PROSPECT WEALTH MANAGEMENT

Investment Prospects

Summary

- **Economic stability appears to be approaching, but don't expect a rapid rebound in growth.**
- **Our equity portfolios have profited from recovery - Alpha portfolio up 20% in April!**
- **Equity price momentum on the point of turning up - prepare for a new bull market.**
- **We re-establish an exposure to commodities in anticipation of a turn in the commodity cycle.**

Global Economy Now Stabilising

Over the past month we have seen convincing evidence globally that the rate of decline in economic activity has passed its low point and that the banking crisis has been contained. The result of the US Treasury's authoritative stress tests was that the US banks needed to raise "just" $75 billion to restore prudent capital ratios. This is easily manageable and, together with improved financial results from the major banks in the first quarter of this year, has done much to reassure markets that the banking system is moving out of intensive care. Inter-bank lending rates of only 0.7% in the US and 1.3% in the UK reinforce the message that normality is returning to the global banking system.

The economic news has also been reassuring. In the UK, after a fall in gross domestic product of -1.9% in the first quarter, it now looks as though the economy may only shrink by -0.5% in the second quarter. Consumer confidence has risen and retail sales grew by a healthy 0.3% in March, bolstered by lower mortgage rates. De-stocking by companies appears to have reached a turning point so industrial production is stabilising, helped by a sharp recovery in exports in April as the 25% fall in sterling made UK goods more competitive overseas. The chart overleaf shows how expectations of UK economic activity, which are a good indicator of future growth, are picking up.

In the US, a range of economic indicators also point to the worst having passed - the decline in industrial production and the pace of job losses have slowed recently, whilst consumer confidence has risen.

Equity Markets Rally Strongly

Signs of economic stabilisation provided the catalyst for a major rally in equity markets during April, a move that has continued into May. Europe and the Pacific Basin were the best performing regions in sterling terms, which was pleasing as we moved overweight in the Pacific region in mid March.

In the UK, those sectors most exposed to the economic cycle (banks, real estate, industrials) produced the strongest returns. Not surprisingly, our Alpha portfolio, which invests exclusively in out-of-favour stocks, produced a return of 20.1% over the month. Our standard UK equity portfolio, which is more diversified, also outperformed with a return of

Total Returns in Local Currency

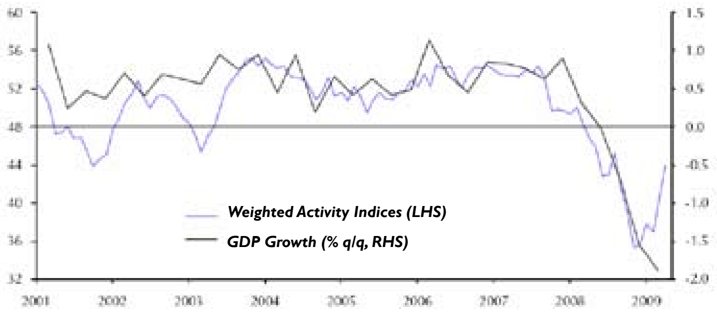
Last month and last 12 months

		Total Return for Market 1 month to 30 Apr %	Total Return for Market 12 months to 30 Apr %
Currencies v £	Rate		
US dollar	1.48	-3.1	34.3
Euro	1.12	-3.3	13.8
Yen	146	-2.8	41.6
Cash (3m)	Yield %		
USA	1.00	0.1	2.9
UK	1.14	0.1	5.7
Euro	1.37	0.1	4.8
Japan	0.65	0.0	0.9
Bonds (10yr)	Yield %		
USA	3.12	-3.6	9.0
UK	3.51	-2.6	14.4
Germany	3.18	-1.3	12.1
Japan	1.43	-0.6	3.5
Equities	Index		
USA	S&P Comp	9.7	-34.5
UK	FTSE 100	8.5	-27.2
Germany	DAX	17.2	-27.9
France	CAC	13.0	-33.3
Spain	SMSI	15.1	-33.8
Italy	BCI Gen	19.3	-37.1
Japan	Topix	8.5	-36.7
Australia	All Ord	6.7	-28.4
Hong Kong	Hang Seng	14.8	-37.0
Alternatives	Index		
Property	IPD	-2.4	-27.0
Commodities	DJ AIG	-0.5	-47.1
Hedge Funds	HFR	2.5	-25.1

Source: Reuters

May 2009

CIPS / Markit Activity Indices & GDP Growth



Source: Capital Economics

10.7%, reflecting our moves into cyclical stocks in recent months.

The initial euphoria that economic meltdown has been avoided is now being replaced by a more sober assessment of the outlook for longer term economic recovery. The Bank of England quarterly report emphasised that the pace of recovery is likely to be slow and unpredictable, as bank lending will be constrained by loan losses and unemployment will continue to rise for some months to come. The path of the equity market is thus likely to remain uncertain over the summer months.

Whilst it may be tempting to "sell in May and go away", there are sufficient positives for us to maintain our overweight position in equities. Price momentum appears to be bottoming, which has been a good indicator in the past that a sustainable bull market has been established. In addition, analysts are beginning to upgrade company earnings forecasts, as can be seen in the chart opposite.

Corporate Bonds Rally

The recovery in corporate bond prices has gathered pace in April and May. Even though gilt prices fell in anticipation of the huge volumes of new gilts to be issued to fund government expenditure, our bond portfolios produced positive returns thanks to their corporate bond exposure. Corporate bond prices have recovered from the collapse seen last November, but there remain some sectors, in particular the financials, that remain attractive. We have recently switched our Tesco bond into HSBC to capture a yield of 6.8%. On average, we are achieving a yield of 5.5% on our corporate bonds. This yield can also be achieved on relatively short dated bonds (an average of 3 years maturity), making this an attractive alternative to bank deposits.

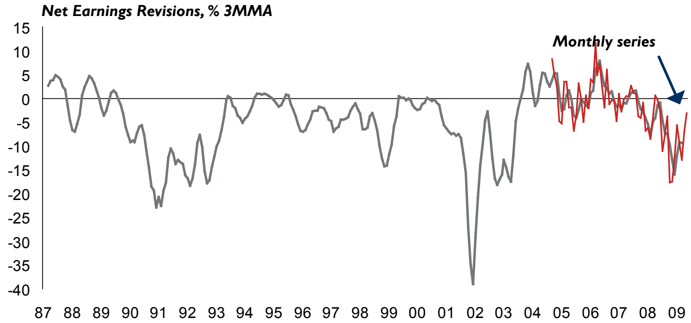
UK consumer price inflation, after allowing for the cut in VAT, has remained stubbornly high at 3.8% in April as the depreciation in sterling has pushed up imported prices. Although the trend in inflation should start to fall, which would be good for bonds, there is sufficient uncertainty for us to maintain our cautious outlook for bonds.

Commodity Holding Re-established

Commodity prices, as measured by the DJ-AIG Index, have fallen by 46% since we sold out last July. We have recently bought back into commodities as the prospect of economic stability and the rebuilding of stocks in China appear to underpin commodity prices. The oil price has risen from a low of $35 a barrel to $60 currently as cut-backs in supply by OPEC have brought supply and demand closer to balance. Similarly, the copper price is up by 50% from the lows as mine output has been reduced to reflect current demand. Those clients without exposure to Alternative Investments should now consider diversifying into this sector.

Matthew Hunt

UK Company Earnings Revisions Balance



Source: Nomura

PROSPECT
WEALTH MANAGEMENT
22 Rathbone Street, London WIT ILA
T: +44 (0)20 7413 2799 F: +44 (0)20 7413 0988
www.prospectwealth.co.uk