.3% p.a. in June (1% March), well below the Bank of England's 'danger level' (4.5%). Unemployment is rising sharply – up by 281,000 in the three months to May.
- The UK economy is now in recession and GDP may fall by around 4% in 2009 (GDP fell by 2.5% in Q1 and 0.8% Q2) but rise by 0.5% in 2010 (and 1.5% in 2011). Leading indicators of recovery – such as consumer confidence, business confidence and new car registrations – indicate that the trough in the recession may have been reached.
- It has been anticipated that consumer spending will fall, though retail sales grew in the year to June (2.9%). A number of retailers have issued profit warnings or entered administration. The squeeze on incomes, and the decline in equity withdrawal from the housing market as prices fall, may further depress demand. House prices have fallen over one year (-6.2%), and mortgage approvals are only 60% of their level two years ago. Capital Economics expects house prices to fall by a further 10% in 2009, but there are also indications that the market is stabilising.

In summary, GDP has shrunk and interest rates are expected to remain low. The government is using both fiscal and monetary policy to combat the downturn. There are signs that the economy has 'bottomed out' in March / April, and recovery is expected to be slow, but sentiment has improved considerably.

3.2 Central banks have co-ordinated activity to supply liquidity to markets so that credit is available to support economic activity. It is expected that USA economic growth will slow by around -3% in 2009, though the Fed is more optimistic and expects growth in the second half of the year. The Fed has reduced rates to 0% - 0.25% and introduced a major programme of quantitative easing, as a response to market volatility, rising unemployment (9.5%) and slow growth. There is evidence that the USA housing market is starting to form a base, and that the USA economy may grow by 1% in 2010 (the Fed expects 2.1% - 3.3%) . The ECB has reduced rates to 1% and taken measures to improve banks' liquidity, but it is expected that Eurozone GDP growth will shrink by -5% in 2009 not grow in 2010. Growth in China and India will slow to around 7.5% and 6% respectively in 2009 following events elsewhere, but accelerate in 2010 to around 9% and 7% respectively. The world economy is expected to shrink by -2.5% in 2009, but grow by 2% in 2010.

3.3 A paper on market events and future prospects is attached, written by the Independent Adviser.

3.4 Table 1 below shows the changes in asset allocation, how asset allocation compares with the benchmark and with the average fund (WM Local Authority average), and how the change in the market value during the quarter is allocated across asset classes. Items marked (*) in columns 4 and 8 cannot be separately

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analysed, but are included elsewhere. The WM Local Authority average asset allocation indicates little change apart from market movements.

Table 1: Asset Allocation as at 30th June 2009 compared with the Benchmark

Market (1)	Market Value 31.03.09 £M (2)	Market Value 31.03.09 % (3)	WM LA Average 31.03.09 % (4)	Fund Benchmark 30.06.09 % (5)	Market Value 30.06.09 £M (6)	Market Value 30.06.09 % (7)	WM LA Average 30.06.09 % (8)
Fixed Interest							
UK Gilts	16.0	4.6	10.9	4.5	15.3	4.2	4.3
Corp.Bonds	23.6	6.8	*	4.5	23.3	6.4	4.9
IL Gilts	-	-	6.3	-	-	-	5.4
Credit alpha	4.5	1.3	-	1	5.1	1.4	-
Overseas	-	-	2.8	-	-	-	2.8
Emerg. Market	3.9	1.1	-	-	4.0	1.1	-
Infrastructure	1.4	0.4	-	0.5	1.4	0.4	-
Secured loans	15.6	4.5	-	5.5	18.4	5.0	-
Credit Opportunties	10.2	2.9	-	2	11.4	3.1	-
Equities							
UK FTSE350	80.9	23.3	31.5	19.5	93.7	25.6	31.0
UK Smaller co's	9.5	2.7	*	4.0	12.5	3.4	*
Overseas	59.6	17.2	31.3	27.5	69.0	18.8	31.9
USA	30.9	8.9	9.8	-	32.5	8.8	9.3
Europe	14.6	4.2	8.7	-	18.3	5.0	9.0
Japan	4.1	1.2	3.8	-	5.1	1.4	3.8
Pacific	4.3	1.2	3.4	-	5.0	1.4	3.7
Other	5.7	1.7	5.7	-	8.1	2.2	6.1
Other							
Property – UK	19.0	5.5	6.5	8.0	17.0	4.6	5.8
Property – Eu.	10.1	2.9	*	*	10.1	2.8	*
Hedge funds	36.9	10.6	1.8	10.0	38.8	10.6	1.8
Private Equity	31.8	9.2	3.3	8.0	25.6	7.0	2.9
GTAA	6.0	1.7	-	4.0	6.7	1.8	*
Cash	18.4	5.3	4.3	1.0	13.8	3.8	4.4
Total	**347.4**	**100.0**	**100.0**	**100.0**	**366.1**	**100.0**	**100.0**

3.5 The main changes have occurred as a result of sharp market movements (equities and credit) and the valuation of private equity funds. During the quarter, £1.74m was invested in private equity. It has been agreed that £0.75m should be returned from the fixed interest portfolio each month, and £2.5m per month invested in global equities. Since the end of the quarter there has also been further investment in private equity (£1m), but progress is slow.

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Performance of the Fund

3.6 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the quarter to 30th June 2009.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.06.09			Year Ended 30.06.09			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
UK Equities			11.1			-19.9	
UK Equities	11.7	10.5		-19.0	-20.5		FTSE 350
UK Small Caps	31.5	32.7		-22.1	-21.0		FTSE Smallcap ex IT
Global Equities	11.8	14.7	7.5	-35.5	-22.5	-18.2	FTSE World 75% Hedge
North America	-2.8	12.1	1.8	-28.8	-23.4	-14.5	FTSE USA
Europe	13.6	17.0	8.6	-22.7	-25.8	-20.3	FTSE Eu Ex UK
UK	8.4	10.9	11.1	-	-20.5	-19.9	FTSE All Share
Japan	10.9	16.3	7.0	-23.2	-26.1	-9.6	FTSE Japan
Pacific (ex Jap)	12.8	23.3	15.0	-15.2	-10.9	-7.9	FTSE Pac. Ex Jap
Other	22.6	8.8	14.9	-18.5	-11.5	-14.3	FTSE World (Other)
Fixed Interest							
Total Bonds	7.8	1.7	3.1	-1.3	7.4	4.1	Brent benchmark
UK Bonds	-1.0	-1.6	-0.3	9.5	6.7	7.0	FTSE UK All Gilts
Index Linked UK	-	-	3.9	-	-	0.5	-
Corp Bonds	5.7	6.4	9.2	7.1	1.3	-0.5	ML Sterling Non-gilt
Secured Loans	18.8	1.2		-13.3	7.1		3 month LIBOR +3%
Credit Opportunities fund	12.7	1.2					3 month LIBOR+3%
Other							
UK Property FOF	-10.1	-7.1	-4.2	-30.5	-25.5	-27.4	IPD All Properties
Eu Property FOF	-0.2	-7.1		8.5	-25.5		IPD All properties
Hedge Funds	5.2	1.3	3.2	-8.9	7.4	-13.8	3 month LIBID+4%
Private equity	-26.7	0.1	-11.6	-11.4	2.4	-9.5	LIBID 7 Day
GTAA	13.2	9.7		-57.6	-20.9		FTSE 100
Cash	-0.5	0.1	1.1	n/a	2.4	2.6	GPB 7 DAY LIBID
Total	**5.2**	**7.9**	**6.4**	**-21.4**	**-13.7**	**-13.6**	

3.7 Details of individual managers' performance tables are attached in Table 3, which shows three month, one year and three year information. Returns for the quarter were positive, but underperformed the benchmark by 2.7% as a result of asset allocation (mainly lower exposure to equities and higher exposure to fixed interest and cash) and stock selection (global equities, private equity and property). The main stock selection factors were:-

a) Fixed interest. Once again there was outperformance in government and corporate bonds as the manager overweighted the fast recovering corporate bonds. Secured loans and the Credit Opportunities Fund also recovered in improving credit markets – the funds are well placed for further growth.

b) UK FTSE350 Equities added value as the portfolio outperformed the index.

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c) Hedge fund of funds outperformed as macro, multiple strategy and equity related strategies were successful.

d) GTAA. The manager outperformed as three of the strategies – equity against bond, bond against bond and currency – have been successful. Bond market stock selection has lost money, but some of the positions have improved in July.

e) Global equities underperformed the benchmark through a combination of underweighting emerging markets (which rose sharply) against the FTSE World index, financials and materials. It appears that the sectors that undermined performance in 2008, causing AllianceBernstein to reduce exposure, recovered last quarter. However, AllianceBernstein have outperformed the average manager through additional exposure to emerging markets against the MSCI and the impact of the currency hedge as sterling rose.

f) Property. There are indications that the UK market may stabilise in 2009 – the current market yield looks attractive when compared to bank rate and gilt yields, though returns are now falling as vacancies increase..

g) Private equity. The value of the portfolio has been sharply reduced as new valuations better reflect falling public markets and the prices on offer for secondaries. Investment activity has been reduced by the declining availability of credit. Some giant funds, such as Permira, are working to preserve cash as selling opportunities are reduced.

3.8 Over one year, the Fund underperformed the benchmark by 6.7%. Asset allocation – lower exposure to equities, exposure to alternatives - has been positive. The main stock selection factors were those that impacted previous quarters. First, the sub prime and credit crises that undermined financials in Global equities, and the Henderson Secured Loans and Absolute Return Funds. Second, poor performance in both currency and Global Tactical Asset Allocation. Poor performance in currency was caused by the market moving away from fundamentals, the rise in the value of commodity currencies and the failure of the model to forecast interest rate changes. Poor performance in GTAA was mainly caused by currency losses and forecasts that equities would outperform bonds. Hedge funds suffered in the market turbulence surrounding the collapse of Lehman Brothers. Private equity is also suffering as funds are valued to reflect the sharp declines in public markets.

3.9 The relative underperformance of the Brent fund against the WM Local Authority average over the quarter derives from the factors set out in paragraph 3.8, the main influence being the asset allocation followed by the Brent Fund.

3.10 The Brent fund has underperformed the average local authority fund by 6.8% over one year for the reasons set out in paragraphs 3.8 and 3.9.

Actions taken by the Brent In-House UK Equity Manager during the Quarter

3.11 There has been little activity during this quarter as markets remained volatile. Some dividends (£0.95m) have been reinvested as markets fell.

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Purchases

a) Purchased stocks to ensure more accurate index tracking (such as Fresnillo and Pace).
b) Took up rights issues, such as 3I, DSG and various property groups.

Sales

a) Sold stocks to ensure more accurate index tracking or as they left the index (Thompson-Reuter)

Future Strategy for the UK FTSE350 Index tracking fund

3.12 The strategy is that of tracking the FTSE 350 within 0.5% over the year. Activity during July and August included taking up rights issues.

NEW DEVELOPMENTS AND FUTURE INVESTMENT OUTLOOK FOR THE BRENT FUND

3.13 Following members' agreement to appoint July, the Brent Pension Fund has joined the Alinda Infrastructure Fund. It is anticipated that the first investment in the Fund, expected to be around 25% of commitment (£6m) will be called in September / October.

3.14 Equity markets have risen during July and August as investors have focused on low share prices and the belief that the worst falls of the recession may have occurred. Other markets, particularly credit markets, have also improved as low interest rates and quantitative easing make riskier assets attractive.

3.15 Fauchier Partners expects opportunities to arise in distressed asset backed and commercial debt. The property manager expects UK commercial property prices to begin to stabilise, but that falling rents as a result of declining economic activity will undermine returns. However, the freeze in purchase and sale of units has ended, enabling Brent to resume reinvestment of dividends. The manager also expects the European market to continue to fall. The UK small company manager, Gartmore, expects excellent opportunities in individual stocks, and is optimistic. The private equity manager, Capital Dynamics, reports that investment activity has slowed sharply and that valuations have reduced to reflect falling equity markets. However, there should be opportunities in secondary investments (existing funds purchased from investors). The fixed interest manager believes that there are good opportunities in corporate bonds and secured loans, but a potential bubble in government bonds as issuance increases.

3.16 Henderson have reported that their Infrastructure Fund is experiencing considerable difficulties. The Brent Fund invested £1.9m in the Infrastructure Fund in 2006, initially with good results. However, officers have been aware that Henderson took part in a bidding battle to buy the main asset – John Laing, formerly a FTSE250 company – and paid a very high price for control. This year the Infrastructure Fund has been hit by a series of issues – the pension fund deficit which led to the value of the investment being marked down by 38% in March, the

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cancellation of various sales because bid prices are very low, the requirement to repay or refinance debt (caused by the inability to sell assets), and the requirement to value assets at current market prices. It is likely that the requirement to value assets at current market prices will lead to a further severe mark down.

3.17 As expected, investment analysts are becoming more confident about the future progress of markets. It is felt that the world economy will grow in 2010. However, it is anticipated that growth will be slow, and that hopes of sharply rising profits may prove over optimistic.

4. FINANCIAL IMPLICATIONS

These are contained within the body of the report.

5. STAFFING IMPLICATIONS

None directly.

6 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8. BACKGROUND INFORMATION

AllianceBernstein – June 2010 quarter report.
Henderson Investors – June 2010 quarter report
WM Annual report for 2008/09.
Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, 020 8937 1472/1473 at Brent Town Hall.

DUNCAN McLEOD
Director of Finance & CR

MARTIN SPRIGGS
Head of Exchequer and Investment

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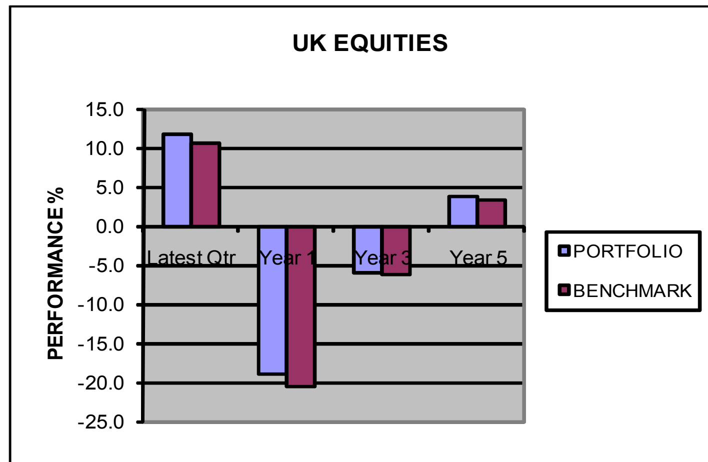
PERFORMANCE FOR INDIVIDUAL PORTFOLIOS 30th June 2009

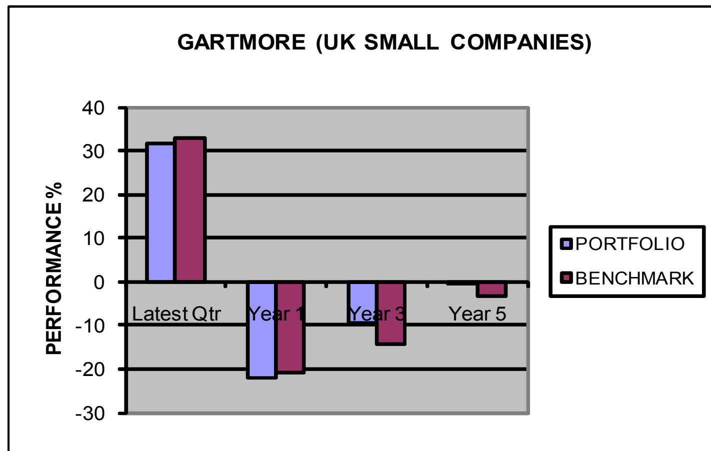
UK EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	11.7	10.5
Year 1	-19.0	-20.5
Year 3	-6.0	-6.3
Year 5	3.7	3.2



GARTMORE (UK SMALL COMPANIES)

	PORTFOLIO	BENCHMARK
Latest Qtr	31.5	32.7
Year 1	-22.1	-21.0
Year 3	-9.4	-14.2
Year 5	-0.05	-3.5



ALLIANCE BERNSTEIN - GLOBAL EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	11.8	14.7
Year 1	-35.5	-22.5
Year 3	-14.0	-7.5

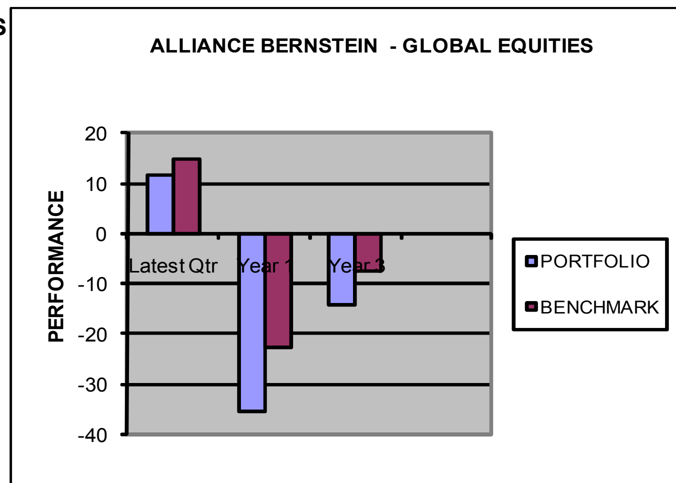


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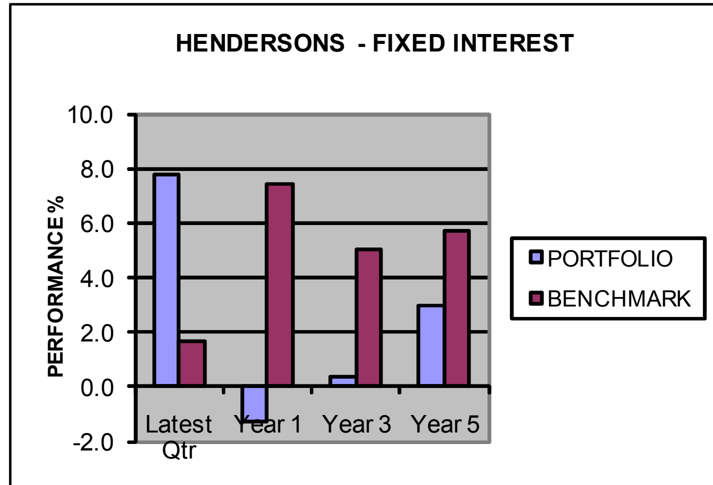
Table 3

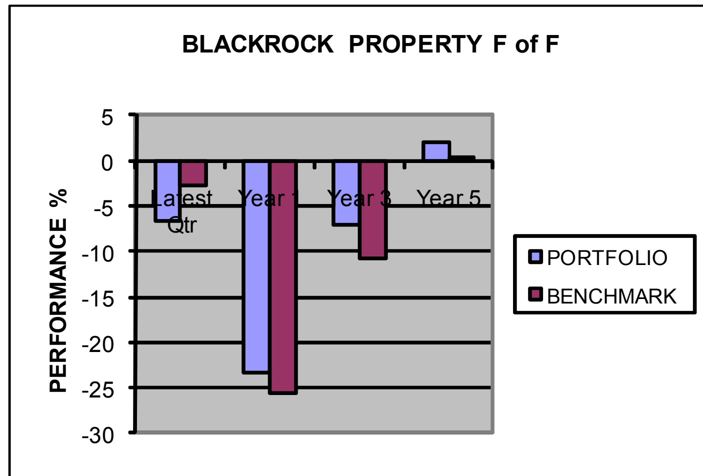
HENDERSONS - FIXED INTEREST

	PORTFOLIO	BENCHMARK
Latest Qtr	7.8	1.7
Year 1	-1.3	7.4
Year 3	0.4	5.0
Year 5	3.0	5.7



BLACKROCK PROPERTY F of F

	PORTFOLIO	BENCHMARK
Latest Qtr	-6.7	-2.7
Year 1	-23.4	-25.6
Year 3	-7	-10.7
Year 5	2.1	0.3



FAUCHIER - HEDGE FUND

	PORTFOLIO	BENCHMARK
Latest Qtr	5.2	1.3
Year 1	-8.9	7.4
Year 3	5	8.6

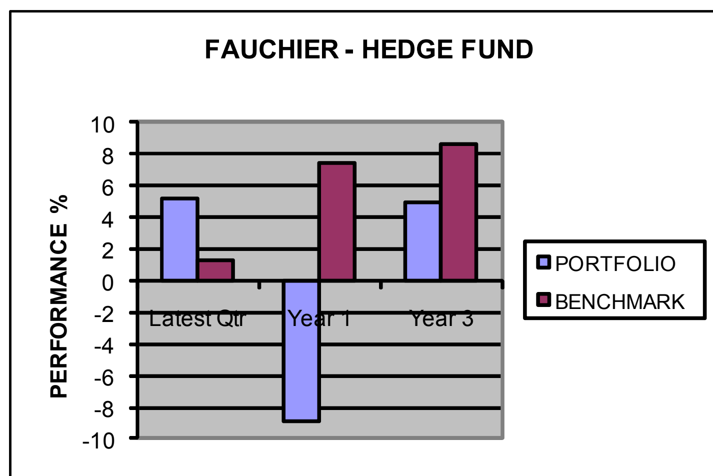


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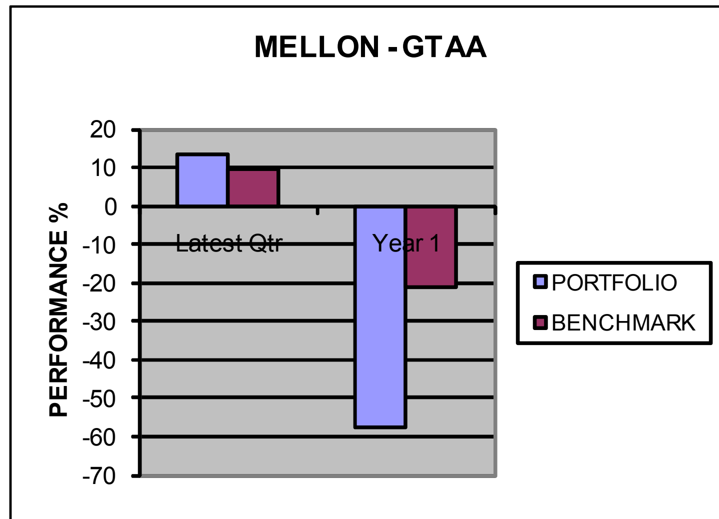
Table 3

MELLON - GTAA

	PORTFOLIO	BENCHMARK
Latest Qtr	13.2	9.7
Year 1	-57.6	-20.9



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Report from the Independent Adviser

Investment Report for the Quarter ended 30th June 2009

Market Commentary

	Index returns expressed in sterling	Quarter ended 30th June 2009
		%
Equities		
Emerging Markets	MSCI Emerging Markets Free	17.4
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	16.2
UK	FTSE All Share	10.9
Europe	FTSE Developed Europe (ex UK)	9.7
Japan	FTSE Developed Japan	7.0
North America	FTSE North America	1.8
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	6.7
UK Index Linked Gilts	FTSE British Government Index Linked Over 5 years	3.5
UK Gilts	FTSE British Government All Stocks	-1.3
Property	CAPS Property	-4.8
Cash	LIBID 7 day return	0.1

Currency Movements for quarter ended 30th June 2009

Currency	31st March 2009	30th June 2009	Change %
USD/GBP	1.433	1.647	+14.9
EUR/GBP	1.080	1.174	+8.8
USD/EUR	1.328	1.403	+5.6
YEN/USD	98.770	96.485	-2.3

As depicted in the table above, on the whole equity index returns for the reported quarter were surprisingly robust. Emerging markets (+17.4%) and Asia (+16.2%) were particularly strong with North America the clear laggard at +1.8%, clearly influenced by the strength of sterling over the quarter. Within the fixed interest classes both corporate bonds (+6.7%) and UK index linked gilts (+3.5%) flourished whilst gilts came in at a disappointing third, down -1.3%. No doubt affected by the Government's adherence to its quantitative easing programme, a printing money exercise by any other name. The currency movement table shows the strength of sterling up 14.9% against the US$ and 8.8% against the Euro. Property (-4.8%) continued to languish as it plumbed the depths of its most severe down cycle.

One of the principal propellants behind the strong equity performances was the very low returns available on cash deposits and savings accounts which caused both institutions and private individuals to commit some of their liquidity to the equity market place, often in high quality shares with yields in excess of 5.0%. Investors had also become nervous at being out of the markets for too long lest they should miss the vital turning point in the recession cycle heralding a genuine recovery in economies and underlying share values. Additionally, macro economic data and forecasts from respected institutes and

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central banks caused investors to understand that, although economic growth rates were still falling, they were declining at a much lesser rate than last year. And the most important influence of all was the perception that the amalgam of reduced rates of taxation, low interest rates and, enormous concerted central bank support programmes, including quantitative easing was at long last having a remedial effect on economies. By way of illustration current central bank interest rates are as follows:-

	%
USA FED	0-0.25
ECB	1.0
Bank of England	0.5
Switzerland	0-0.75
Japan	0.10

There has been a tangible easing in volatility. In short, alarms of a deep depression with all that entailed have lessened and the duration of the current recession is generally being estimated to be shorter than was at once feared, when the monetary and market systems both in the UK and globally, appeared to be on the edge of an abyss.

UK

Positive Influences

- The manufacturing purchasing managers' index for June increased to 47.0 from the 45.9 recorded in May.
- House prices rose by 1.2% in April.
- The British Retail Consortium reported a rise of 3.2% p.a. in June retail sales (May +0.8% p.a.).
- The purchasing managers' index for the services sector rose to 51.7 in May from 48.7 in April, the sixth consecutive monthly rise.
- The Bank of England's mortgage approvals for house buying grew to 43,000 in April, an improvement on the 40,000 recorded in March. This was the third consecutive monthly rise.
- The Office of National Savings said April retail sales returns expanded by 2.6%. This was higher than consensus economists' predictions.
- Corporate investment receded by 8.4% in the year to April 2009.
- June CPI reduced to 1.8% from 2.2% in May against the Bank of England's target of 2.0%.

Negative Influences

- In the three months to May unemployment rose by 281,000 to a 13 year high of 2.38M, the largest quarterly increase since records began in 1971.
- The OECD estimates that the UK economy will contract by 4.3% in 2009 and expects "modest growth in 2010". On 13th May Mervyn King gloomily stated "the risks are weighted towards a relatively slow and pedestrian recovery". He added "there are pretty solid reasons for supposing there will be a recovery next year, but also reasons for questioning if this will be sustained".

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- On 22nd May British Airways scrapped its dividend policy and gave no profit guidance. Other companies to cut their dividends were Marks & Spencer and BT.
- The Financial Times house prices index fell 0.3% in June or 13.1% p.a.
- GDP growth for the first quarter of 2009 was revised down to 2.4% from the previous estimate of -1.9%.
- Manufacturing output decreased by 0.5% in May, equivalent to a fall of 13.7% annualised. This was weaker than expected.
- The Bank of England, through its quantitative easing programme, as of 31st May, now owns £103B of tradable gilts, equivalent to 15% of the whole gilt market. This is the most aggressive programme of any of the leading central banks. By way of comparison, the Federal Exchange Board owns just 3.0% of US Treasury stock.
- It is estimated that one in ten borrowers with good credit records are trapped in negative equity according to the Fitch rating agency. The UK has the largest number of negative equity positions and repossessions in Europe.
- On 24th June Mervyn King, the governor of the Bank of England, insisted that the Government's "extra ordinary and enormous levels of borrowing" had to be reduced at a faster rate than the government planned.
- The highly indebted West Bromwich Building Society is struggling to retain its independence.
- The Standard & Poors credit ratings agency cut its economic outlook from stable to negative, stating worries over the Government's mounting debt. The agency placed the UK on "negative watch" due to the poor state of the county's public finances. It also worried that the UK might lose its triple A credit rating which would of course result in higher borrowing costs for the British Government.

USA

Positive Influences

- The Treasury ordered certain large banks to submit to stress tests with Tim Geithner, the Treasury Secretary, reportedly stating "these tests will help ensure that banks have a sufficient capital cushion to continue tending in a more adverse economic scenario".
- The Institute for Supply Management's (ISM) manufacturing index recorded 47.0 in June, up from 44.0 in May. This was better than forecast.
- First quarter GDP growth was revised up to -5.5% from -6.1%. By contrast, GDP growth in the fourth quarter of 2008 was a negative 6.3%.
- May housing starts advanced by a surprisingly robust 17.2%. In that regard Bernanke said "there are signs of bottoming in the housing market".
- The Federal Reserve Board "continues to anticipate that economic conditions are likely to warrant exceptionally low levels of federal funding interest rates for an extended period".
- Retail sales were up 0.5% in May.
- Pending house sales increased by 6.7% in April, the biggest gain for more than 7 years.

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Negative Influences

- 467,000 jobs were lost in June versus a consensus estimate of 350,000. The underlying rate of unemployment rose to 9.5% from 9.4% in May, the highest rate for 26 years.
- The Conference Board's index of consumer confidence fell markedly to 49.3 in June, down from 54.8 in May.
- The state of California is grappling with its most severe financial crisis as its governor Schwarzenegger addresses a $26B deficit. The state has resorted to issuing IOUs. As a consequence the Fitch rating agency has downgraded California to A minus.
- May industrial production receded by 1.1% in part due to car plant closures.
- May consumer prices rose a minuscule 0.1% which was below market expectations.
- Bernanke, the governor of the FED cautiously state "a US recovery will only gradually gain momentum".
- On 1st June General Motors filed for Chapter 11 bankruptcy.
- Producer prices in June rose 1.8%, well ahead of estimates and largely due to an 18.5% lift in petrol prices.

Europe

Positive Influences

- German manufacturing orders for May increased by 4.4%, much better than the consensus forecast of+0.5%.
- German industrial production increased by 3.7% in May, but on an annualised basis, it was down by 17.9%.
- The IFO Institute's German business climate index advanced to 85.9 in June from 84.3 in May.
- The Eurozone purchasing managers' index for May increased to 42.4 from 40.7 in April.
- The OECD estimates that Italy's GDP will grow by 0.4% in 2010 versus a previous estimate of -0.4%.
- On 7th May the ECB cut interest rates by ¼% to 1%.
- On 11th May Mr Trichet, governor of the ECB, said many Eurozone countries had now seen the worst of the recession. He stated "in all cases we see a slowing down of the decrease in GDP".
- The ECB lent €375B to more than 1,100 banks in an attempt to unlock credit markets.
- On 7th May the ECB cut interest rates by ¼% to 1%. However, on 4th June the ECB left interest rates unchanged with Trichet, the governor, predicting positive Eurozone growth by the middle of 2010. Nevertheless, he warned on rising unemployment.
- Industrial production in the Eurozone increased by 0.5%, below most expectations.
- Eurozone inflation in May dropped to zero, (April +0.6%), the lowest rate since 1991.

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- Consumer spending in April on manufacturing goods rose 0.7%, better than expected.

Negative Influences

- The Spanish government estimates that the economy will shrink by 3.6% in 2009 and by 0.3% in 2010.
- The Bundesbank estimates that German GDP will fall by 6.2% in 2009.
- Eurostat reported that the Eurozone's unemployment rate in April increased to 9.2% (March 8.9%).
- Swiss GDP for the first quarter of 2009 fell 0.8% making a fall of 2.4% for the year, the biggest drop since 1976.
- Swiss exports in the first quarter of 2009 fell 5.4% (quarter four 2008 -8,7%).
- Russia's economy contracted by 10.1% in the first half of 2009.

Japan

Positive Influences

- Industrial output in May increased by 5.9%, the highest rise recorded since March 1953. However, on an annualised basis the drop was a marked 29.5%.
- April retail sales increased 0.6%.
- Despite its own recession Japan felt able to offer $100B to those Asian states most affected by the financial crisis.

Negative Influences

- There are countless calls for the prime minister Aso to step down to make way for a stronger candidate ahead of the forthcoming election which has to be held before October. Currently the Democratic party is making large inroads into the ruling Liberal Democrats.
- May exports fell no less than 41%p.a. largely due to the collapse in markets for electronics and cars.

Asia

Positive Influences

- China has demonstrated that it is likely to become the world's largest exporter. This will further highlight the importance of its currency the renminbi.
- China's industrial production in May expanded at a rate of 8.9% p.a. (April 7.3% p.a.) whilst retail sales grew more strongly by 15.2% p.a. (April 14.8% p.a.).
- China's June exports increased 7.5%.
- China's June car sales increased by an enormous 48% p.a.
- The Hong Kong authorities introduced additional economic stimulus measures of £1.4B.
- On 18th May, in the Indian parliamentary elections, the Congress Alliance won a second term of office. On this news Mumbai's stock market advanced 17.0%.

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- Australia's GDP in the final quarter of 2009 grew by 0.4%, helped by strong exports.
- Whilst Singapore's second quarter GDP dropped by 3.7% this was a considerable improvement on the first quarter's fall of 9.6% p.a. The Government is now estimating a fall in GDP of 4 to 6% in 2009 versus its previous estimate of a fall of 6 to 9%.

Negative Influences

- The Malaysian government estimates that its economy is likely to shrink by 5.0% in 2009.
- Singapore's first quarter rate of GDP collapsed at an annual rate of -10.1%. Its government has estimated that the nation's rate of GDP is likely to contract in 2009 in the range of 6.0 to 9.0%.

Conclusion

At some stage the vast array of emergency measures across the world will have to be unwound. This process will embrace debt repayment by governments, banks, corporations and consumers. In other words it is pay back time and this deleveraging programme will be both painful and lengthy – possibly more lengthy than markets are currently discounting. Certainly governments will implement heavy tax rises and severe cut backs in public spending.

As time goes by, if macro economic data improves then in turn the investor appetite for risk may also improve. Particularly if it can be seen that the global economic recession has indeed moved past its low point. Certainly there are a few mildly encouraging straws in the economic wind. Namely OPEC has stated "we are beginning to see light at the end of the tunnel" and has forecast a price in the region of $75-80 a barrel with demand expected to pick up from China, India and Asia. Also the Baltic Dry Index, a usually reliable barometer of world trade, at the end of May jumped 7.6% through the 3000 mark for the first time since October due, in part, to increased transport demand for iron and coal. However, on the bear tack, the World Bank estimates that the global economy will shrink by 2.9% in 2009 versus its previous estimate of a 1.7% contraction. When economic growth eventually emerges it will be led just as much by China as by the USA. It is significant that in the recent past, whereas the economies of the USA, UK, Europe and Japan have ostensibly shrunk into recession, those of China and India have continued to grow, albeit at a lesser rate than in the past. There seems little doubt that the baton of world economic leadership will, in the future, most surely pass from the Western Hemisphere to that of the East.
On the currency front, sterling is likely to suffer erosion as it is recognised that the state of the UK economy is one of the very worst of the industrialised nations and will take the longest time to recover. The US dollar could also come under pressure, although to a lesser extent than sterling.

Another prerequisite for an improvement in investor sentiment is to be assured that governments and central banks have at last been successful in pressuring the banks to finally recommence lending to credit starved companies and to cash starved individuals, thereby at last unclogging the national arteries for supplying a much needed life blood transfusion to the financial system. Only then will the scene be set for an improvement

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in the investment landscape embracing equities, property, private equity, hedge funds and other alternatives. All these asset classes have been so badly damaged by a lack of liquidity.

It is a fool's game to predict that it is possible to accurately deduce the bottom of the market as no celebratory flag gets raised. That said, if the economies of the leading industrialised nations start to exhibit genuine and consistent rates of recoveries, most likely at the start of next year, then this could start to be discounted by stock markets in the final quarter of this year. Until then beware of false dawns and bear market rallies. The old adage will be more important than ever before – caveat emptor!

Valentine Furniss

Investment Report for the month of July 2009

	Index returns expressed in sterling	Month ended 31st July 2009
		%
Equities		
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	10.8
Emerging Markets	MSCI Emerging Markets Free	10.6
Europe	FTSE Developed Europe (ex UK)	10.4
UK	FTSE All Share	8.5
North America	FTSE North America	7.2
Japan	FTSE Developed Japan	3.4
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	2.7
UK Gilts	FTSE British Government All Stocks	-0.8
UK ILGs	FTSE British Gov. Index Linked Over 5 years	-1.0
Property	Caps Property	N/A
Cash	LIBID 7 Day	0.03

Currency Movements for month ended 31st July 2009

Currency	30th June 2009	31st July 2009	Change %
US $/£	1.647	1.658	+0.7
Euro/£	1.174	1.169	-0.4
US $/Euro	1.403	1.418	+1.1
Yen/US $	96.485	95.195	-1.3

The return tables above for the month of July demonstrate that equity markets have continued the very strong momentum of the quarter to 30th June 2009. Asia/Pacific, Emerging Markets and Europe led the way with double digit returns followed by a 8.5% return from the UK. The return from North America was also buoyant and even Japan managed a 3.4% return. Within Fixed Interest only corporate bonds managed a positive return with both index linked gilts and pure gilts disappointing with negative returns – scarcely surprising with all the Bank of England machinations regarding increased quantitative easing and other pseudo sophiscated ploys. No return for property was available for the month, but suffice it to say that, when it is published, it will almost certainly be marginally negative. Hedge fund of funds, although not shown in the table, continued to provide a worthwhile positive return, thus proving their worth as a form of portfolio insurance in all market conditions.

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Influences of a general nature during the month were as follows:-

- Fears that interest rates might rise in the longer term together with inflation and government budget deficits.
- Investors with an increasing appetite for risk being prepared to switch substantial amounts of liquidity from very low yielding money market funds and deposits into equities.
- Reported corporate earnings being generally been higher than expected together with accompanying statements suggesting the worst is over with improving second half outlooks. In certain areas earnings have been boosted by a rush to replenish corporate inventories which had been allowed to sink to unrealistically low levels.

Macro economic data and events from the regions were:-

UK

- Due to the extremely weak state of the nation's public finances there has been an increasing pressure for investors to sell both gilts and sterling. Furthermore, concerns regarding an oversupply of gilts has caused investors to switch their holdings to high quality corporate bonds.
- The growth of GDP in the second quarter of 2009 was much worse than expected in recording a 5.6% drop. In part this awful figure was due to dire conditions in the service industry.
- On 9th July the Bank of England held interest rates at ½% and announced no further expansion of its controversial quantitative easing programme (printing money).

- The National Debt service line said that it had received a record number of calls from consumers worried about credit card arrears. Scarcely surprising as the UK consumer is one of the most indebted in the world, with the possible exception of the USA.
- The Land Registry index for house prices rose by a miniscule 0.1% in June. This was the first rise since January 2008. This could indicate that the market is bottoming out.
- The purchasing managers' service sector index increased to 53.2 in July from 51.6 in June.
- In July new car registrations grew by 2.4% to 157,149, the first rise since April 2008 in part due to the government's car scrapping incentive.
- The British Retail Consortium reported that July retail sales increased by 3.6% p.a. (June +1.2% p.a.).
- In the second quarter of the year 33,073 people in England and Wales became insolvent this represented an annualised rise of 27.4%, the highest figure since records began in 1960.

USA

- Existing home sales were up by 3.6% in June, the third successive monthly rise.

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- Over the corporate reporting season the majority of companies have exceeded earnings expectations and have been appreciably better than expected. A reflection no doubt of the speed at which US companies are able to cut costs and boost productivity in weakening economic conditions. Sadly this has a social cost in rising unemployment levels and concerns over job security.
- On 13th July Tim Geithner, secretary of state, said “policy has been very successful in arresting and mitigating the force of the storm and we are starting to see a better basis for recovery”.
- On 17th July CIT (a large US company lending to small businesses) announced it was facing bankruptcy and would most likely file for Chapter 11.
- On 21st July Bernanke of the FED stated, in his biennial report to Congress, “I want to be clear that we have a very long haul here because even if the economy begins to turn up in terms of production, unemployment is going to stay high for quite a while. So its not going to feel like a really strong economy.
- On 23rd July the Dow Jones industrial index advanced strongly through 9000, buoyed by better than expected corporate earnings.
- On 29th July the Federal Reserve’s Beige Book (depicting a picture of the economy) suggested that overall economic activity has stabilised at a low level versus June’s report which showed that economic conditions had been weakening.
- House prices grew by 0.5% in May, but were down 17.1% on an annualised basis. This was the first monthly rise in prices since the peak in July 2006.
- The Conference Board’s index of consumer confidence in July receded to 46.6 from 49.3 in June.
- New home sales advanced by 11.0% in June.
- Car sales in July were up a marked 16.0% due to the government’s scrappage initiative.
- Second quarter GDP growth was -1.0% versus a negative 6.4% in the first quarter.
- The IMF estimates that US GDP will only grow by a meagre 0.8% in 2010.
- The Institute for Supply Management’s non manufacturing index eased to 46.4 in July from 47.0 in June.
- Job losses in July were 247,000 compared with a consensus estimate of 320,000. The unemployment rate slipped from 9.5% in June to 9.4% in July.

Europe

- France’s purchasing managers’ index eased fractionally to 47.2 in July from 47.8 in June.
- Germany’s composite index of manufacturing and services increased strongly to 48.9 in July compared with 44.0 in June.
- Germany’s IFO Institution’s business climate index advanced to 87.3 in July (June 85.9).
- German exports in June rose 7.0% whilst industrial orders increased by an unexpectedly strong 4.5%.
- German unemployment in July was unchanged at 8.3% which was a better result than expected.
- Sweden’s trade surplus in June expanded to SK17.3B (May SK9.7B) due to the marked growth in exports as a result of the Krona’s weakness.

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- Spanish GDP for the second quarter of 2009 fell 0.9% (first quarter -1.9%).

Japan

- On 13th July the prime minister, Taro Aso, announced a general election for August 30th. This could easily prove to be political suicide both for him and his Liberal Democratic Party who have been dominant for so long.
- June machinery orders rose by 9.7%.

Asia/Pacific

- India's central bank warned that inflation could rise to 5.0% by March 2010.
- China's foreign exchange reserves reached £1,307B at the end of June reflecting a robust economy which proved highly attractive to foreign investors. Indeed, there are distinct signs that China will use its foreign exchange reserves (the largest in the world) to make further investments and acquisitions overseas.
- China's second quarter GDP growth was 7.9%, very close to the government's declared target growth of 8.0% for 2009 as a whole.
- Indonesia's second quarter GDP rate grew by 4.0% p.a. (first quarter +4.4% p.a.).

Conclusion

In the recent past some investors have been carried on a wave of flawed optimism, assuming some magic wand will, in the near future, restore economies to their erstwhile pre credit crunch strength. This optimism has translated into higher equity market values. For instance, the FTSE 100 index, over 11 consecutive sessions to 27th July, rose by 10.6%.

In the less optimistic camp investors have adopted a more realistic attitude suggesting markets are not out of the bear woods yet and that there is still more bad news to be announced concerning the debt levels of governments, corporations and individuals, particularly in the UK with the appalling state of its public finances. At the time of writing, this former camp of investors are having the greater influence in stock markets and have demonstrated that they are increasingly prepared to look across the valley of economic despair to the better times they envisage next year.

Taking into consideration the strong equity market returns for the month of July, nothing of sufficiently material impact has occurred to alter the principal conclusions reached in the report for the quarter ended 30th June 2009. That is to say, a sustained recovery in markets will most likely have to await the final quarter of the year in anticipation of positive increases in respective rates of GDP growth in the first quarter of 2010. As mentioned before, rates of GDP growth in the Western Hemisphere countries of the USA, the UK and the Eurozone nations will probably be somewhat anaemic compared with the more positive growth rates of China, India and other emerging markets. Japanese growth is likely to be distinctly lacklustre. With regard to other asset classes, fixed interest returns could well be flat (with the exception of corporate bonds), the property down cycle is not over yet, private equity will continue to suffer from both lack of investor interest together with a scarcity of liquidity. Hedge fund of funds should continue to prove their worth and build on their

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good performances so far in 2009. There will also be attractive opportunities in infrastructure. It is currently fashionable to predict which letter of the alphabet will best describe the course of economic recovery? A shallow shaped U most probably, as opposed to the W which the majority of economists are currently expecting. However, it should be emphasised that most of the economic forecasts made over the last 6 months have often proved to be wide of the mark. Hence the current forecasts should be taken with a proverbial pinch of salt.

In summary it should be stressed again that it will be many years before the current levels of government, corporate and consumer debt are paid off. In the shorter term markets will also have to contend with the harrowingly high rates of unemployment and the consequently poor sentiment that this brings both for nations and individuals.

Valentine Furniss
12th August 2009

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