

PORTFOLIO INTERIM SUMMARY

August 2008

July and August (Summer season) in Britain and Europe is considered a "silly period" insofar as government and businesses tend to holiday and as such, news events are subdued; newspapers and TV news outlets seeking any new item for their front page or headline grabber, then often print or present extreme/bizarre comments. This is no less true of the financial markets and their pundits. Recently we have had pundits proclaiming the "worst is over" and the alternative "the worst is yet to come". It would be useful if information was available whereby we could parse their statements over the last eighteen months and have some record as to their assessment credibility skills. However, many pundits felt that those early critics with negative views were overly pessimistic yet a quick review of present day statements, indicate that those pundits are the very ones, now presenting the doom and gloom scenario. As has been stated many times within these Interim Reports and Quarterly Reviews most of the financial news disseminated today is geared towards "short term traders" rather than pragmatic long term investors. A case in point is the Freddie Mack and Fannie Mae situation.

These financial entities underpin the USA mortgage system, insofar as they provide direct mortgages to individuals and buy quality packaged mortgages from banks and private mortgage lenders. The latter service provides a great deal of the liquidity in the system. They are supposed to be private, but they work within a US government mandate. Neither of these entities are being hit by "Sub prime losses" their mandate is restricted to a maximum of 80% loans and high qualification benchmarks requirements are needed to obtain a loan. Because of these higher standards the government oversight committee did not establish such a high percentage of capital to be available as reserves to underpin the loan portfolio as they sought with other, lower quality lending institutions. The US government's move to create more liquidity is, the recognition that even some of these "higher end" mortgages will default, because of the general slowdown of the economy, however the way that the media has presented the circumstances is to connect the share value to the portfolio value.



Actually the share prices have fallen dramatically while their loan paper has risen in value. When the media incorrectly presents the government's assistance package as a "Bail out" it implies that the assets held are similar to those in the sub prime sector, when they most definitely are not. Additionally the money the US treasury will make available is to increase the liquidity within the loan portfolio and not the shares of the companies, which further underpins the portfolio (Although there are those who believe they should do both). This is reflected as the loan paper is rising in value.

I use the above example to illustrate how information is disseminated. The truth is that both of them have problems, the slowdown in the economy and foreclosures will not pass them by and leave them unscathed. However, it is prudent at these times to be conscious that not all information is as black and white as presented and caution should be exercised when attempting to fully understand specific situations. This is especially true when they then seek to extrapolates a general viewpoint using the inaccurate data.

In my recent quarterly review, I stated that November would probably be the time when the existing, obscure circumstances of the state of the markets would begin to clear somewhat, going forward. There are too many reasons, to list, why this scenario is valid but I will choose a few to illustrate my thinking. In nervous markets volatility is exacerbated by perceptions, either good or bad. The November US election...No matter whom wins... will be perceived as a new start and as such, notwithstanding party policies, their implementa-

tion and associate cost etc., most of the world will breathe a little easier and react positively. The slowdown in economies and rising inflation may even bring a few countries into technical recessions. If so, they are likely to be predominately shallow and short lived. Equalling, overall demand shall track lower, even in those countries showing positive, although reduced growth and as such commodity prices will likely fall. The British and European economies, will contract, with the possibility of the UK entering a shallow recession and this will reflect on the USD strength against the Euro and GB Pound. This will add further downward pressure on commodity prices, demand and exchange rates, which with Central banks expecting to increase base rates to stem inflation, further underpins USD Forex rates... Which once again reduces demand and so the cycles continue.

I acknowledge the above paragraph is somewhat a simplistic "basic Economics 101" review; when the world is a much more complicated affair, but we are space constrained and I stand by the general tenet of the points made. Over the last year the price of a barrel of oil in USD terms rose, at its height, by 100%. While in contrast it rose only 15% in Euros. Nothing really happened in the past year to create such a large disparity!

This should help US consumers however, at every occasion in the past, when US oil demand has fallen, world oil prices have literally collapsed simply because a systemic change in US habits which uses 25% of all world energy has a greater short term effect, than any increases in emerging economies demand. When the latter is constrained by inflation then demand is further reduced adding to the negative cycle.

In April/May 2009, first quarter results will be compared against the dismal 1st quarter 2008 performances as shall all subsequent quarters their 08 equivalent and some positive quarters will be seen, adding to the historical myopically challenged short term traders, positively charged "perceptions".

Real economics and investor confidence/perceptions is oxymoronic, but my final reason to identify the last quarter of this year as the changing moment, is that markets tend to react a minimum of six month prior to the actual event. Therefore in simple terms those who believe the worst will be over before the third quarter 09, will begin to position their portfolio strategies late 08 beginning 09 going forward. This month has seen some rallies within the beaten down Banking and financial sectors and I believe this testing of market sentiment regarding these sectors will continually evolve until finally a higher position is established on the "lower" trading range.

Traditionally, it is the newer economies which although volatile, begin to lead the way in the early "bullish" trends. The established economies are slower to respond and lag by, up to a year.. If as expected the Iraq debacle begins to wind down over the next two years which will eventually releases ten of billions of needed US Dollars per month back into the US economy. The recent Russian...Georgian escapade, will likely influence on going geo political decisions. The US Defence sector must service or replace the used equipment of the Iraq war and if the newly elected US government believes that is important to send a message to Russia, then cooler relationships can easily see the investment into a new arms race.

However I believe that around mid 2009, the most important event shall occur, insofar as the cost of the financial meltdown will finally be pretty accurately defined and with this, its solution... It is inevitable that a solution will be found, because every country in the world is dependent on the necessary liquidity to finance its private and national needs. Once the hint of the perception that the worst is really over, then market makers will boost financial stock values and the next "bull run" will start its process. If my timetable is correct then November/December would be the earliest period to expect to see the movement back into the beaten down sectors. Additionally before November/December it is quite likely that some negative news could seriously affect the markets 5-8% downwards. If so then we could be offered the perfect moment to pragmatically re enter the markets, as this "bottom" could... unlike other recent occasions when the markets rallied; actually be the occasion when we see the rally continue...rather than lose steam and fall back, within their trading ranges. The other November/last quarter events, stated above could then add the positive sentiment factor needed to begin turning the corner.

I do not seek to suggest that actual economical growth will be spectacular in 09, but the “future perception quotient” will be empowered and I would expect that valuations will receive a positive and larger percentage lift than each country’s GDP figures would otherwise warrant.

Next month I shall identify, and analyse a number of likely possibilities which are more likely to benefit from those early boosts.

Regards

Alan Lamb

Managing Director.