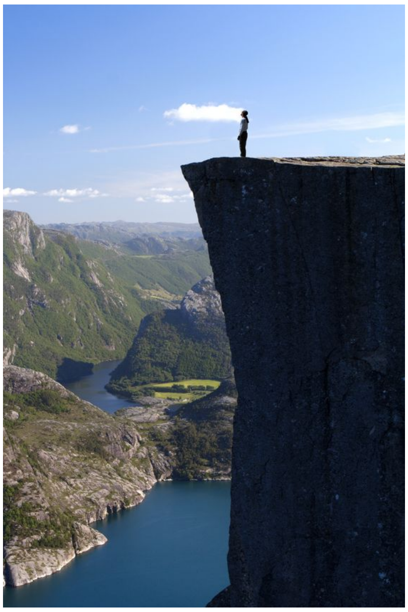
January 2013

Quarterly Strategy



Despite fears about the European debt crisis, faltering Chinese growth and US political events, returns in 2012 were strongly positive for equities and corporate bonds.

Looking at the new year, Europe is gradually improving, China's economy seems to be stabilising and the last-minute deal struck by US politicians to avert the economy 'falling off a fiscal cliff' should all help create compelling investment opportunities.

In this environment, we believe equities and other risk assets should continue to outperform 'safe haven' investments such as government bonds.

C. Hoare & Co.
PRIVATE BANKERS SINCE 1672

Our current investment strategy

The dark storm clouds of 2012 are slowly dispersing over the horizon. We recognise that the world will be more cautious, and government finances are still a concern, but we expect the bad news to diminish. This should result in improving business and consumer confidence and create a broad-based investment opportunity.

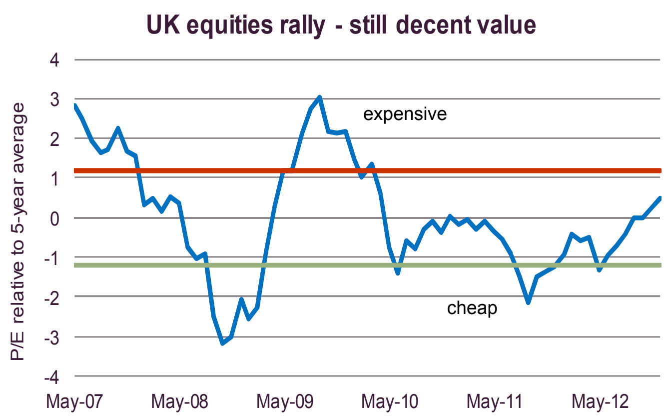
In this environment, the incremental attractions of bonds are beginning to wane, and equities and other risk assets are becoming increasingly compelling. We expect equities to outperform bonds in 2013.

Asset class	Region or sub-class	Our current position	Our expected next move
Equities		++	
	UK	neutral	
	US	–	
	Europe	+	
	Japan	neutral	
	Asia Pacific & GEM	++	
Bonds		–	
	Government bonds	– –	
	Corporate bonds	++	
Alternatives		+	↑
Property		– –	↑

We are increasingly positive on equities

It was difficult for companies to deliver sales growth in 2012, but with management teams remaining cautious and labour costs still muted, they were able to increase margins. In 2013, companies are likely to see their sales improve at the expense of margins.

Equities have rallied since the summer, but are still reasonably good value. The blue line in the following chart represents the Price-to-Earnings ratio of the FTSE All Share index relative to its medium-term average.



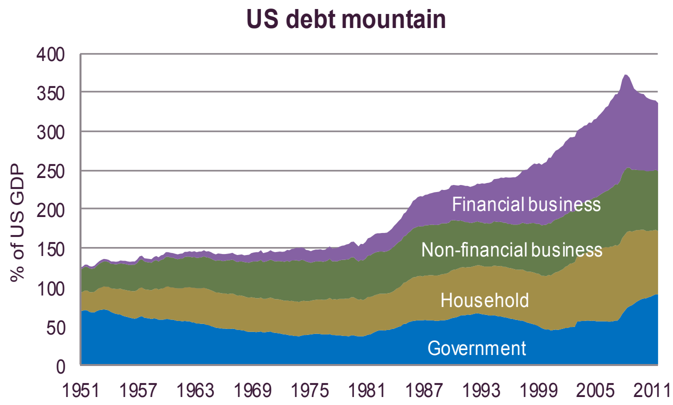
Source: Bloomberg, to 31st December 2012

Although the uncertain environment is likely to act as a constraint on valuations compared to previous bull markets, we believe equity prices are likely to rise this year, particularly in Asia.

Looking at prospects at the regional level, companies in the UK should benefit from global growth and rising consumer confidence. The government's Funding for Lending scheme should also provide some support.

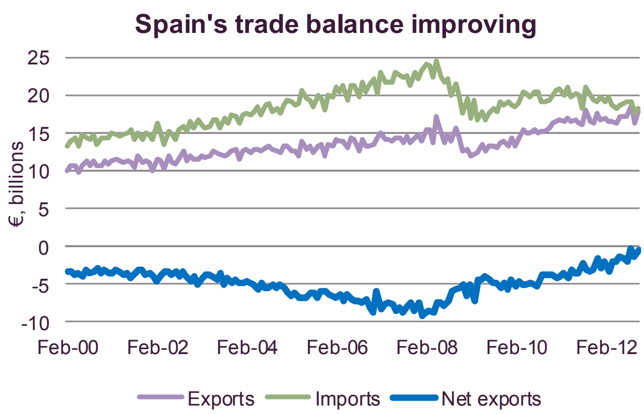
In the US, we expect the moderately improving trend of the economy to continue into 2013. Loose monetary policy and Quantitative Easing (QE) programmes have helped the banking sector and housing market to begin to recover, and unemployment to decline.

The last minute deal by US politicians to avert tax increases has removed an immediate source of risk, but the extent of the government's debt will remain highly contentious.



Source: Ecowin, to 30th September 2012

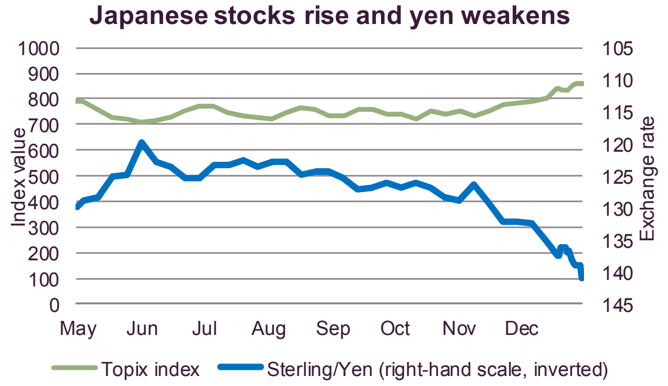
In Europe, we expect to see Germany continue its modest economic growth and countries in the periphery to benefit from improving competitiveness. We have concerns about further fiscal slippage in Spain, as well as regional funding and political issues. The trade picture there is improving, however, as illustrated in the chart below, and this development should benefit the Spanish economy.



Source: Bloomberg, to 31st October 2012

Turning our attention to Asia, we note that Japan's newly elected government is focussed on increasing the inflation target to combat deflation and weaken the yen. The weaker yen will in turn boost corporate profitability, particularly in terms of Japanese exporters.

Valuation levels in Japan are now more consistent with those in the rest of the world, and we added a Japanese equity fund to portfolios in May 2012. While the Japanese stock market (the Topix index in the following chart) has held up reasonably well since then, our decision to hedge the currency enhanced the return, as the yen has weakened relative to sterling.

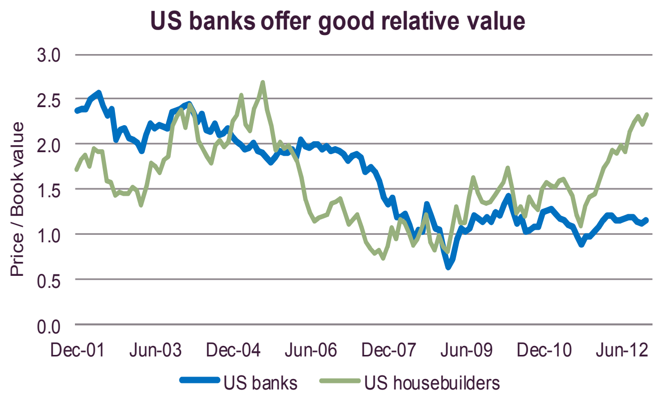


Source: Bloomberg, to 31st December 2012

We believe the rest of Asia and global emerging markets overall will benefit from better export growth to developed economies coupled with a stabilisation in China's growth outlook. China's new leadership now has an opportunity to support its economy through structural reform.

Sectors and themes

The clearest area of incremental improvement has been in the US housing and financial sectors, with the latter remaining at cheap valuations, in part due to the medium-term structural and regulatory issues. The following chart highlights what we view as a compelling investment opportunity in the US financial sector.



Source: Bloomberg, to 31st December 2012

The technology sector also continues to offer secular growth prospects and modest valuations.

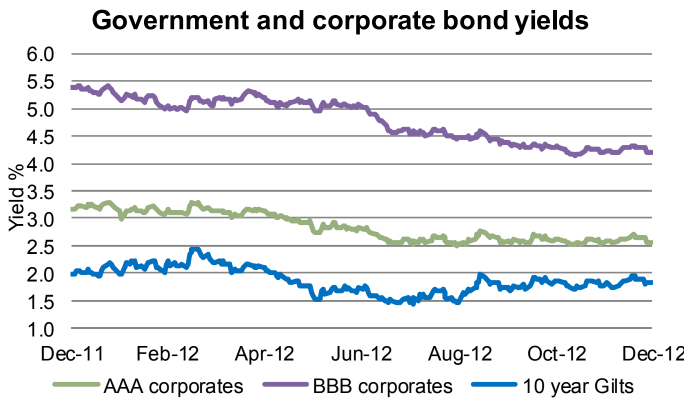
We expect to see selective opportunities in European consumer discretionary and financial sectors. We are more cautious on some of the defensive sectors, with utilities and telecoms affected by structural issues and consumer staples now fully valued. We expect to see a modest increase in corporate spending in 2013, so we remain cautious on the industrial and commodity sectors.

In currencies, we favour sterling over the US dollar

Globally, inflationary pressures remain muted and central banks remain focussed on alleviating the deflationary risks that poor economic growth creates. The US Federal Reserve has been so active in this regard that it could result in weakness in the dollar. We do not expect the Bank of England to consider raising interest rates until 2014, but its reluctance to engage in further QE should benefit sterling.

We are increasingly negative on bonds

An environment combining poor economic growth, easing inflation worries, increasing QE programmes and a general flight to safety was a positive backdrop for bond markets in 2012. Yields in 'safe haven' Gilts, US Treasuries and German Bunds fell during the first half of the year and remained at long-term lows.



Source: Bloomberg, JP Morgan, to 31st December 2012

We expect 2013 to be quite different for government bonds, with a lack of further catalysts pushing their yields higher, although the pace of increase is likely to be modest, given low interest rate policies.

Credit also performed well in 2012, as the ECB's actions in the summer reduced the risks of a systemic event, and allowed financials to recover. The yields of lower-rated securities are still elevated and are likely to remain relatively attractive while 'safe haven' bond yields are at historical lows.

We remain positive on alternative assets

In our view, gold continues to have a role in portfolios as a diversification tool, offering protection against excessive monetary easing and a weaker US dollar.

We would expect returns from hedge funds to pick up as financial markets normalise.

Property could become more attractive

UK commercial property had a difficult year, declining in capital terms, due to weak demand and challenging financing conditions. For now, we remain out of property as an asset class.

Looking ahead, however, we could see some opportunities in global property as yields on quoted securities remain well above those of sovereign bonds.

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Important Information

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