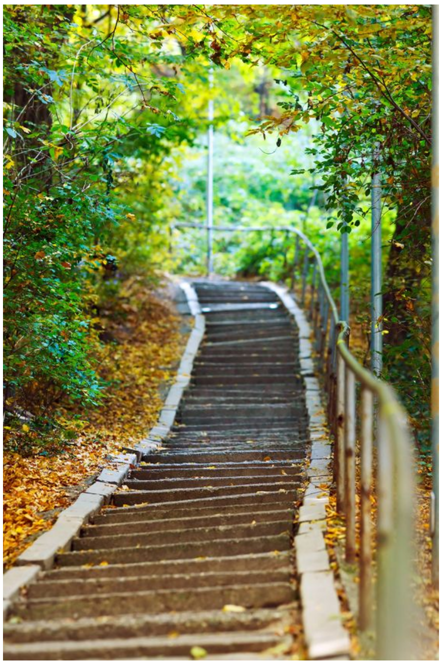
Quarterly Strategy



The European and US central banks have helped ease fears about the global economy and Eurozone crisis. Actions by the European Central Bank in particular should give countries such as Spain much-needed time to get their finances back on track, which has made us more positive on European equities.

The uncertainties surrounding the US elections and 'fiscal cliff' have led us to reduce holdings in US dollar assets, but we believe equities in general still offer good prospects for growth at reasonable valuations. The path will not be easy, but we expect financial markets to climb higher from here.

C. Hoare & Co.
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Our current investment strategy

Mario Draghi promised that the European Central Bank would do 'whatever it takes' to save the euro and was committed to buying more government bonds from countries that ask for assistance and are meeting certain criteria. As the systemic concerns eased, we increased portfolio exposure to European equities, as appropriate.

In the US, the Federal Reserve initiated the third round of quantitative easing (QE), which led us to reduce portfolio exposure to US dollar assets, as it tends to depreciate the value of the currency. Disappointing economic growth and increasing political concerns in the US also influenced our decision.

In the months ahead, the big focus will be the 'fiscal cliff' in the US, when over $600 billion worth of tax cuts and government spending measures come to an end in January 2013. Mitigating what equates to a 4% hit on nominal GDP will be a major area of debate in the run up to the Presidential elections in November.

Whilst acknowledging the risk, we believe if consumers and the global economy stabilise and central banks remain accommodative, markets could grind higher.

We are positive overall in equities

UK: broadly neutral but see recovery potential

- Low growth and fiscal challenges, but the stability of consumers could lead progression

US: positive but wary of risks on the horizon

- Improving consumer outlook, but political risks to dominate

Europe: increasingly positive

- Spanish bailout still to come, progress on institution building, but continuing recessionary conditions

Japan: neutral

- Growth prospects will be enhanced if yen weakens

Asia ex Japan, Global Emerging Markets: negative

- China slowdown and lack of visibility are concerns

We are positive overall in bonds

- There are technical concerns about government bonds due to the extent of 'safe haven' buying
- Moderate corporate leverage and low but stable economic growth are supportive of corporate bonds

We retain a positive view on alternatives

Gold: positive

- Benefits from unconventional central bank policies

Hedge funds: positive

- Diversification from returns of traditional assets

We are negative in property

- Risks surround fundamentals and supply overhang

Currencies and interest rates

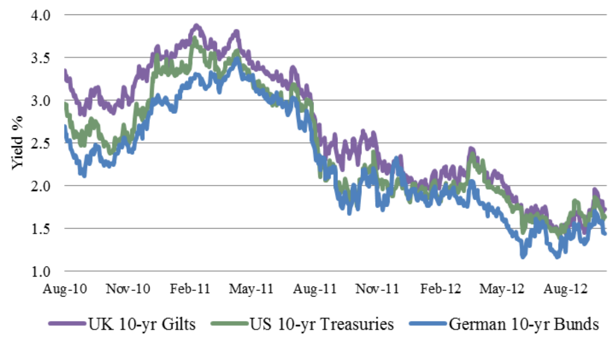
Exceptionally low interest rates are almost certainly going to be with us for the next couple of years at least. In such an environment, our currency views are being driven by the relative willingness of the central banks to engage in further quantitative easing and also the 'risk on/risk off' environment. We favour sterling and the euro over the dollar and yen.

Bonds

Low government bond yields are the result of diminished economic growth in the years since 2008, and lack of confidence in a cyclical recovery. The other key feature is the actions of central banks, via asset purchases and managing expectations.

While this acts as an anchor on short- and medium-dated government bond yields, such unconventional policies give investors concern over longer-term inflationary risks. We are also concerned by the fact that so many equity and even cash investors have been using the asset class as a safe haven.

'Safe haven' bonds offer little value

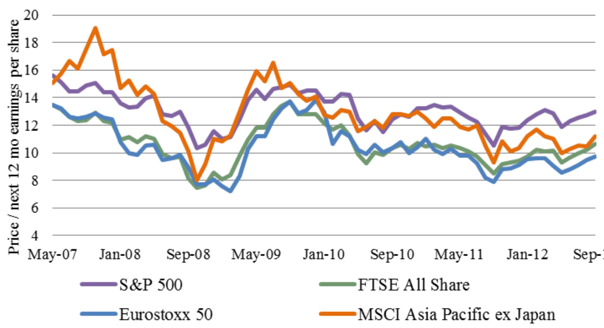


Source: Bloomberg, to 30th Sept 2012

The ECB's backstop for liquidity in the Eurozone and the Fed's decision to purchase mortgage-backed securities has been positive for corporate bonds, providing an incentive to rotate exposure to the asset class. Economic growth and corporate leverage levels provide adequate support, and we expect corporate bond yields, relative to government bonds, to come down as investors search for higher yields.

Equities

Equities still relatively good value



Sources: Deutsche Bank, Bloomberg, to 30th Sept 2012

As a result of the weak global economy, corporate earnings continue to be downgraded, for the 14th consecutive month. The pace of downgrades remains stronger in Europe than in the US, although it is worth noting that Japan, Asia Pacific and Emerging Markets are all seeing profit forecast declines.

With some of the systemic concerns abating from markets, but earnings not improving, we are not surprised to see equity valuations increase from what were cheap levels over much of the last 12 months.

We believe there is room in the US and the UK for valuations to grind higher, as investors anticipate an end to the downgrade cycle, and better earnings next year. Asian equities remain cheap, but we suspect investors are waiting for better visibility of growth and earnings rather than focusing only on valuations.

Sectors and themes

From a sector perspective, we remain cautious on global cyclical sectors such as resources and industrials, primarily due to the uncertain growth prospects of China. Some of the key defensive sectors such as healthcare, telecoms and utilities continue to be impacted by their own structural issues and sovereign connected woes.

In contrast, forecasts for 2013 earnings growth look to be more positive in domestic cyclical sectors, such as financials and consumer services. Technology also continues to benefit from strong interest in new products, especially smartphones and tablets.

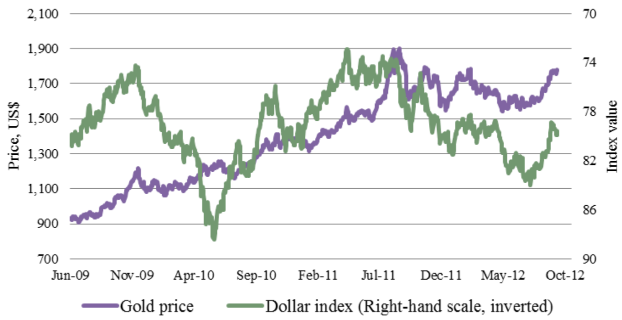
MSCI World sector	Earnings growth		Price/Earnings	
	2012e	2013e	2012e	2013e
Consumer discretionary	35.9%	16.0%	14.2	12.4
Consumer staples	6.1%	9.6%	17.0	15.5
Energy	-8.9%	8.6%	10.9	10.0
Financials	10.1%	11.5%	11.3	10.1
Healthcare	3.0%	7.9%	13.8	12.8
Industrials	9.4%	12.2%	13.1	11.7
Info technology	11.9%	16.8%	14.6	12.5
Materials	-14.5%	20.7%	13.5	11.2
Telecoms	1.1%	9.3%	13.6	12.4
Utilities	14.8%	15.4%	16.0	13.9
MSCI World Index	**5.7%**	**12.5%**	**13.2**	**11.7**

Source: Deutsche Bank Consensus Earnings, Sept 2012

Alternative assets

Gold has performed well recently, with the Fed's quantitative easing measures effectively pushing up the price of gold relative to paper currencies. The lack of yield from gold is currently not detracting from its attraction, given the low yields elsewhere.

Gold strengthens with dollar weakness



Source: Bloomberg, to 30th Sept 2012

While precious metals are well supported, building materials such as iron ore and copper remain particularly vulnerable to declines in infrastructure investment, particularly in China.

Chinese trade not driving global economy

Source: Bloomberg, to 31st Aug 2012

Turning to energy, we do not expect sharp rises in the oil price given the declining trend in developed world consumption, but we are aware of the upside risks to the oil price in the shorter term due to Middle East tensions.

We maintain a negative view on commercial property, as rents remain under pressure due to economic weakness impacting valuations. We are also conscious of the significant level of property owned by banks, and any improvement in the outlook could lead to a significant increase in supply.

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Image credit: http://www.123rf.com/photo_11102804 'stairs going uphill in a peaceful forest in autumn'

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