PROSPECT
WEALTH MANAGEMENT

Investment Prospects

Sell in May and Go Away?

- Major equity markets have fallen by less than 5% over the month, with the exception of Japan, down 7%. The FTSE 100 is now down 10% from the high reached in April. Bond markets were little changed over the month.
- The economic fundamentals remain sound and point to this equity sell-off representing no more than profit-taking following an extended rally.
- Economic growth has been better than expected in Europe and Japan. Expect interest rate rises this month. US and UK rates are likely to be unchanged.
- Company earnings growth is supportive of current equity valuations even though it is expected to slow next year to a rate of around 8%.
- Volatility in all markets should remain high through the summer, but as equity valuations are close to average, we regard dips as opportunities to buy shares.

Inflation worries are overstated

Consensus expectations for inflation remain unchanged, with economists forecasting inflation in 2007 to be very similar to that of 2006 in all the major economies. Rising energy and commodity prices may well push up headline inflation modestly over the next six months, but underlying inflation, the focus of central banks, is not expected to rise significantly over the next 12 months. Yields on 10 year government bonds have either fallen or are little changed over the past month, indicating a consensus view that energy prices and borrowing rates have risen enough to cool consumer demand, which in turn will keep inflation under control. The latest US employment data support this, with 70,000 jobs having been lost in the retail sector in the last two months and only a 0.1% overall rise in wages in May. Globalisation is a potent force keeping wages and prices down.

Commodity Prices were due for a Correction

Our price momentum model, shown in our last newsletter, indicated that gold and copper prices had been rising too far too fast and were vulnerable to correction. In the long term, the strong growth of central bank monetary reserves may well support further price rises, but in the short term the risk is that metals prices fall further as speculators continue to reduce long positions in metals.

Total Returns in Local Currency
Last month and last 12 months

		Total Return	
		1 month to 31st May %	12 months to 31st May %
Currencies v £	**Rate**		
US dollar	1.87	-2.4	-2.5
Euro	1.46	-1.0	1.1
Yen	210	-1.3	-6.7
Cash (3m)	**Yield %**		
USA	5.19	0.5	3.3
UK	4.61	0.4	4.8
Euro	2.89	0.3	2.1
Japan	0.25	0.0	0.0
Bonds (10yr)	**Yield %**		
USA	5.12	0.0	-4.4
UK	4.58	1.0	2.2
Germany	3.99	0.0	-2.5
Japan	1.82	0.0	-3.9
Equity Markets	**Index**		
USA	S&P Comp	-3.1	8.3
UK	FTSE 100	-4.6	19.3
Germany	DAX	-5.1	29.9
France	CAC	-4.7	22.5
Spain	SMSI	-4.5	23.4
Italy	BCI Gen	-4.2	18.3
Japan	Topix	-7.9	39.3
Australia	All Ord	-4.1	26.0
HongKong	HangSeng	-4.5	17.6
Commodities	**Spot Price**		
Gold	645	-1.4	54.6
Copper	n/a	11.4	146.9
Oil	70.4	-2.2	38.8

Source: Reuters

June 2006

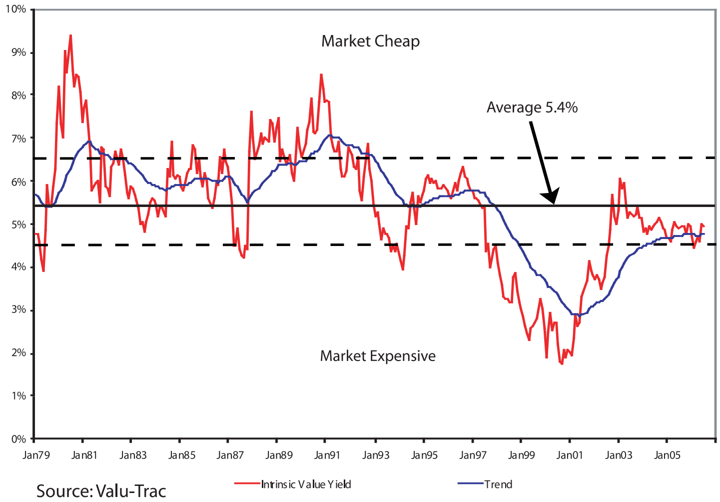
Company Earnings Growth remains Robust

The indicators of economic growth in the US and UK have been mixed over the past month, though generally have been supportive of growth moving towards long term trend levels. This is positive for equities. Over the past month there were as many company earnings upgrades as downgrades and though the rate of earnings growth is expected to slow in 2007, probably to around 8%, this should support current global equity valuations.

Equity Market Valuations not Stretched.

The cash flow yield on UK equities, shown in the graph below, has risen over the past month as prices have fallen, but the market remains modestly expensive. Other markets show similar valuations. The average correction in a bull market is 20% from the last peak. Another 10% fall in UK equities would take valuations back close to the long term average, so a further fall of this magnitude should not be ruled out. With attractive company earnings growth forecasts and unattractive bond valuations, such a fall should be seen as an opportunity to buy equities.

Equity Intrinsic Value Yeild - United Kingdom



Source: Valu-Trac

UK Equity Sector Performance

In May there was a flight towards defensive stocks. The total return for the month for the large cap FTSE 100 index was -4.6%, a 1% better performance than both the mid cap and small cap indices.

The only positive performing sectors across large and mid cap UK equities were Telecoms, Food and Drug Retailing, Utilities and Transport. The worst performers were Oil Equipment & Services, Mining, and both Life and Non-life Insurance sectors.

High dividend yield stocks performed well in May and should continue to find favour over the summer when the markets may well remain volatile. Banks and utilities have high dividend yields, the highest respectively being Lloyds TSB and United Utilities. International Power, another stock in our UK equity portfolio are developing an impressive portfolio of international power and water utility assets. The stock is up 21% year to date but remains attractively priced.

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