

Summary

- *Foundations for global economic expansion steadily strengthening - confidence, employment up.*
- *Inflation outlook in UK remains uncertain and bond prices are likely to be volatile this quarter.*
- *Equities are now a little overvalued though company earnings are growing strongly.*
- *There are plenty of potential catalysts for an equity setback - we are looking to take profits.*
- *Commercial property and hedge funds offer useful diversification in the coming months.*

Review of Recent Events

The first quarter of 2010 was characterised by improving global economic trends despite some setbacks caused by the huge debt overhang and the poor weather in the Western hemisphere. In the US, the economy grew at 5.6%, twice the long term average, in the fourth quarter of 2009, and employment growth turned positive in the first quarter of this year. Business surveys in all the major economies showed confidence rising sharply, with UK manufacturing optimism hitting a 15 year high in February. High confidence, together with strong economic growth in Asia, dispelled fears of a return to global recession, even though growth in the UK and Europe has been insipid. This better economic outlook fuelled a rise in share prices, from which our portfolios were able to take full advantage as they were positioned close to their maximum overweight in equities relative to bonds.

Gilts Little Changed

Internationally the trend was for yields to decline. In the UK though, 10 year government bond yields ended the

**The risk of a short
term correction is
increasing**

quarter little changed. Stubbornly high 3% inflation and uncertainty over how and when an unsustainably large government debt burden would be reduced, meant that UK bond prices were volatile. At one point yields reached 4.3% before falling back to 4.0% at the quarter end. We remained cautious about the outlook for UK bonds and continued to hold only securities with a short average maturity that are less exposed to inflation risk.

Corporate bonds continued to perform strongly. The yield advantage on some better quality names, such as RWE, the utility company, fell to just 0.8% above gilts (compared to 2.2% a year ago), as the risk of default receded. At this level, our RWE 2013 holding offered little scope for improvement and we sold the bond in early April at a yield of just 2.8%. We reinvested in another utility company's bond, Electricity North West 2015, for a more attractive yield of 4.6%.

UK Equity Prices Rise

Our strategy during the first quarter was to overweight the UK and US equity markets by reducing holdings in Europe and Asia. In the event, as the table on page 3 shows, Europe produced the lowest returns, with the most highly indebted countries (Spain and Italy) falling in price. Hong Kong also fell as investors took profits in a

April 2010

market that appeared to have risen too far, too fast and had become overvalued. The UK and US produced 6% returns, whilst Japan, where economic growth has rebounded sharply, was up 8%. Our US and Japanese investments were enhanced by a 6% rise in the US dollar and the yen, as sterling responded to the UK's relatively weak growth outlook, concerns over debt and political uncertainty ahead of the election.

All equity markets benefitted from upgrades to expectations for company earnings growth. It became apparent that cost cutting in the past two years has left companies well-positioned to take advantage of even a modest upturn in demand. In the UK, the best performing sectors were mining (benefitting from a 6% rise in the price of base metals), industrial companies (benefitting from the devaluation in sterling) and media, where advertising revenues are picking up, as is typical at this point in the economic cycle. Our portfolios are well represented in these areas, but did suffer from an overweighting in insurance, which underperformed after Prudential announced a bid for the Asian assets of the troubled US insurer AIG.

Overall, our UK portfolio underperformed the market by 1% over the quarter, though this was partly offset by outperformance in the international investments. Our computer-driven Alpha portfolio, by contrast, continued to perform strongly in this recovery environment, outperforming by 2.2% for the quarter and by an impressive 29% over 12 months with a return of 74%.

Alternative Investments

Commercial property has seen some slowing both in the pace of price appreciation in prime properties and in the amount of cash flowing into the sector. Whilst prime property is up around 18% from the lows of last year, second tier properties are still attracting little attention and yields are close to the highs of the past two years. Our Aviva property fund, which holds predominantly prime real estate, was up 6.2%, slightly ahead of the IPD property index.

Commodity markets overall were down by 5.0% as agricultural prices such as corn, wheat, soyabeans, cocoa and sugar, weakened across the board. Declines in this segment more than offset rises in base metal prices, which continue to be driven higher by demand from China, where a 12% rate of economic growth has fuelled a 93% rise in the price of copper over the past year. Our commodity fund, managed by Schroders, was down 4.1%, outperforming the benchmark.

Our hedge fund, Valu-Trac Strategic, was down 1% for the quarter as losses on commodities and equities in January were not fully recovered by the end of the quarter. However the fund is up 16% over the past 12 months and recently received an award for being the best European managed futures fund in 2009.

Finally, our Deposit Alternative portfolio produced a positive 1.5% return for the quarter. Each component of the portfolio produced positive returns in line with our expectations of producing a stable 6% annual return.

Prospect Wealth Management: Performance of Model Portfolios at 31st March 2010

Model Portfolio	Last Quarter		Last 12 Months		Benchmark Name
	Prospect %	Benchmark %	Prospect %	Benchmark %	
Deposit Alternative	1.5	0.1	7.6	0.8	3 month LIBID
Bond	4.3	2.1	12.9	-0.4	FTSE 5-15 years
UK Equity	3.9	4.9	45.2	44.7	FTSE 100
UK Equity Funds	8.4	4.9	49.8	44.7	FTSE 100
UK Alpha	7.1	4.9	74.1	44.7	FTSE 100
International Equity	10.6	9.1	46.3	45.1	FT All World ex-UK
Equity Alternatives	0.4	0.0	15.5	19.6	Prospect Composite*

* IPD Property index, DJUBS Commodity index, HFRX Directional index

Total Returns in Local Currency and in Sterling Terms

3 months and 12 months to 31st March 2010

	Total Return Local			Total Return Sterling	
	31 st Mar	3 mths to 31 st Mar %	12 mths to 31 st Mar %	3 mths to 31 st Mar %	12 mths to 31 st Mar %

Currency v	Rate				
US dollar	1.52	6.4	-5.6		
Euro	1.12	0.4	-3.8		
Yen	142	5.8	-0.2		

Cash (3m)	Yield %				
UK	0.53	0.1	1.5	0.1	1.5
USA	0.32	0.1	1.3	6.5	-4.4
Euro	0.43	0.1	1.5	0.6	-2.3
Japan	0.13	0.0	0.5	5.8	0.3

Gov't Bonds 10yr	Yield %				
UK	3.95	1.5	-3.2	1.5	-3.2
USA	3.83	1.0	-6.8	7.5	-12.1
Germany	3.1	3.4	2.1	3.8	-1.7
Japan	1.41	-0.8	0.8	4.9	0.6

Equities	Index				
UK	FTSE 100	6.0	50.4	6.0	50.4
USA	S&P Comp	5.5	50.0	12.2	41.5
Germany	DAX	4.2	55.6	4.6	49.7
France	CAC	1.8	46.8	2.3	41.2
Spain	SMSI	-8.4	45.4	-8.0	39.9
Italy	BCI Gen	-1.0	53.3	-0.6	47.5
Japan	Topix	8.3	29.6	14.6	29.3
Australia	All Ord	1.4	47.1	10.2	83.9
Hong Kong	Hang Seng	-2.2	61.8	3.9	52.4

Alternatives	Index				
Property	IPD	4.6	15.1	4.6	15.1
Commodities	DJ UBS	-5.0	20.5	1.0	13.7
Hedge Funds	HFRX	4.2	28.3	10.9	21.0

Source: Reuters

Macroeconomic Outlook as at 31st March 2010

US	UK	Eurozone	Asia
GDP Growth			
Very positive data. US Q4 2009 GDP growth was 5.6% annualised. Economic momentum improving, business investment in inventories and equipment starting to build. ISM non-manufacturing index rose to 55.3 in March from 53 in Feb. Pending home sales rose 8.2% in Feb, best rise since 2001. Case-Shiller house price index has gained for 8 straight months. Employment up with 163,000 jobs created in March and retail spending up in March.	Recovery fragile. Manufacturing domestic sales for Q1 fell, though this is partly weather related. Fall in business investment in Q4 2009 bodes badly for productivity. Services and house construction are expanding. UK house prices rose 6.2% yoy in January, double the expectation, and homeowners predict a 5.7% rise in the next 6 months after budget increased stamp duty threshold for first time buyers.	Recovery stalled in Q4 2009, but industrial production in January rose 1.4% yoy. Germany economic sentiment fell slightly in February, but was better than expected. French business confidence rose in March on higher demand for exports, now being helped by weaker euro. Greek debt problems likely to be resolved by European and IMF support without serious contagion to rest of Europe.	Japan: Coincident indicator of economic health rose for 11th month. Large manufacturers less pessimistic; profits recovering. Machine orders rose 3.7% in February, after falling 3.7% in January. Export led recovery not yet spreading to domestic consumption, down 0.5% yoy. Bank of Japan doubled lending program in March to encourage recovery. China: Q1 GDP up 11.9%. Exports rose for fourth consecutive month.
Employment			
Unemployment peaked at 10.2% last year, expected to end 2010 at 9.5%. Jobs being added in manufacturing, healthcare, temp agencies and warehouses. Negative news: long term unemployment and underemployment are both up and hourly wages dropped.	Jobless claims fell by 32,000 in February, the largest monthly fall since November 1997. Wage growth slowest since 2004; manufacturing slump creating wage freezes. Employment indicator declined sharply. Government job creation necessary.	Unemployment at 10% in February. Worst is Spain with 19%. Labour cost rises moderated through 2009, up 2.7% in Q4 after a 3.2% rise in Q3.	Japan: Unemployment rate of 4.9% well below 5.7% peak 6 months ago. China: Unemployment remains high in at 9.2% in spite of a rapid economic growth rate.
Inflation			
Inflation eased from 2.7% in Feb to 2.6% in March. Fed not worried about inflation as capacity utilisation remains low. A rising dollar has brought 0.3% deflation in import prices YTD. Economists expect the Fed to raise rates by 0.5 to 0.75% in Q4 2010. Fed will delay if inflation doesn't pick up, probably forcing dollar to resume downward trend later this year. Rising global currency reserves is blunting rise in Treasury yields.	Consumer price inflation was 3.0% in February, down from 3.5% in January. Rising house prices and weak sterling mean inflation likely to rise again in March. BOE likely to hold base rate at 0.5% until at least November. Prospect of hung parliament weighing on Sterling against major currencies apart from the Euro.	Eurozone: Inflation rose 1.5% (1.1% forecast) in March on rising oil costs and weak euro, after rising 0.9% in February. ECB expects inflation to ease towards 0% later this year, and thus will probably hold rates at 1% until Q1 2011. Eastern Europe: Russian central bank may halt year long cycle of rate cuts, as they expect inflation to reaccelerate amid global recovery and as bank lending rises 5-10% in 2010.	Japan: Deflation persists. Govt may pressure BOJ to spur economy ahead of July election. BOJ expected to leave rates on 0.1% for full year. China: Gov't raised mortgage rates and tightened credit terms for home buyers to cool property bubble. Interest rate rise may wait until H2 as CPI came in lower than expected.
Balance of Payments			
Current account remains in deficit despite recession, which would normally reduce imports more. Policy likely to promote weaker dollar therefore. Net capital inflows fell from \$53.6 bn in December to -\$33.4 bn in January. Treasury aims to double level of exports. Bearish for USD	UK trade deficit in January was largest since Aug 2008 as exports of chemicals slumped. Exports slow to respond to sterling weakness, though expected to improve this year. Perhaps foreign importers expect further weakness.	In 2009, European exports overall fell by 18%, down 20% to the US and UK, while exports to China rose 4%. Fall in Euro/USD YTD and even more to the yuan will further encourage European exports	Japan: exports to China are recovering as Chinese stimulus continues and should further raise the current account surplus. China: Slowing recent trade deficits against many countries and first overall small monthly trade deficit since 2004.

Economic Forecasts as at 31 March 2010

	Real GDP growth		Unemployment rate		Inflation (CPI)		Budget % GDP	Central Bank rate		Current A/c % GDP
	2010 %	2011 %	6m ago %	2010 %	Latest %	2010 %	2010 %	Nominal %	Real %	2010 %
US	3.1	2.9	9.8	9.7	2.1	2.2	-11.1	0.25	-1.9	-3.5
UK	1.3	2.1	7.9	7.8	3.0	2.7	-13.5	0.5	-2.5	-0.7
Eurozone	1.2	1.4	9.5	10.0	0.9	1.2	-7.2	1.0	0.1	-0.1
Japan	1.7	1.6	5.7	4.9	-1.1	-0.9	-7.8	0.1	1.2	4.1
China	9.7	8.2	9.0	9.6	2.7	3.5	-2.9	5.3	2.6	4.4

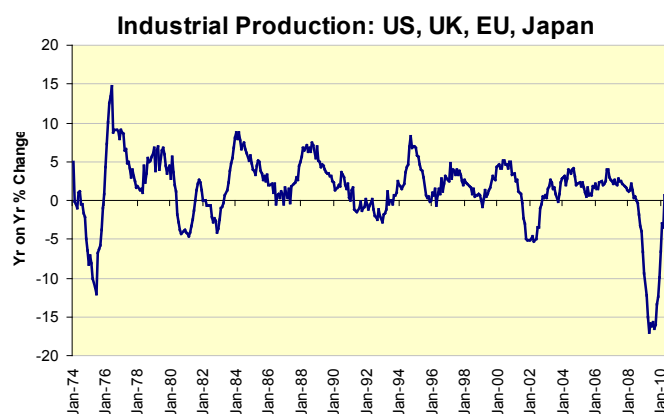
Source: The Economist and Bloomberg

Market Outlook

Interest Rates & Currencies

Over the past three months, forecasts for economic growth have been raised modestly in all regions, although the US is still the only developed economy expected to grow at above the 2.5% long term trend rate over the next 2 years. These forecasts reflect the worry that current high levels of debt will have to be reduced and that the process of doing so will be a constraint on economic expansion. The solution to the debt problem is a combination of growth and austerity. The challenge is to find the right mix - too much growth and inflation will rise, leading to excessive financing costs for government debt. Too much austerity, through spending cuts and higher taxes, and the growth will be snuffed out.

We continue to believe that current forecasts underestimate the ability of the global economy to grow and bring debt down to manageable levels. Industrial production is on a strongly rising trend in all economies, as can be seen in the chart above. This is partly due to companies restocking, a process that has further to run, but it is also now being accompanied by



Source: Valu-Trac

a recovery in investment spending. For example, Intel, the manufacturer of microchips for computers, has just reported a 44% rise in sales as companies re-equip for recovery. Already, unemployment is declining in all the major economies and consumer confidence and spending is picking up as a result. This classic cycle of regeneration is in its early stages and is supported by low interest rates that are unlikely to rise in the US, UK and Europe for at least six months, as central banks seek to reinforce the growth trends.

Longer term stability requires global trade to be rebalanced so the huge surpluses in China, the Middle East and Germany can be used to support export growth from the indebted countries: the US, UK and parts of Europe. Although these imbalances are



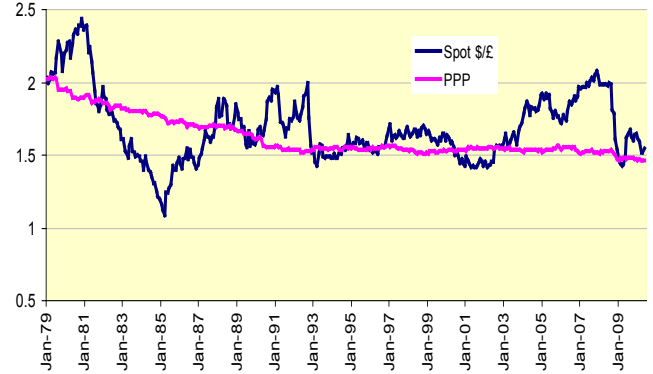
partly structural (does the UK manufacture goods the Chinese want to buy?) it seems inevitable that exchange rates will shift to promote rebalancing. This means Asian currencies may appreciate and sterling should depreciate against the US dollar. As the chart opposite shows, the pound is still slightly expensive relative to the dollar on an inflation adjusted basis, so there is room for a further devaluation of sterling. Our portfolios are positioned for this outcome.

In the short term, sterling faces a further risk. If the forthcoming election produces a hung parliament, it would not be surprising to see the pound depreciate as political stalemate leads to fears that a debt reduction strategy may not be agreed quickly. Despite the polls, we see the probability of the Conservative party being unable to form a government as low (around 30%). The Conservatives have the support of 10 Ulster MPs and voter apathy, which is high and rising, favours the Conservatives. As a result, our investment policy is not as defensive as it might be if we predicted a hung parliament.

UK Bonds

Below trend economic growth and forecasts from the

US \$ per GB £ vs Purchasing Power Parity
to 31 March 2010



Source: Valu-Trac

Bank of England that inflation will fall back to 2% should be reassuring for the UK bond market. However, with yields on 10 year government gilts at 4.0%, or just 1.0% after current 3.0% inflation, there is little room for disappointment. The risk is that economic recovery produces supply bottlenecks and that price rises accelerate rather than slow. High levels of government debt create an inherent instability and with the trend pointing to further falls in bond prices, we are maintaining a defensive position in government bonds.

Corporate bonds have now become expensive relative to gilts as their yields have fallen sharply. Despite this, we are still able to achieve yields on average 2% above gilts, so are maintaining 50% of our bond exposure in corporates because the economy is growing and default risk receding.

Measures of Market Valuation

As at 30 June	BONDS				
	Inflation forecast	10 yr bond yield		10 yr bond yield	
		Nominal	Real	3m chg	12m chg
	%	%	%	%	%
US	2.8	3.8	1.5	0.2	1.2
UK	3.1	4.0	0.8	-0.1	0.8
Eurozone	1.6	3.1	1.5	-0.1	0.1
Japan	1.9	1.4	-0.5	0.1	0.1

Source: ThomsonOne, Nomura

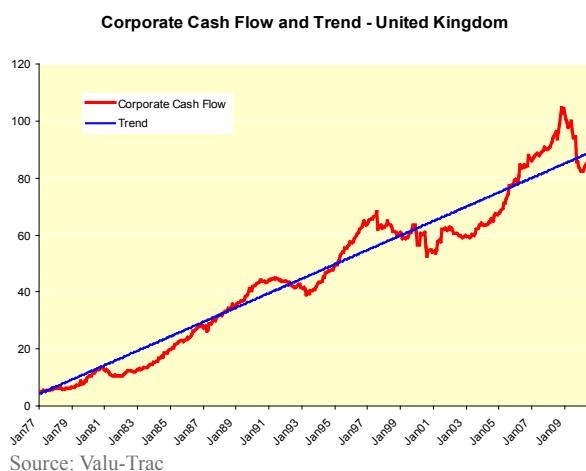
The inflation forecast is the average of the past 5 years' inflation.

	EQUITIES					
	P/E 2010	Valuation		Earnings growth		Volatility
		ERP*	Div Yield	2010	2011	
	%	%	%	%	%	%
S&P 500	15.0	2.8	1.9	25	20	21
FTSE 100	12.3	4.2	3.7	45	21	19
EURO Stoxx 600	13.1	4.5	3.8	48	24	22
Topix (Japan)	34.5	1.5	1.7	140	75	22
China	18.1	2.1	1.7	59	19	27

* Equity Risk Premium = (earnings / price) * 100 - 10yr bond yield

Global Equities

Equity markets are now up by an average of more than 50% over the past 12 months. The key driver for these large gains has been expectations for a recovery in corporate profits. Increased earnings are now starting to materialise in all markets and we show below how cash flow is clearly turning up in the UK after a precipitous fall from the peak in 2007. We

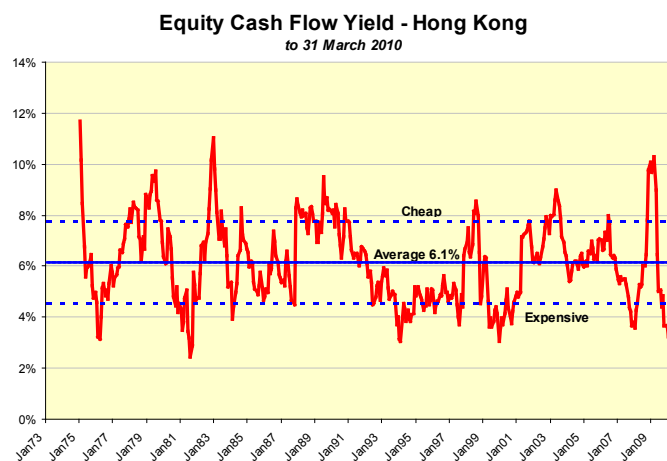


expect that UK company earnings will rise by 45% this year, a forecast that has been increased from 28% just 3 months ago. This rapid rate of growth reflects the impact that modest revenue increases can have on the profits of businesses that have pared back costs and are benefitting from renewed stockbuilding. Such impressive productivity gains are typical at this stage of the cycle and are being seen in all the major economies. Japan, for example, is expected to see earnings growth of 140% this year and Europe of 48%.

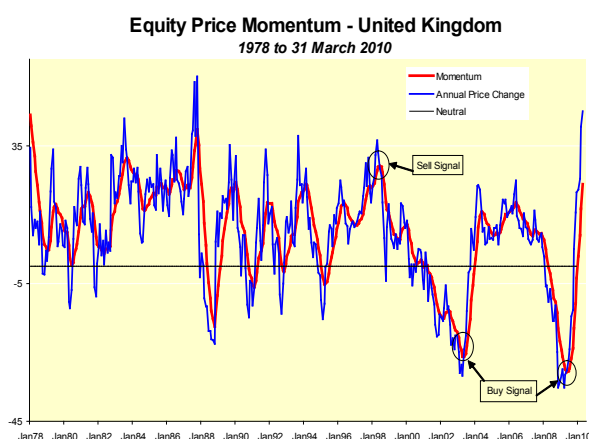
There is little evidence of earnings being constrained by a lack of bank finance, as the major corporations have been able to refinance themselves in the capital markets. We expect that by the time bank finance becomes essential for growth in the wider economy, banks will have rebuilt their balance sheets and will be better able to increase lending to support small and medium sized companies.

Valuations currently vary widely across markets (see table on page 6), reflecting the different growth rates and levels of debt. Interestingly, there is a close relationship between the level of government debt and the valuation of stock markets: the higher the debt, the lower is the valuation. Swiss equities (debt is very low in Switzerland) are thus twice as highly valued as Italian equities. It has also been shown that reducing debt through cutting spending is more effective than by raising taxes. Relating this to the forthcoming UK election, one would expect a Conservative majority to be well received, given their debt reduction plans are expected to be more aggressive than those of the other parties. We see perhaps 5% upside immediately from a Conservative victory and perhaps 10% downside in the event of a hung parliament.

Using current cash flow yield as a measure of value, the UK and Japanese equity markets are close to their average valuations, making them attractive relative to the US and Europe, where valuations are becoming excessive, though not extremely so. Hong Kong, as we show in the graph below, has reached an extreme level of over-valuation, making the market unattractive. We are therefore about to switch our Asia Pacific exposure into Japan, where valuation and growth prospects are more attractive in the medium term.



Whilst equity valuations based on current earnings are not compelling overall, expected strong earnings growth over the next 2 years does mean that equity markets can rise further. We expect the economic news over the next month to be positive as Western economies rebound from the poor winter weather, but the further markets rise, the greater is the probability of a material correction. Markets do not move in a straight line and price momentum in all markets is now very extended after the large moves of the last 12 months. The UK is a good example of this, with the graph below showing that we are close to a point at which a correction typically occurs. There are many



Source: Valu-Trac

potential catalysts for this - another debt scare in Europe, higher inflation, a political upset - to name but a few.

With portfolios currently close to their maximum overweight in equities, we are therefore poised to reduce exposure back to a benchmark level and lock in some of the significant gains we have seen over the past year.

In conclusion, the outlook for company earnings growth continues to be positive, but equity valuations are mildly expensive and markets are vulnerable to a summer setback given the prevailing uncertainties.

UK Stock Comments

We are currently overweight in the mining sector as expected earnings growth of between 40% and 70% over the next two years leave the companies we hold on fair valuations and represent an attractive means of participating in the global economic recovery. They are, of course, vulnerable to any slowdown in China, so we are ready to pare back these holdings if signs of Asian weakness appear.

We have held an overweight position in media for some months and it is only now that, with economic growth accelerating, we are seeing advertising revenues increase and media companies benefitting. This sector should continue to perform well in coming months.

Telecoms is an area that we have recently increased exposure to, through the purchase of BT. The stock had become very cheap as fixed line telephony appeared to be yesterday's technology. However, with the increased importance of large volume data transfer over the internet, fixed line should gain competitive advantage over mobile. With forecast earnings growth of 8% and a dividend yield of 6%, we consider the shares have 50% upside potential relative to the market.

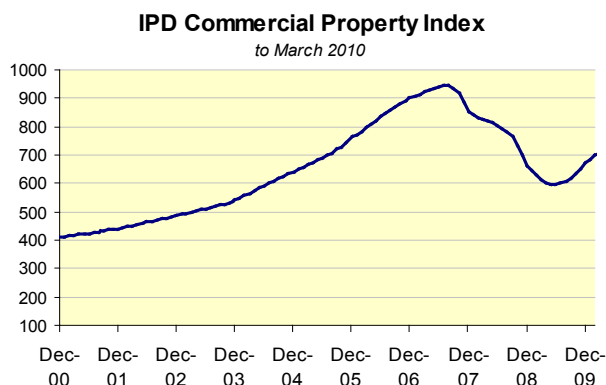
In the financial sector, the largest component of the UK market, we have a neutral weighting, though are underweight banks and overweight insurance companies. Insurance stocks have lagged the recovery in the stock market, even though they are exposed to the markets through the investment of their reserves. We therefore expect a catch-up from the sector whilst banks continue to be constrained by the prospect of higher taxation and regulation.

Alternative Investments

Commercial Property

Investors are likely to add to their UK commercial property allocations in 2010 as the class offers better yields than investment grade bonds and less risk than equities after their strong rally over the past year.

A two tier market in UK commercial property looks likely to persist for at least the next year. Banks will be selling property assets this year, but are likely to shed prime central London assets where foreign demand is highest, and hold onto their non-prime properties to avoid realising book losses. New property funds are another source of demand. Though the recent fall of the euro might discourage this buyer segment, new dollar and Asian buyers should emerge.



Source: IPD

Commodities

Oil prices are likely to be supported by stronger economic growth and OPEC's statement that they will only increase output if oil price rises above \$100. With Chinese growth coming in stronger than expected, and the Chinese authorities using muted inflation data to justify postponement of a rate rise, we would expect crude prices to drift higher in the current quarter, with the US driving season extending gains into the summer.

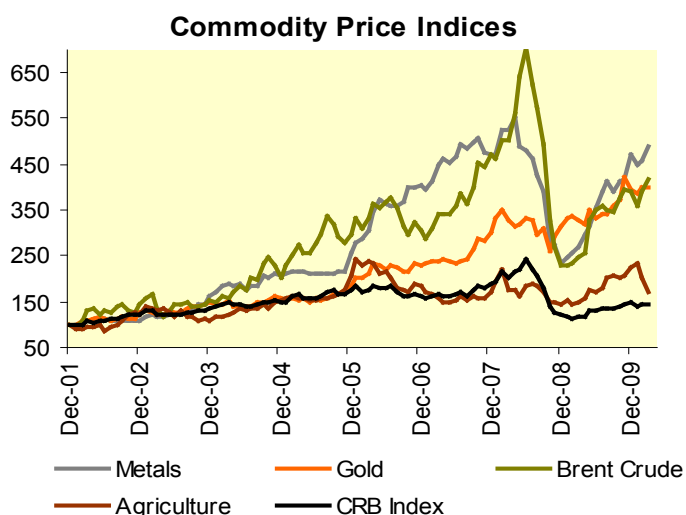
Gold and other precious metals are poised for an outbreak if the impressive rebound year to date in the dollar stalls or if inflationary pressures begin to be seen in response to stronger growth. Base metals, such as copper, which are at 20 month highs, have probably approached resistance levels despite continued strong global demand.

Agricultural commodities have lagged other commodity groups, but hedge funds are unwinding short positions on wheat and soybeans, in response to an increase in Chinese demand.

Hedge Funds

Our Valu-Trac hedge fund has no bond exposure at present, but is overweight equities with an emphasis on Spain and Japan. They have recently increased their gold exposure and have a significant weighting in agricultural commodities. These positions reflect their focus on markets that are undervalued or where price momentum is rising.

Matthew Hunt 0207 392 2811



Source: Bloomberg

Asset Allocation For April 2010*

50% Bond / 43% Equity / 7% Alternative Model

		Strategic Benchmark			Q2 2010 Tactical weights	Weighting vs Strategic Benchmark
		Min %	Benchmark %	Max %	%	%
Cash		0	0	10	1	+1
Bonds:	UK Government	20	50	60	20	-30
	UK Corporate	0	0	30	24	+24
	Total Bonds	40	50	60	44	-6
Equities:	UK	20	30	40	29	-1
	US	0	6	16	8	+2
	Europe (ex UK)	0	3	13	2	-1
	Japan	0	2	12	4	+2
	Asia / Emerging	0	2	12	2	0
	Total Equities	33	43	53	45	+2
Alternatives:	Property	0	3	13	5	+2
	Commodities	0	2	12	2	0
	Hedge funds	0	2	12	4	+2
	Total Alternatives	0	7	17	11	+4
Total			100		100	0

Source: Prospect Wealth Management

***This table shows the asset allocation agreed to be applied to all portfolios for the current quarter, using a 50/50 benchmark as an example.**

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