



Seasons Greetings

- **Equities are in a consolidation phase; fundamentals remain supportive.**
- **Interest rates will remain low for many months. Bonds are vulnerable so we have shortened maturity.**
- **Currencies are approaching extremes of valuation - expect more volatility in 2010.**
- **Alternative investments have produced strong returns in November.**

Consolidation Phase for Equities

The equity markets have remained, as we expected, in their consolidation phase over the past month, as news of company earnings and economic growth catches up with the 50% rise in Western markets that we have seen from the lows of March. In general, the global economic news continues to point to gradual recovery, particularly in the US, where the unemployment rate improved in November from 10.2% to 10%, raising the prospect of a return to job creation as virtually no net jobs were lost over the month. Improving demand from Asia and the US is boosting trade in Europe, potentially adding 1% to European growth in the third quarter and contributing to a rapid improvement in business sentiment in Europe. The UK, by contrast, has yet to return to growth in industrial production after 18 months of declining output, though the CBI industrial trends survey points to improving confidence and house prices have now been rising for 5 months, according to the Halifax index.

Improving confidence is also reflected in company dividend payments. In the UK and Europe, aggregate dividend payments rose in October, after falling in the first 9 months of this year and the number of companies increasing their dividends was higher than those cutting. This combination of factors appears to be establishing a sound base from which we expect equity markets to rise further in the first quarter of 2010.

Debt Fears Rattle Markets

The threatened default of Dubai World provided a brief scare for markets in November. However, investors quickly realised that the \$80bn of Dubai property loans were minor in the context of the £3,000 billion of property loans outstanding in the US and Europe, particularly as the huge wealth of the United Arab Emirates means some form of refinancing arrangement is almost certain. Nevertheless, it does serve as a reminder that the path to recovery will not be smooth and that other surprises must be expected.

Greece, for example, faces major challenges in financing its debt burden, the implications of which are likely to ripple through the European Union.

These debt related issues mean that we are still some months away from interest rate rises in the US, UK and

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	1.65	0	-6.4
Euro	1.10	1.9	10.6
Yen	142	4.3	3.5
Cash (3m)	Yield %		
USA	0.25	0.0	2.2
UK	0.46	0.0	3.9
Euro	0.48	0.0	3.8
Japan	0.17	0.0	1.0
Bonds (10yr)	Yield %		
USA	3.20	1.9	0.6
UK	3.53	1.1	5.9
Germany	3.16	1.0	4.1
Japan	1.26	1.6	2.7
Equities	Index		
USA	S&P Comp	5.9	25.8
UK	FTSE 100	3.4	26.3
Germany	DAX	4.2	26.1
France	CAC	2.3	18.2
Spain	SMSI	2.2	33.1
Italy	BCI Gen	-0.3	16.9
Japan	Topix	-5.9	3.4
Australia	All Ord	1.9	37.1
Hong Kong	Hang Seng	0.5	62.3
Alternatives	Index		
Property	IPD	2.5	-7.1
Commodities	DJ AIG	3.5	11.4
Hedge Funds	HFR	1.9	23.3

Source: Reuters

Europe, though some scaling back of emergency lending is likely. For this reason, UK bond yields fell over the past month, producing a 1.1% return on a 10 year government bond, with corporate bonds again outperforming. We still believe that the balance of risk over the coming two years is that inflation, and therefore bond yields, will rise as monetary and fiscal stimulus is kept in place too long in order to ensure recovery. We are therefore further reducing our exposure to interest rate risk by taking profits on our longest dated bond, the HSBC 6.5% 2023, and replacing it with a GE bond maturing in 2017.

US Dollar Now Cheap

Stresses are also developing in the currency markets. The US is facing a budget deficit this year of 10% of GDP and escalating debt as a result of increasing baby boomer entitlements and the introduction of healthcare reform. The obvious way out is to seek growth through currency devaluation and debt reduction through inflation. So far, Europe and Japan have acquiesced to dollar devaluation in the interests of restarting the US engine of growth. However, as the chart below shows, the dollar is now close to an extreme level of undervaluation compared to purchasing power parity and there is likely to be resistance to further weakness as export orders are now under pressure.

China has not participated in these efforts to rebalance global trade, having refused to re-value its currency against the dollar. In fact, by investing massively in further infrastructure projects over the past 12 months, China

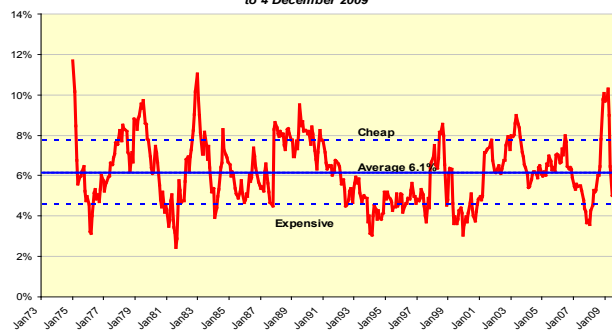
US Dollar vs All Currencies & PPP - \$ Now Very Cheap



Source:Valu-Trac

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Equity Cash Flow Yield - Hong Kong to 4 December 2009



Source:Valu-Trac

has increased its need to export more to fill this spare capacity, thereby exacerbating the situation. If growth were to slow in China as government spending is withdrawn in 2010, there is the possibility that far from revaluing the renminbi, the Chinese could devalue the currency to promote export growth. Such an outcome could easily promote a trade war, which is perhaps the biggest danger for markets next year. We can only hope that China moves to rebalance their economy by promoting domestic growth and a revaluation of the renminbi. This serves to highlight that the China growth story is not a one way bet. Indeed, after a near 80% rise from the lows, the Asia Pacific markets are now greatly overvalued, as can be seen in the graph above and we are taking profits on these markets.

Alternative Assets Perform Well

The alternative markets have performed strongly over the past month. Our hedge fund appreciated by 7.1% with gains from currencies and gold in particular. Our commodity fund was up 1% and our commercial property investment is now up 7.4% since purchase in September.

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