

Summary

- **US economy continues to slow, but concerns over inflation remain.**
- **Equity returns were mixed last month as corporate earnings slow but takeover activity intensifies.**
- **Alternative investments produced strong returns in November.**
- **Falling price momentum and moderately expensive equity valuations point to higher risks for equities.**

Economic Slowdown, Stable Equities

Global economic growth is now forecast to be below trend in 2007. Business cycles around the world are losing the high degree of synchronicity that we saw a year ago when Europe and Japan began to recover, while the US had not yet begun to slow. While the US economy is now faltering and interest rates have probably peaked, the UK, Eurozone and Japan are still clearly in an expansion phase, with further rate rises expected. The good news is that a US slowdown, or even recession, will not necessarily result in a global recession. Asian consumption, now growing by 7% per annum, can compensate to a great degree for a slowdown in US growth.

Global inflation has been easing due to slowing US growth and falling energy prices. Nevertheless, the Bank of England, the European Central Bank and the US Federal Reserve all think that inflation remains a threat. The Bank of England, for example, raised interest rates in November by 0.25% to 5.0% and there is likely to be another rate rise in February as the UK housing market remains buoyant. October mortgage approvals were at their highest level since December 2003 and consumer debt is now at an all time high.

Bond Outlook is Positive

The UK bond market does not appear to share these concerns over inflation: 10 year bond yields were virtually unchanged in November. Even though real 10 year yields are presently at 1.8%, slightly below the long-term average of 2.0%, we are positive about the bond outlook. Rising short term interest rates and the appreciation in sterling, against the US dollar, place downward pressure on inflation and point to lower bond yields in due course. We have, therefore, lengthened the duration of the bond portfolio during the past month.

Global equity markets showed little net change over the

month, except for the Pacific Basin markets (where we are over-weighted), which produced the highest returns. The FTSE 100 generated a slightly negative return in November, but all our model UK equity portfolios are outperforming their benchmarks since inception.

Total Returns in Local Currency

Last month and last 12 months

		Total Return for Market	
		1 month to 30 Nov %	12 months to 30 Nov %
Currencies v £	Rate		
US dollar	1.95	-2.2	-11.1
Euro	1.48	0.7	-0.8
Yen	226	-1.8	-8.5
Cash (3m)	Yield %		
USA	5.27	0.4	4.4
UK	5.17	0.4	4.6
Euro	3.60	0.3	2.4
Japan	0.45	0.0	0.0
Bonds (10yr)	Yield %		
USA	4.46	1.5	5.0
UK	4.51	0.4	1.8
Germany	3.69	0.7	1.5
Japan	1.66	0.8	-0.5
Equities	Index		
USA	S&P Comp	1.8	13.8
UK	FTSE 100	-0.9	15.3
Germany	DAX	0.8	23.6
France	CAC	-0.2	19.3
Spain	SMSI	1.6	36.0
Italy	BCI Gen	2.3	21.6
Japan	Topix	-0.8	5.3
Australia	All Ord	2.4	22.8
Hong Kong	Hang Seng	3.7	30.1
Alternatives	Index		
Property	IPD	1.0	19.3
Commodities	DJ AIG	5.5	10.4
Hedge Funds	HFR	1.0	8.5

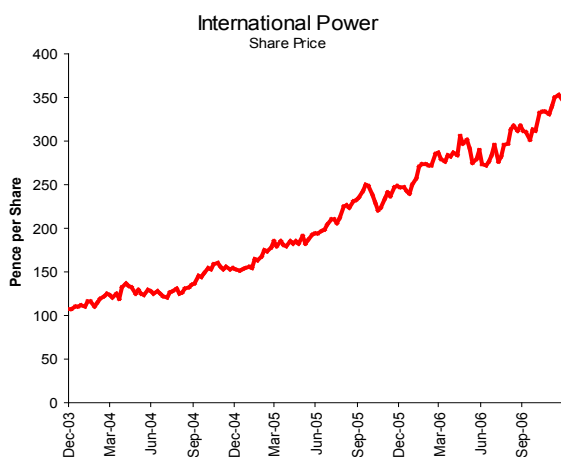
December 2006

Alternatives Outperform

Commercial property produced a steady 1.0% return, but the pace of monthly increases is slowing. Commodities had another strong month, up 5.5%, as metals and soft commodities performed well. Our hedge fund, Valu-Trac Strategic, produced a 3.8% return for the month and this, combined with strong returns from the Norwich Property Trust and our Schroder commodity fund meant our alternatives portfolio outperformed its benchmark with a 3.6% total return.

Takeovers Support UK Utilities

Out of the top 350 companies in the UK, the best performing sector over the past month has been Electricity Utilities. This has had more to do with takeover speculation than a move by investors towards what is traditionally seen as a defensive sector due to its predictable cash flows. There is still an estimated £75bn of private equity funds looking to invest in the utility sector.



Our holding of International Power has allowed us to participate in this rally, but the time is fast approaching when we shall look to take profits.

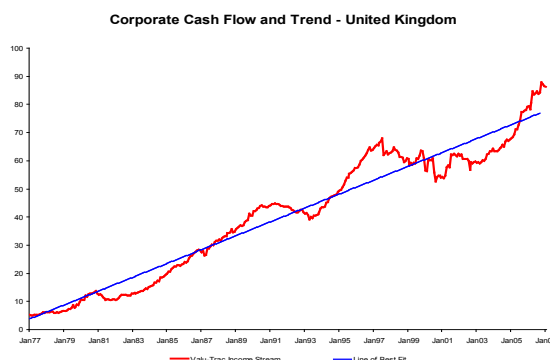
We have recently sold British Airways, locking in a strong gain, following a profits warning over extra pension and security costs. We replaced British Airways with Speedy Hire, which hires out equipment to the construction industry. First half earnings rose 19% on strong construction activity, new safety laws requiring additional

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equipment and a trend toward firms renting rather than buying equipment. Since the date of purchase, the stock has outperformed the FTSE 100 by 5%.

Clouds on the Equity Horizon

As the equity bull market matures, so the scope for further rises in equities appears to be diminishing. In the UK, company cash flow per share has recently stopped growing, after a meteoric rise over the past three years (see the chart below). In addition, share price momentum



has turned down, which is frequently a precursor to a market correction. The prospect of higher interest rates and stronger sterling is discouraging for UK equities, although the growth outlook for the UK economy remains favourable, with the government forecasting 3.0% growth in 2007. A further support for the equity market is the wall of money, held by private equity funds, that is seeking a home. Continued strong merger and acquisition activity may help the FTSE 100 to reach new highs for this cycle, over perhaps the next six months, but returns on private equity are diminishing as more money chases fewer opportunities. Eventually, the excessive leverage in many of these transactions will end in losses, as we have seen so many times in the past. We look to reduce equity exposure over what we anticipate will be the last phase of this bull market.



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