ITEM NO: 7

BRENT COUNCIL	**Pension Fund Sub Committee** 24th November 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 September 2009**

1. SUMMARY

This report provides a summary of fund activity during the quarter ended 30th September 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 sharply during the quarter, while private equity fell in value. Equity markets fell marginally during October.

b) The Fund has grown in value from £366m to £418m, and has outperformed its benchmark over the quarter (0.7%) mainly as a result of improved performance in global equities, GTAA, fixed interest and hedge funds. The Fund underperformed the average local authority fund (2.7%), as a result of lower exposure to equities. Over one year, the Fund has underperformed its benchmark (-4.1%) and the average fund (-8.5%) as a result of poor manager performance in global equities, fixed interest, currency and GTAA.

2. RECOMMENDATIONS

Members are asked to

a) Amend the benchmark and currency discretion used in the fixed interest portfolio, as set out in paragraph 3.14, and to
b) Note this report.

3 DETAIL

ECONOMIC AND MARKET BACKGROUND - QUARTER ENDED 30TH SEPTEMBER 2009

3.1 All equity markets, apart from Japan rose strongly during the quarter believing that the worst of the recession has passed. The UK rose by 21%, USA 15%, Germany 28%, HongKong 14% and Japan by 2% . The UK economic background was:

- UK base rates remained at 0.5%. Medium and long-term interest rates fell marginally. Credit markets have improved – LIBOR and LIBID have moved closer to bank rate. The Bank of England has extended its programme of Quantitative Easing (QE) to increase the money supply and credit.
- Headline inflation (RPI) fell by 1.4% in the year to September (-1.3% August), and the Index of Consumer Prices (CPI) rose by 1.1% (1.6% August). It is thought that this is the low point in the current cycle, and that the VAT increase back to 17.5% and rising fuel costs will increase CPI inflation to around 2% for 2009. However, it is anticipated that inflation will fall again in H2 2010.
- Average earnings growth (including bonuses) was 1.6% p.a. in August (2.3% June), well below the Bank of England's 'danger level' (4.5%). Unemployment is rising, but slower than previously.
- The UK economy is in recession and GDP may fall by around 4% in 2009, before rising by 1% 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. There is some optimism that the economy may grow in Q4.
- It has been anticipated that consumer spending will fall, though retail sales were up 2.4% in the year to September. 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 risen over the last few months and over one year. Mortgage approvals are only 60% of their level two years ago. Capital Economics still expects house prices to fall by a further 10%.

In summary,the recession may have ended but interest rates are expected to remain low. The government is using both fiscal and monetary policy to combat the downturn. The recovery is expected to be slow with occasional setbacks, 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 decline by around -2.5% in 2009, though the economy will grow 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 rising unemployment (10.2%) 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 3% in 2010 (but only 1.5% in 2011). 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 -4% in 2009 and only grow by 1.5% in 2010. Growth in China and India will slow to around 8% and 6% respectively in 2009, but accelerate in 2010 to around 9% and 8% respectively. The world economy is expected to shrink by -3% in 2009, grow by 3% in 2010, but only expand by 2% in 2011.

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

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 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 September 2009 compared to the Benchmark

Market (1)	Market Value 30.09.09 £M (2)	Market Value 30.09.09 % (3)	WM LA Average 30.09.09 % (4)	Fund Benchmark 30.09.09 % (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	17.6	4.2	9.9	4.5	15.3	4.2	9.2
Corp.Bonds	24.3	5.8	*	4.5	23.3	6.4	*
IL Gilts	-	-	5.4	-	-	-	5.4
Credit alpha	5.6	1.3	-	1	5.1	1.4	-
Overseas	-	-	2.6	-	-	-	2.8
Emerg. Market	3.3	0.8	-	-	4.0	1.1	-
Infrastructure	0.7	0.2	-	0.5	1.4	0.4	-
Secured loans	19.7	4.7	-	5.5	18.4	5.0	-
Credit Opportunties	12.7	3.0	-	2	11.4	3.1	-
Equities							
UK FTSE350	114.8	27.5	33.6	18.5	93.7	25.6	31.0
UK Smaller co's	16.0	3.8	*	4.0	12.5	3.4	*
Overseas	94.5	22.7	33.6	26.5	69.0	18.8	31.9
USA	41.8	10.0	9.8	-	32.5	8.8	9.3
Europe	28.6	6.9	9.9	-	18.3	5.0	9.0
Japan	4.0	1.0	3.8	-	5.1	1.4	3.8
Pacific	8.6	2.1	4.2	-	5.0	1.4	3.7
Other	11.5	2.7	5.9	-	8.1	2.2	6.1
Other							
Property – UK	18.0	4.1	5.3	8.0	17.0	4.6	5.8
Property – Eu.	7.4	1.8	*	*	10.1	2.8	*
Hedge funds	40.7	9.8	1.1	10.0	38.8	10.6	1.8
Private Equity	26.8	6.4	3.0	8.0	25.6	7.0	2.9
GTAA	10.1	2.4	-	4.0	6.7	1.8	*
Infrastructure	5.4	1.3		2.0	-	-	*
Cash	0.5	0.2	4.2	1.0	13.8	3.8	4.4
Total	**418.1**	**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, £1.05m was invested in private equity and £5.4m in Infrastructure (on 30th September). It has been agreed that £0.75m should be returned from the fixed interest portfolio each month, and £1.25m / £2.5m per month invested in global equities. Since the end of the quarter there has also been further investment in private equity (£3.5m), and UK property.

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 September 2009.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.09.09			Year Ended 30.09.09			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
UK Equities			22.5			11.6	
UK Equities	22.0	22.2		11.7	10.6		FTSE 350
UK Small Caps	24.4	35.2		17.5	25.5		FTSE Smallcap ex IT
Global Equities	19.9	17.2	22.3	-5.6	1.1	15.7	FTSE World 75% Hedge
North America	21.9	16.3	19.1	-2.9	-5.4	4.5	FTSE USA
Europe	31.6	22.9	27.7	16.1	3.9	15.4	FTSE Eu Ex UK
UK	20.8	22.4	21.8	-5.8	10.8	11.6	FTSE All Share
Japan	11.1	1.1	10.5	4.0	-12.4	10.2	FTSE Japan
Pacific (ex Jap)	35.6	20.3	26.6	40.7	27.0	38.2	FTSE Pac. Ex Jap
Other	17.6	11.2	24.2	17.2	11.2	28.7	FTSE World (Other)
Fixed Interest							
Total Bonds	9.0	4.2	7.3	9.9	9.1	11.1	Brent benchmark
UK Bonds	6.3	5.9	8.3	13.6	13.3	12.9	FTSE UK over 15 years
Index Linked UK	-	-	4.4	-	-	5.6	-
Corp Bonds	8.8	8.9	-	16.4	11.9	-	iBoxx Sterling Non-gilt
Secured Loans	15.2	0.2		4.5	5.9		3 month LIBOR +3%
Credit Opportunities fund	12.6	0.7		7.0	6.4		3 month LIBOR+5%
Other							
UK Property FOF	3.1	2.6	2.2	-26.2	-25.4	-21.6	IPD Pooled index
Eu Property FOF	-26.8	3.3		-20.1	-19.2		IPD All properties
Hedge Funds	5.1	1.1	5.4	11.8	6.1	-3.5	3 month LIBID+4%
Private equity	1.0	0.1	1.7	0.8	1.2	-10.0	LIBID 7 Day
Infrastructure	-	-	-	-	-	-	3 Month LIBID +4%
GTAA	50.6	21.9		1.6	9.5		FTSE 100
Cash	-0.5	0.1	0.5	n/a	2.4	1.9	GPB 7 DAY LIBID
Total	**13.3**	**12.6**	**16.0**	**-0.1**	**4.0**	**8.4**	

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, and outperformed the benchmark by 0.7% as a result of positive stock selection (global equities, fixed interest, hedge funds and global tactical asset allocation) offset by asset allocation (mainly lower exposure to equities and GTAA, and higher exposure to fixed interest and cash). The main stock selection factors were:-

a) UK small companies. The fund underperformed as the manager overweighted smaller AIM stocks that did not rise in value as rapidly as their larger FTSE counterparts.

b) Fixed interest. Once again there was outperformance in government and corporate bonds as the manager overweighted 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.

c) Hedge fund of funds outperformed as multiple strategy and equity related strategies continued to be successful.

d) GTAA. The manager outperformed as all four strategies – equity against bond, bond against bond, bond stock selection and currency – have been successful. The main contributor was the overweight in equity markets, which has now been reduced.

e) Global equities outperformed the benchmark as stock selection, particularly in the 'value' portfolio', and currency added value. The house overweighted financial and IT stocks, which rose sharply in value.

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. The European fund fell in value, partly as a result of currency issues (falling euro) and partly because property values have continued to decline.

3.8 Over one year, the Fund underperformed the benchmark by 4.1%. 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. Second, poor performance in both currency and Global Tactical Asset Allocation. 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. The UK small companies fund has also underperformed as the manager has overweighted small, AIM stocks as against larger FTSE stocks.

3.9 The relative underperformance of the Brent fund against the WM Local Authority average in Q3 arises as a result of the asset allocation followed by the Brent Fund (lower exposure to equities) and the currency hedge used for overseas equities.

3.10 The Brent fund has underperformed the average local authority fund by 8.5% 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 some purchases and sales during this quarter to invest dividends (£1,086k) improve tracking error and rebalance the Fund towards global equities .

Purchases

a) Purchased stocks to ensure more accurate index tracking (such as Taylor Wimpey and Aberdeen Asset Management).

b) Took up rights issues, such as GKN and Marstons.

<u>Sales</u>

a) Sold stocks to ensure more accurate index tracking or as they left the index (Wincanton and Galiform)

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 October included selling stocks to fund increased exposure to global equities and private equity.

NEW DEVELOPMENTS AND FUTURE INVESTMENT OUTLOOK FOR THE BRENT FUND

3.13 Equity markets have fallen marginally during October following the sharp rise since March. Other markets, including UK property and credit markets, have improved as low interest rates and quantitative easing make riskier assets attractive.

3.14 Henderson Global Investors believe that bond yields will rise when Quantitative Easing ends and the size of the funding requirement (through the issue of government gilts) becomes apparent. The manager has suggested that the core fund benchmark for gilts reverts to the All Stocks index from the Over 15 years index to reflect that the manager will reduce duration to acknowledge the risks to longer dated stocks. The manager has also suggested that the discretion to use active currency investment be extended from the core portfolio to include the satellite portfolio. As members will be aware, Henderson has hired a highly rated team from Fortis Bank which has added value to returns from the core portfolio. The manager will outline both proposals at the meeting of the Sub Committee.

3.15 Members will be aware that Gartmore Investment Management is owned by a private equity firm, Hellman and Freeman, and by its staff. There is speculation that the house is planning a stock market flotation, and has recruited new, experienced staff to improve its investment capability. However, at present there is no clear information.

3.16 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 – September 2010 quarter report.

Henderson Investors – September 2010 quarter report

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.

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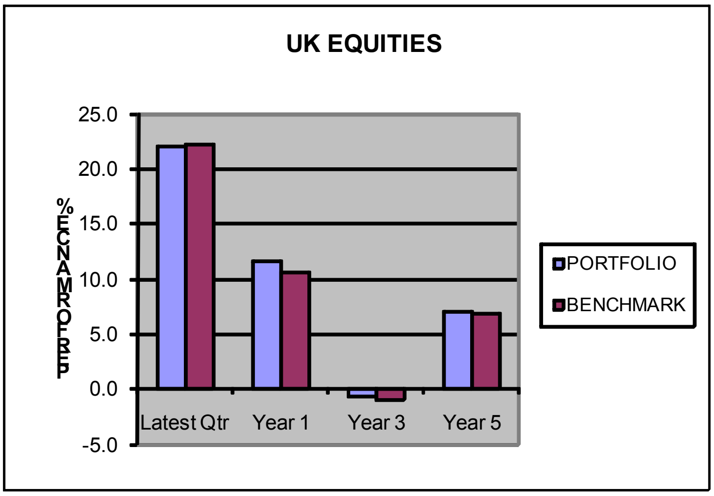
Director of Finance & CR

MARTIN SPRIGGS
Head of Exchequer and Investment

PERFORMANCE FOR INDIVIDUAL PORTFOLIOS 30th SEPTEMBER 2009

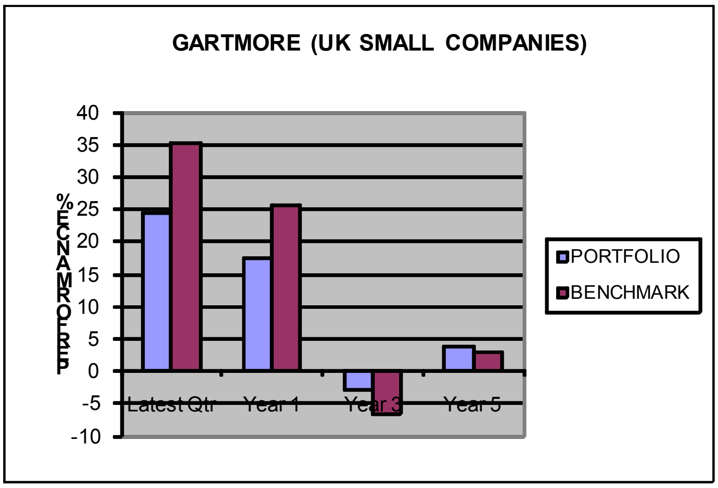
UK EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	22.0	22.2
Year 1	11.7	10.6
Year 3	-0.7	-1.0
Year 5	7.1	6.8



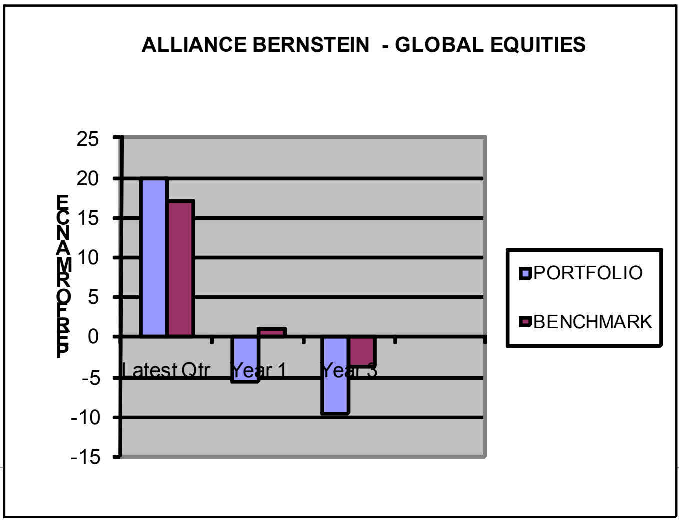
GARTMORE (UK SMALL COMPANIES)

	PORTFOLIO	BENCHMARK
Latest Qtr	24.4	35.2
Year 1	17.5	25.5
Year 3	-3.0	-6.7
Year 5	3.9	2.8



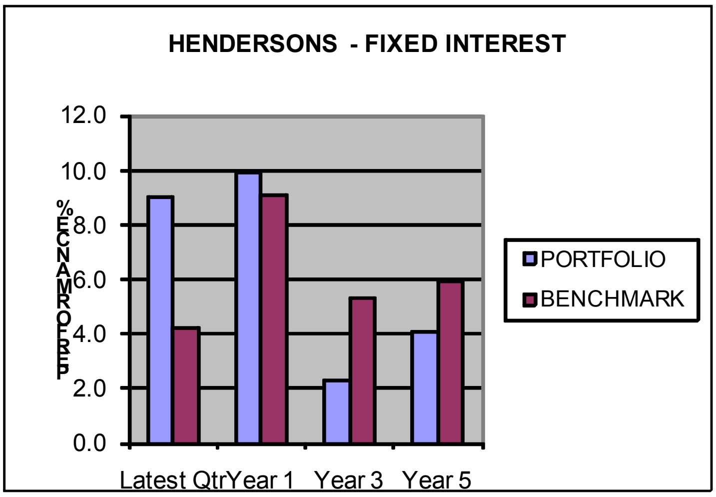
ALLIANCE BERNSTEIN - GLOBAL EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	19.9	17.2
Year 1	-5.6	1.1
Year 3	-9.5	-3.7



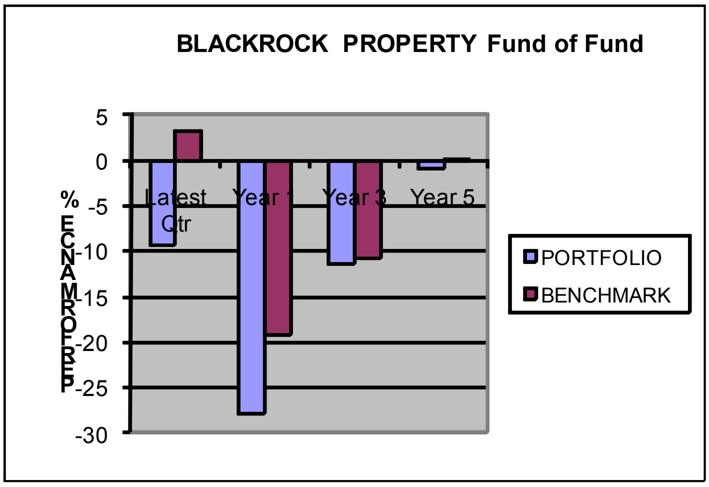
HENDERSONS - FIXED INTEREST

	PORTFOLIO	BENCHMARK
Latest Qtr	9.0	4.2
Year 1	9.9	9.1
Year 3	2.3	5.3
Year 5	4.1	5.9



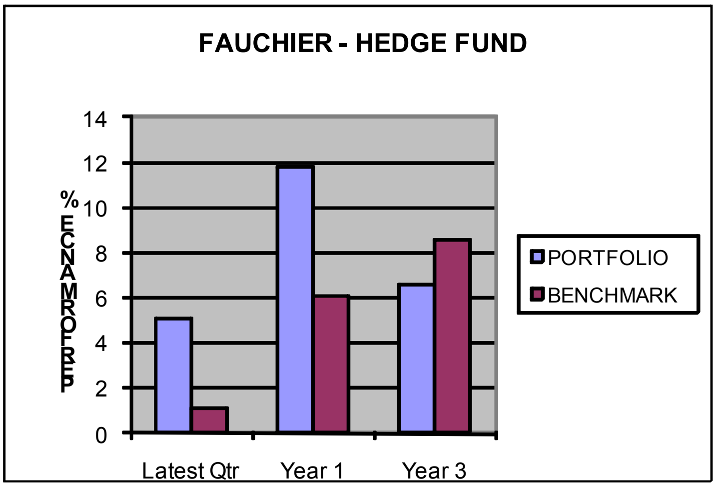
BLACKROCK PROPERTY Fund of Fund

	PORTFOLIO	BENCHMARK
Latest Qtr	-9.4	3.3
Year 1	-27.9	-19.2
Year 3	-11.4	-10.8
Year 5	-0.8	0.1

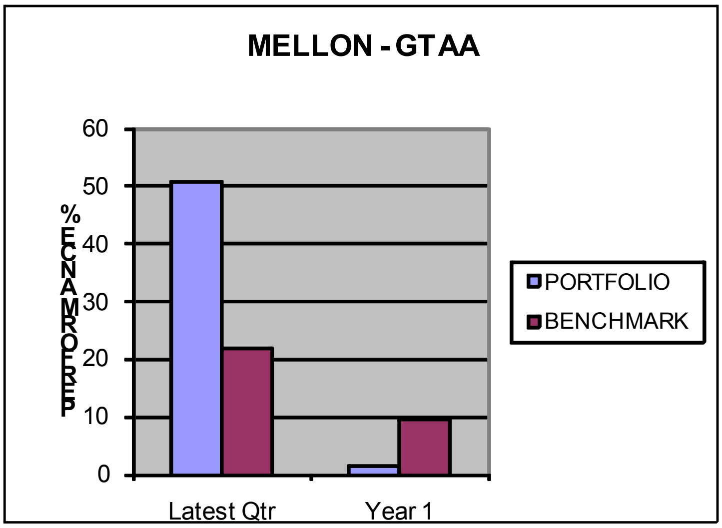


FAUCHIER - HEDGE FUND

	PORTFOLIO	BENCHMARK
Latest Qtr	5.1	1.1
Year 1	11.8	6.1
Year 3	6.6	8.6



MELLON - GTAA		
	PORTFOLIO	BENCHMARK
Latest Qtr	50.6	21.9
Year 1	1.6	9.5



Report from the Independent Adviser

Investment Report for the Quarter ended 30th September 2009

Market Commentary

	Index returns expressed in sterling	Q/e 30.09.09
		%
Equities		
Europe	FTSE Developed Europe (ex UK)	29.4
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	27.7
Emerging Markets	MSCI Emerging Markets Free	24.6
UK	FTSE All Share	22.4
North America	FTSE North America	19.3
Japan	FTSE Developed Japan	9.3
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	9.2
UK Gilts	FTSE British Government All Stocks	3.1
UK Index Linked Gilts	FTSE British Gov. IL Over 5 years	3.0
Property	CAPS Property	n/a
Cash	LIBID 7 day return	n/a

Currency Movements for q/e 30.09.09

Currency	30.06.09	30.09.09	Change %
USD/GBP	1.647	1.599	-2.9
EUR/GBP	1.174	1.094	-6.8
USD/EUR	1.403	1.462	+4.2
YEN/USD	96.485	89.535	-7.2

As the above table shows, this was a banner quarter in terms of equity returns right across the global spectrum. Indeed in the UK, it was the strongest quarter for equities for the last 25 years. Each year, with monotonous regularity, the financial press come out with the much hackneyed adage “sell in May and go away. Come back on St Leger Day” (usually the second Friday in September). To have adopted this investment policy this year would indeed have been an unmitigated disaster.

The equity returns for the quarter are remarkable. It is significant that Asia Pacific (+27.7%) and Emerging Markets (+24.6%) were second and third on the leader board as it is these areas on which investors are placing increased emphasis for the future in view of their prospects for strong rates of GDP growth. However, Europe was the clear winner returning 29.4%. Within Fixed Interest, corporate bonds (+9.2%) were to the fore due to the popularity of the sector for providing a high income return in uncertain times. The gilt edged sector produced a worthwhile return of 3.1%, and Index Linked 3.0% as investors began to anticipate that inflation is likely to pick up later in the year. Although not shown in the return table, hedge fund of funds produced worthwhile returns and private equity together with property showed distinct signs that liquidity was at last improving and both classes were in the process of bottoming out and passing the low point of their cycles before starting the long process of recovery.

There were two obvious propellants to the equity market surge. Firstly, investors had been treating cash deposits as a sanctuary in the troubled times experienced last year and earlier this year. Indeed, very considerable amounts of liquidity were invested in these safe haven deposits. However, when macro economic data was not as bad as many economists had predicted and when it was seen that many high quality equities stood at yields of 4% or more, equity markets generated considerable momentum with investors showing an increased appetite for risk. As this rally continued to build even further momentum those cautious investors that had hesitated to commit funds back into the market place became fearful of being seen to miss a meaningful uplift and switched large amounts of liquidity into equities. After all, no investment house likes to be seen to have missed out, particularly when reporting to investment committees. Secondly, there was a growing perception that governments and monetary authorities of the principal industrialised countries were being successful with their truly vast array of innovative emergency measures, not the least of which was implementation of very substantial Quantitative Easing (printing money) programmes. Important to investor morale was the growing perception that economies were recovering from the meltdown conditions of a year ago when the whole global financial system was in danger of rupturing with Armageddon a distinct possibility.

It was the effect of the above propellants that fuelled equity performances to levels that appeared to have confounded even the most seasoned and experienced strategists, economists and market timers.

Additional positive influences were as follows:-

- Corporate cost cutting and labour shedding resulted in improved productivity. This in turn translated into better earnings growth than expected.
- Strong rates of inventory building and restocking.
- Contained rates of national inflation.
- The maintenance of historically low rates of central bank interest rates.
- Signs of increasing merger and acquisition activity.
- Improved politics with President Obama experiencing a reasonably successful honeymoon period. Angela Merkel, the German Chancellor, receiving an increased vote of confidence in the general election and, in Japan, the ousting of the moribund Liberal Democratic Party.

In contrast to the beneficial factors listed above the following adverse influences were of concern both in the UK and elsewhere:-

- Unemployment rates continued to increase.
- Consumers trading down often due to concern over job security.
- Credit card indebtedness remained at high levels.
- Bankruptcies were at record levels.
- The poor availability of mortgages affecting the housing markets.

UK
Positive Influences

- In the first 9 months of 2009 house prices increased by 4.1%, but were still 13.5% lower than the October 2007 peak.

- The Confederation of British Industry estimates that the economy will grow by 0.3% and 0.4% in quarters three and four respectively.
- The UK banks are to prepare "living wills" in the event that, in another emergency, they need to undergo fundamental restructuring.
- The purchasing managers' index of activity in the service sector for September increased to 55.3 (August 54.1).
- On 10th September the Bank of England held interest rates at 0.5% and signalled economic improvement.
- In the second quarter the GDP growth rate fell 0.7% versus a previous estimate of -0.8% and the first quarter drop of 2.4%.
- The Nationwide house price index for August advanced by 1.6%.
- A sign of returning consumer confidence was the substantial 15.7% increase in July's online sales.
- The Office for National Statistics reported that CPI inflation was at a level of 1.8% in July, unchanged from June. This compared with estimates of 1.5%.

Negative Influences

- August income tax receipts fell by 13.0% p.a.
- The Bank of England warned of "a slow and pedestrian recovery" and stated "the depth of the recession is great and it will continue even if we get a small positive growth rate over the next few quarters". It expects interest rates to stay low for a longer period than expected. £175B of Quantitative Easing is unlikely to be unwound any time soon.
- July's number of unemployed was 2.47M, the highest level since 1995 with an unemployment rate of 7.9%.
- August retail sales fell 0.6% (July -0.2%).
- The rate of business spending deteriorated by 10.4% in Q2 of 2009, an appreciably higher decline than economists estimates of -3.6%, and higher than Q1 (-7.6%).
- The Office for National Statistics reported that non manufacturing output in August fell 0.9% compared with estimates of +0.3%.
- The IMF estimates that the UK will suffer a sharper decline in growth rate as a result of the credit crisis than the Eurozone, the USA, Japan, Canada and Sweden.
- Official minutes show that the Bank of England's Monetary Policy Committee was divided on the effectiveness of the Quantitative Easing programme.
- Both the Government and the opposition parties have started to prepare for the General Election in Spring 2010. It is to be hoped that this will not take Parliament's eye off the critical healing process for the economy.

USA

Positive Influences

- On 23rd September the Federal Reserve Board (FED) left interest rates unchanged and indicated that rates would remain unchanged "for an extended period".

- In July house prices increased by 1.6%, the largest monthly gain for 4 years and better than forecast. The National Association of Realtors reported that July house sales increased by 7.2%, the biggest monthly rise since 1999. This represents the fourth successive monthly increase.
- August retail sales were better than forecast growing 2.7%, but 6.0% lower on an annualised basis.
- August consumer spending was up 1.3%.
- The Chicago purchasing managers' index for August showed a substantial improvement at 50.0, up from 43.4 in July.
- Durable goods orders expanded 4.9% in July, the biggest increase for almost 2 years. This was partly due to a spike in aircraft orders.
- Ben Bernanke has been nominated for a second term at the head of the FED by President Obama. This was very well received by stock markets.
- The weak US $ has helped to strengthen the nation's exports.
- At the Federal Reserve conference Bernanke stated "after contracting steeply over the past year, economic activity appears to be levelling out, both in the US and abroad and the prospects for a return to growth in the near term appear good".

Negative Influences

- The Institute of Supply Management's index of manufacturing activity for September eased back to 52.6 from August's 52.9.
- Non farm payrolls in September fell markedly by 263,000, much worse than the consensus expectation of 175,000. The unemployment rate reached a 26 year high of 9.8%.
- The Conference Board's index of consumer confidence for September disappointed at 53.1 against estimates of 57.0.
- There has been a distinct decrease in "safe haven" demand for the US dollar.
- The Institute of Supply Management's non manufacturing index for August was 48.4 versus 50.0 a level which signals expansion.
- The White House projected that the budget deficit would be US $2000B higher over the next 10 years than it had originally projected, thus demonstrating America's deteriorating debt position.

Europe

Positive Influences

- On 28th September Angela Merkel's Christian Democratic Party, together with the Free Democrats, formed an alliance which won a majority in the general election. As a result this Centre/Right coalition now stands a much better chance of enacting the essential legislation that Germany needs to improve its economy. For instance, the new coalition almost immediately promised to make early income tax cuts and a reform of corporate and inheritance taxes.
- The German purchasing managers' index grew to 49.2 in August (July 45.7) whilst that of France expanded to 50.8 in August (July 48.1).
- Germany's IFO Institute's business climate index rose to 90.5 in August from 87.4 in July, its fifth consecutive monthly rise.

- German consumer spending in quarter two 2009 increased by 0.7% (Q1 +0.6%).
- For the second quarter of 2009 France's GDP grew by 0.3% (quarter one -3.5%) whilst that of Germany grew by 0.3% (quarter one -1.3%). Both of these turnarounds to positive growth surprised most economists. Germany and France account for 48% of the Eurozone's GDP. The GDP growth of the 16 nation currency bloc aggregated to 0.1% compared to the consensus estimate of -0.5%.
- The European Commission's economic sentiment index rose to 82.8 in September (August 80.8) accompanied by Trichet of the ECB estimating "only a very gradual recovery" and stating that "there are increasing signs that the global recession is bottoming out while the pace of Eurozone contraction is slowing".
- On 3rd September the ECB left interest rates unchanged at 1.0%.
- The Eurozone's purchasing managers' index, covering services and manufacturing, advanced to 50.0 in August from 47.0 in July.

Negative Influences

- In the second quarter of 2009 Spain's GDP fell by 1.0%.

Japan

Positive Influences

- In the parliamentary election, the Democratic Party secured power by winning 307 seats in the Lower House against 119 won by the Liberal Democratic Party.
- Between April and June output increased by 3.7%.
- Exports grew by 2.3% in July due to stronger demand from Asia and the replacement of low inventory levels.
- In the second quarter of 2009 GDP rose by 0.9%, its first rise for a year.

Asia/Pacific

Positive Influences

- CNOOC, one of China's 3 major energy companies, wants to buy stakes in Nigeria's richest oil blocks. This could become a trend as China's economy continues to be so robust.
- China's industrial output in August rose at 12.3% p.a. (July +10.8% p.a.).
- China's CPI inflation rate for August lowered to 1.2% from July's 1.8%.
- China is set to issue renminbi denominated bonds, further evidence that it wishes to build the role of the renminbi as an international currency.
- China's manufacturing purchasing managers' index rose to 55.1 in August from 52.8 in July.

Negative Influences

On 31st August the Shanghai Composite index tumbled almost 7.0% due to fears that the authorities would curb bank lending and impose restrictions on exports to rein in industrial over capacity.

Conclusion

It has become an annual aspiration that springtime in the market place will be conducive to the emergence of fresh green shoots of economic vigour. Such green shoots may well appear in 2010, but the risk is that they could be smothered by the toxic weeds grown in the sub prime era. Certainly governments and central banks will have to continue to apply strong doses of weed killer. However, on a more hopeful note it does seem that the green shoots will win out and that macro economic data over the turn of the year will give rise to a degree of optimism with regard to the return of growth to global rates of GDP. However, such growth is likely to be anaemic, especially in the Western Hemisphere economies and particularly in the UK. Nevertheless, the world's barometer of economic growth is pointing up with the slope of the recovery likely to be a shallow "U" as opposed to a "W", "V" or "L".

To be realistic, it should be stressed that, as a result of the financial crisis and the implementation of a plethora of remedial measures, the levels of debt that must necessarily be repaid over a protracted length of time (particularly in the UK and the US) are huge. These debts belong to governments, companies and consumers. It does seem that markets may be taking an overly sanguine view of this time horizon. In the UK, whatever the persuasion of the winner of the forthcoming general election, the successful party will have to contend with the repayment of the UK's biggest ever debt levels. It will be critical for that government together with the Bank of England to successfully time the exit strategies and to dismantle the emergency measures. Only when this is seen to happen can the UK economy move from intensive care into the recovery ward.

In sum, it appears reasonable to suggest that if macro economic data (particularly GDP growth rates) translates into sustainable recoveries, then equity markets make further, muted progress. Eastern Hemisphere equity markets will most probably outperform their Western counterparts. With regard to other asset classes Fixed Interest (with the exception of corporate bonds) will most likely be dull as official interest rates continue to remain at low levels. Property should start to recover from the depths of its recessionary cycle, as should Private Equity and Infrastructure as their access to liquidity improves. Hedge funds of funds seem well placed to take advantage of the abundant opportunities that are emerging within the sub sectors.

As always, with the increasing trend to globalisation in all asset classes, currency protection programmes will become increasing important, particularly for sterling based portfolios.

Valentine Furniss
13th October 2009

Investment Report for the month of October 2009

	Index returns expressed in sterling	Month ended 31.10.09
		%
Equities		
UK	FTSE All Share	-1.8
Emerging Markets	MSCI Emerging Markets Free	-2.8
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	-3.9
North America	FTSE North America	-5.1
Europe	FTSE Developed Europe (ex UK)	-5.4
Japan	FTSE Developed Japan	-5.5
Fixed Interest		
UK ILGs	FTSE British Gov. Index Linked Over 5 years	2.8
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	0.6
UK Gilts	FTSE British Government All Stocks	-0.3
Property	Caps Property	N/A
Cash	LIBID 7 Day	N/A

Currency Movements for month ended 31st October 2009

Currency	30th September 2009	31st October 2009	Change %
US $/£	1.599	1.648	+3.0
Euro/£	1.094	1.117	+2.1
US $/Euro	1.462	1.475	+0.9
Yen/US $	89.535	90.520	+1.1

It is clear from the negative returns in the table above that equity markets suffered from a dose of realism in October. This was partly attributable to the increasing investor awareness that economies would take longer to emerge from their respective recessions than the markets had been expecting and also that governments and central banks would have to continue to struggle with ballooning deficits and further banking problems for longer than originally anticipated. There were also concerns with the strategies necessary to exit from the myriad of complex emergency measures imposed last year to combat the global financial crisis. An additional important influence in October's equity market decline was that, over the last two quarters, the return for equities had been substantially higher than forecast. Therefore investors have more recently been inclined to de-risk their portfolios by locking in some worthwhile profits.

Whilst all equity markets produced negative returns, it was the UK which fell by the least (-1.8%) with the worst performance by Japan (-5.5%). Even the popular Emerging Markets fell by 2.8%. Fixed interest returns, on the other hand, proved relatively resilient with the index linked sector returning +2.8% as more investors concluded that it was almost inevitable that central bank quantitative easing programmes (printing money) would be followed by rising inflation. Whilst returns for property are not yet available it seems reasonable to suggest that returns will demonstrate a measure of recovery.

Macro economic data and events from the regions were:-

UK

- The Nationwide Building society reported that October house prices advanced by 0.4% representing the sixth consecutive monthly rise.

- Government borrowing rose to £77.3B in the first six months of the financial year. This level was more than double the same period a year ago.
- Output fell in the second quarter of 2009 by 5.9% continuing the longest recession since records began more than 50 years ago.
- Third quarter GDP growth was down 0.4% against consensus estimates of +0.2% and compares with a drop in the second quarter of 0.6%. This announcement caused sterling to fall 1.9% on the day against the US dollar.
- The September unemployment rate was unchanged at 7.9%, but at least it was less than those rates in the US of 9.8% and in the Eurozone of 9.1%.
- The British Retail consortium reported that sales volume in September rose 4.9%.
- The consumer price index in September decreased to 1.1% from 1.6% in August in part due to stable gas and electricity prices.

USA

- The Institute of Supply Managers' factory index increased to 55.7 in October from 52.6 in September.
- New house sales receded 3.6% in August and 7.8% year on year.
- For the third quarter of 2009 GDP grew by 3.5% against an expectation of 3.2%.
- September producer prices fell 0.6% which was worse than expected.
- House rices advanced by 1.0% in August, the third consecutive monthly gain.
- The Conference Board's index of consumer confidence dropped significantly to 47.7 in October from 53.4 in September. This was blamed on worries over unemployment and wages. This is concerning as the US economy depends on the consumer sector for over two thirds of its output.
- The consumer price index increased by 0.2% to 1.3% in September.
- The amount of tax collected in the second quarter of 2009 showed a substantial fall of 16.6% (Quarter one -11.7%).
- Due to a slump in vehicle sales September retail sales were 1.5% lower.

Europe

- The European Commission estimates regional growth of a meagre 0.7% in 2010 and warned of record high budget deficits and levels of public debt.
- Norway's central bank increased interest rates by ¼% to 1 ½% and signalled more increases ahead.
- Eurostat reported that Eurozone unemployment in September rose by 184,000 with the unemployment rate marginally increased to 9.7% (August 9.6%). This is the highest rate since January 1999.
- The Eurozone corporate purchasing managers' index increased to 53.0 in October from September's 51.1.
- Germany's IFO institute announced that its business climate index inched up to 91.9 in October (September 91.3).
- France's corporate purchasing managers' index (industry and services) demonstrated a worthwhile increase to 58.4 in October from 54.8 in September.
- At the ECB governor Trichet advised the banks "to return to their traditional role of providing a service to the real economy". He accused them of having focussed too much on "unfettered speculation and financial gambling". On 8th October the

ECB left rates unchanged at 1.0% with Trichet warning of "an increasingly pressing need for ambitious and realistic fiscal exit strategies". He also stated that it was necessary to rein in soaring public deficits.

Japan

- The September unemployment rate fell to 5.3% (August 5.5%) which was better than expected.

Asia/Pacific

- The Australian government estimates economic growth of 1.5% for the year to 30th June 2010. This compares with its previous estimate for that period of a 0.5% fall. On 6th October the Reserve Bank of Australia increased interest rates by ¼% to 3¼%. It was the first G20 nation to increase rates. The RBA estimates GDP growth of 2 ¼% in 2010 buoyed by China's insatiable demand for natural resources. On 10th October the Australian dollar increased to a 14 month high of A$0.91 against the US dollar
- South Korean third quarter GDP rose by 2.9% due in part to strong exports, particularly to China.
- The People's Bank of China suggested that the Euro and Yen would be increased in its foreign exchange reserves, although the US dollar would still remain dominant. China's third quarter 2009 GDP increased by a substantial 8.9%. China's September exports fell 15.2% p.a. (August -23.4% p.a.) whilst September imports reduced 3.5% p.a. against August's 17.0% p.a. drop.

Conclusion

It should be re-iterated that a meaningful and sustainable recovery from current equity market levels only seems likely in the new year as much will depend on whether or not the macro economic data depict a genuine improvement in the rates of GDP growth of the major industrialised nations. It seems likely that the growth rates of emerging nations and of the Eastern Hemisphere will set world growth on a recovery course.

It should also be stressed that equity markets have already appreciated to higher levels than could have reasonably have been foreseen earlier in the year and to an extent they appear to be over discounting both the strength of global economic recoveries and the timing of these recoveries. In reality, economic recoveries are likely at first to be relatively muted with the exception of China, Asia and Emerging Markets and it will most likely take longer than envisaged for economies in general to demonstrate robust rates of GDP growth. Fixed interest will likely produce relatively dull rates of return against a background of historically very low interest rates which will probably be increased at a very slow pace. However, should inflation rates pick up then there could be more to go for in Indexed Linked Stocks. Corporate bonds have shown strong returns over the last six months, but could still produce positive returns, albeit at a much lesser rate. Hedge funds should continue to prosper. The private equity and property sectors should benefit as improved levels of liquidity filter through for the purchase of assets currently standing at attractive valuations.

Valentine Furniss
6th November 2009