PROSPECT
WEALTH MANAGEMENT

Investment Prospects

Summary

- *Pace of economic recovery is slowing and prospect of austerity programmes increases uncertainty.*
- *Inflation in UK now more likely to decline, but gilts offer little value on a real yield of 0%.*
- *Equity valuations range from cheap in Japan to expensive in the Pacific Basin.*
- *Company earnings revisions and price momentum are both falling in all equity markets - warning!*
- *Commercial property prices are slowing - we are alert to the risk of a renewed downturn.*

Review of Recent Events

The economic recovery that developed over the 12 months to March faltered during the last three months. The rebuilding of inventories that has been the basis of recent growth was expected to lead to capital investment and higher employment. However, inventories appear to be peaking, employment growth is weak in all the Western economies and business confidence is slipping, albeit from high levels. The debt crisis in Europe has been contained in the short term, but excessive debt remains the over-riding issue for Western countries. There is little agreement between countries as to the appropriate balance between growth, spending cuts and structural change so the result is widely diverging policies: the US continues to promote growth, the UK emphasises spending cuts whilst Germany talks of cuts but continues to stimulate. It is not surprising therefore, that market returns have varied dramatically from country to country. In general though, bond markets have benefited and equity markets have suffered from the weaker growth forecasts. We anticipated the equity decline but have been surprised by the strength of bonds.

Government cutbacks threaten more pain

Gilts Rally

A weaker economic outlook is typically good for bonds as inflation expectations normally fall. 10 year government bond yields fell from 4.0% to 3.4% for a total return of 5.9% over the quarter. Gilts were supported by a flight of capital from Europe into the relatively safe haven of sterling, especially after George Osborne's budget appeared to put the UK on the path to a more sustainable level of debt. We did not fully participate in this rally as we remained underweight in bonds due to our concern that stubbornly high inflation of 3.2% makes bonds intrinsically expensive.

Corporate bond prices appreciated in response to the lower inflation expectations, but worries over economic weakness meant that credit concerns rose and price increases lagged those of gilts. We sold our short dated utility bond, RWE, and reinvested in a slightly longer dated utility, ENW, with a relatively high yield of 4.6%.

Equity Markets Fall

At the start of the last quarter equity markets generally appeared overbought and ready for a correction. From a position of being overweight in equities we progressively reduced our exposure over the quarter until, at the end of the period, we were modestly underweight in the expectation of further price declines.

Equity markets did indeed fall as forecasts for company earnings growth reached a peak in May and then declined - weaker economic news and the European debt crisis dampened hopes for continued rapid earnings expansion. Declines varied considerably between markets, with Germany down 2% on the quarter while Italy was down 15%. Currency moves were also large, with the euro falling by 8.0% against sterling while the yen rose by 7.4%. Over the quarter, our asset allocation produced returns in line with our benchmarks as what we gained by being underweight in Europe, we lost by being underweight in Japan and the Pacific Basin.

In our UK equity portfolio, activity centred on reducing exposure whilst leaving a portfolio that remained well diversified but with a bias towards those companies that would perform relatively well in a weak market. On this basis we sold Xstrata, the mining company, and United Business Media, both of which are sensitive to the business cycle. In addition, we sold Glaxo to ensure that the portfolio was not overly biased towards the pharmaceutical sector. This strategy worked well and the portfolio outperformed the FTSE 100 benchmark by 1.5% over the quarter.

Our portfolio of international equity funds also outperformed, whilst our Alpha portfolio moved in line with the market after 12 months of outperformance.

Alternative Investments

Commercial property rose in value, according to the IPD index, by 3.8% over the quarter. This represented a slowdown relative to the previous two quarters and reflected property values returning to an approximation of equilibrium after two years of unusual volatility. The Aviva Property Trust lagged the index with a 1.9% return, this being primarily attributable to the income from the underlying property holdings. There were few or no capital gains on the properties over the quarter.

Commodity markets overall fell by 4.8% as energy and base metal prices fell by 9% and 17% respectively due to the weaker economic outlook. These declines were in part offset by a 12% rise in the price of gold as investors saw this as security against either debt default or higher inflation. Agriculture prices were mixed over the quarter, being modestly down on balance. Our commodity fund, managed by Schroders, moved roughly in line with the benchmark.

Our hedge fund, Valu-Trac Strategic, was up 4.1% over the quarter, outperforming the hedge fund index by 6.5%. Profits from long positions in bonds and gold and a short position in the euro currency vs the dollar more than offset their losses on long positions in equities.

Finally, our Deposit Alternative portfolio produced a positive 1.0% return for the quarter. Our corporate bonds, life settlements and securitised loans all produced positive returns as expected. The Absolute Return fund disappointed, however, and we replaced this with the Threadneedle Credit Opportunities fund.

Prospect Wealth Management: Performance of Model Portfolios at 30th June 2010

	Last Quarter		*Last 12 Months*		
Model Portfolio	Prospect %	Benchmark %	Prospect %	Benchmark %	Benchmark Name
Deposit Alternative	1.0	0.1	6.4	0.6	3 month LIBID
Bond	2.6	5.4	13.8	13.5	FTSE 5-15 years
UK Equity	-11.9	-13.4	17.9	15.7	FTSE 100
UK Equity Funds	-11.8	-13.4	18.5	15.7	FTSE 100
UK Alpha	-13.5	-13.4	24.9	15.7	FTSE 100
International Equity	-10.3	-11.8	22.3	21.7	FT All World ex-UK
Equity Alternatives	-0.5	-1.0	10.7	14.2	Prospect Composite*

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

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Total Returns in Local Currency and in Sterling Terms

3 months and 12 months to 30th June 2010

		Total Return Local		Total Return Sterling	
	30th June	3 mths to 30th June %	12 mths to 30th June %	3 mths to 30th June %	12 mths to 30th June %
Currency v	**Rate**				
US dollar	1.50	1.6	10.8		
Euro	1.22	-8.0	-3.7		
Yen	132	7.4	20.4		
Cash (3m)	**Yield %**				
UK	0.70	0.1	0.9	0.1	0.9
USA	0.77	0.1	0.8	1.7	11.6
Euro	0.62	0.1	1.1	-7.9	-2.7
Japan	0.20	0.0	0.4	7.4	20.9
Gov't Bonds 10yr	Yield %				
UK	3.36	5.9	5.8	5.9	5.8
USA	2.93	8.7	8.2	10.4	19.8
Germany	2.55	5.6	1.1	-2.9	-2.7
Japan	1.09	3.4	4.2	11.1	25.5
Equities	**Index**				
UK	FTSE 100	-12.6	19.8	-12.6	19.8
USA	S&P Comp	-11.3	14.9	-9.9	27.3
Germany	DAX	-2.3	28.4	-10.1	23.6
France	CAC	-12.5	14.2	-19.5	9.9
Spain	SMSI	-13.3	1.2	-20.2	-2.6
Italy	BCI Gen	-14.6	9.3	-21.5	5.2
Japan	Topix	-13.6	-7.4	-7.2	11.6
Australia	All Ord	-10.4	16.8	-16.7	34.6
Hong Kong	Hang Seng	-4.5	12.8	-3.3	24.3
Alternatives	**Index**				
Property	IPD	3.8	24.1	3.8	24.1
Commodities	DJ UBS	-4.8	2.0	-3.3	13.0
Hedge Funds	HFRX	-2.4	14.9	-0.9	27.3

Source: Reuters

PROSPECT WEALTH MANAGEMENT

Macroeconomic Outlook as at 30th June 2010

US	UK	Eurozone	Asia
GDP Growth			
Growth is slowing but remains positive. US retail sales fell 1.2% in May (0.2% rise expected) after rising in each of the previous 6 months. New home sales fell 32% yoy to 40 year low after end of Federal homebuyer tax credit. Auto sales fell sharply after end of 'cash for clunkers. Durable goods orders and manufacturing supporting the recovery. Further recovery in housing and autos depends on jobs growth. Nevertheless, as households boosted savings, consumer confidence rose by more than expected. Cutbacks in government spending to reduce GDP growth by just 0.25% in 2010 & 2011.	UK growth likely to have accelerated to 0.5% in Q2 but appears to be faltering now. June business surveys show services index fell and expectations collapse after budget. Manufacturing has been strong but now appears to be running out of steam as Europe slows. Retail sales strong in May due to World Cup, but now confidence is weakening ahead of government spending cuts. House prices are static as mortgage lending at about 50% of pre-crisis peak. Government spending cuts expected to take 0.5% pa off rate of growth 2010-15.	The ECB cut its 2011 growth forecast from 1.5% to 1.2% on weakening domestic demand, and effect of Greek GDP which will contract 3.9% this year and 1.2% in 2011 as it endures an austerity program. Both manufacturing and services business surveys eased in June despite strong German manufacturing performance. Q2 growth accelerated to 0.7% but growth set to slow in H2 as government spending cuts begin.	Japan:Factory output fell 0.1% and household spending fell 0.7% in May. Manufacturers' sentiment at 7 quarter high. BOJ discussing extending stimulus plan, measures thus far have not revived domestic demand. China: Growth is moderating slightly, but remains strong. Retail sales rose 18.7% and industrial production growth fell to 16.5% in the year to May, refuting the government's 8 June statement that 'China doesn't have a solid recovery in domestic demand'. Urban fixed investment eased for 3 straight months, now + 25.9% yoy.
Employment			
Private sector employment growth is insipid. Upward pressure on unemployment remains with public sector job cuts of 200,000 next year as the Federal stimulus is withdrawn, Unemployment at 9.5%, down from 9.7% as the labour force shrank. Will take years to bring employment back up to pre-recession level.	Unemployment rate of 7.8% is below rates elsewhere but unemployed numbers are rising slightly. Hope is that private sector growth will offset government job losses. The scale of public sector job losses has yet to be defined and will not impact until 2011.	Eurozone unemployment now at 9.6%, having fallen from 12 month high of 10%. Companies reluctant to hire as recovery loses momentum.	**Japan:** unemployment has risen from 4.9% to 5.2% in past 3 months; jobless rate of 15-24 yr olds is 10.5%. **China:** unrest over wages means unemployment is a potentially explosive issue.
Inflation			
Inflation fell by the most in May in 1.5 years. The Fed is still worried more about deflation than inflation, as they expect European debt crisis to weigh on global growth. The US state and local government budget cutbacks are further justification for keeping rates on hold for an extended period.	June inflation eased to 3.2% after hitting a 17 month high of 3.7% in April. Inflation expectations are rising, now at 3.3% for a year forward, the highest level since August 2008, up from 2.5% in February. Wage increases are unlikely given unemployment rate, but input prices are rising by 11% yoy as raw materials prices go up.	The Euro has fallen 20% against the dollar since November 2009. This has raised inflation pressure (oil price in Euros). High unemployment and wage cuts in Germany should keep a cap on inflation, even though producer price inflation accelerated to 3.1% in May as energy prices rose by 7%.	**Japan:** Wages rising as people doing more overtime so deflation rate declining since Q3 09 but too soon for BOJ to tighten. **China:** Inflation was 3.1% annualised in May, above the full year target. M2 growth moderated slightly but is still at 21%. In response to US threats of protectionist measures, China lifted the yuan/USD peg. Interest rates likely to rise in Q4.
Balance of Payments			
TIC (Treasury International Capital) net capital inflows fell from $53.6 bn in December to -$33.4 bn in January. Bearish for USD. US trade deficit unexpectedly widened in May on surge in imports.	Net exports crucial to UK growth, but trade deficit hasn't improved. Trade deficit with Eurozone widened, highlighting the adverse effect of Eurozone fiscal crisis on the UK.	Weak Euro is helping German export sales, making it difficult for Italian manufactured goods (eg autos, machinery) to compete against Germany.	**Japan:** export sector has performed strongly despite the appreciation in the yen. **Chinese** exports rose 48% in the year to May, a 6 year high. Dropping the dollar peg should encourage more Chinese imports, redress imbalances and pressure to allow further appreciation in remninbi.

Economic Forecasts as at 30 June 2010

	Real GDP growth 2010 %	Real GDP growth 2011 %	Unemployment rate 12m ago %	Unemployment rate 2010 %	Inflation (CPI) Latest %	Inflation (CPI) 2010 %	Budget % GDP 2010 %	Central Bank rate Nominal %	Central Bank rate Real %	Current A/c % GDP 2010 %
US	3.3	3.0	9.4	9.5	2.0	1.9	-8.8	0.2	-1.8	-3.2
UK	1.3	2.1	7.9	8.0	3.2	3.0	-12.0	0.5	-2.7	-1.0
Eurozone	1.1	1.3	9.2	9.6	1.6	1.4	-7.0	1.0	-0.6	-0.4
Japan	2.7	1.7	5.7	5.1	-1.2	-1.0	-7.8	0.1	1.3	3.5
China	9.9	8.1	9.0	9.6	3.1	3.3	-3.0	5.3	2.2	4.3

Source: The Economist and Bloomberg

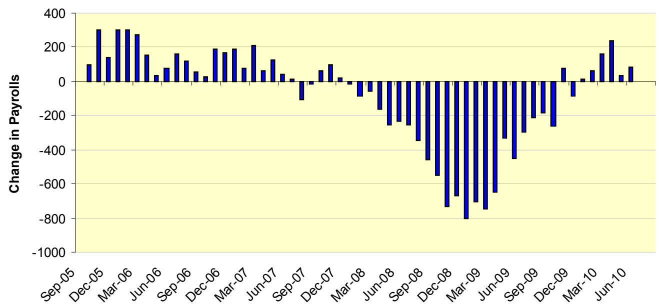
Market Outlook

Interest Rates & Currencies

At the beginning of April, we had expected the pace of economic growth and employment in Western economies to accelerate as businesses rebuilt depleted inventories. In the event, although the technology sector is seeing an increase in demand as computer hardware is replaced, recent business surveys in the US, UK and Europe point to a slowing in the rate of growth. Industry in the US has not reached the tipping point at which it starts to increase materially the number of people employed (as the chart opposite shows) and as a result retail sales have been disappointing, with declines over the past 2 months. The US Federal Reserve has recognised the weaker growth outlook by cutting its forecast for growth next year to 3.0% from 3.2%. This remains attractive compared to forecasts for UK growth (2.1%) and Europe (1.3%) but is nevertheless, unusually weak for this early stage in the economic cycle when growth should be accelerating. For this reason we do not expect a rise in US interest rates until 2011.

In the UK, David Cameron has skillfully engineered a workable coalition government that has delivered a credible framework for bringing the runaway budget deficit under control by 2015. The hope is that this will inspire sufficient confidence to encourage growth in private sector investment, exports and employment to replace the output due to be lost in the public sector. This is a tall order as the planned cutbacks mean that in the next 5 years government current expenditure will grow by just 0.4% pa, the slowest rate since WWII, and capital investment will fall by 18%, with up to 750,000 job losses in total.

Change in US Private Sector Payrolls



Source: Reuters

World Cup fever has kept the consumer spending in the UK but it is likely that the coming months will see reduced demand as confidence ebbs in the face of the forthcoming tax rises and cuts to government

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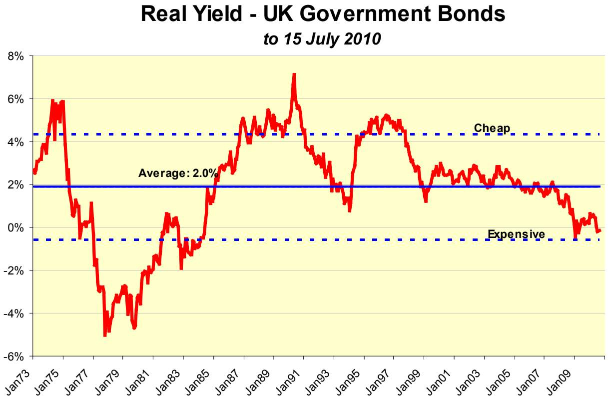
spending. In June, the PMI business expectations survey fell to a 15 month low with the biggest drop in 14 years, highlighting the risk that the inventory led recovery may be faltering. Given this outlook, even though consumer price inflation, currently at 3.2%, is well above the Bank of England's target of 2.0%, there is little chance of a rise in interest rates this year. Inflation has been trending lower and while this continues it is likely the Bank will promote a further depreciation in sterling against the dollar to encourage an export led recovery.

European governments have recently rescued Greece, Spain and Portugal from a debt crisis, which threatened many French and German banks. However, it appears inevitable that Greece will have to default on its some of its government debt within two years and will quite possibly leave the euro at the same time. The uncertainty this creates will be destabilising for months to come.

UK Bonds

Slowing growth should help UK inflation to fall fom current levels, which in turn should be supportive of bonds. However, with 10 year gilt yields at 3.3%



Source: Valu-Trac

inflation would have to fall to 1% for bond valuations to be attractive. We still think this is unlikely as supply bottlenecks, the VAT rise next January and a potential further depreciation in sterling all stand in the way of inflation expectations falling. With real 10 year gilt yields (i.e. after inflation) at 0% we prefer to hold cash rather than risk creating capital losses from new gilt investment at current values.

Corporate bond yields have not fallen in line with gilts, reflecting the added credit risk created by a renewed economic slowdown. As a result, yields 2.0% higher than gilts can now be found for single A bonds which are starting to offer value and we will look to raise our corporate bond exposure as suitable opportunities arise.

Measures of Market Valuation

BONDS

As at 30 June	Inflation forecast	10 yr bond yield Nominal	10 yr bond yield Real	10 yr bond yield 3m chg	10 yr bond yield 12m chg
	%	%	%	%	%
US	2.8	3.0	0.2	-0.9	-0.5
UK	3.1	3.3	0.1	-0.7	-0.3
Eurozone	1.6	2.5	0.9	-0.6	-0.8
Japan	1.9	1.1	-0.8	-0.3	-0.3

Source: ThomsonOne, Nomura

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

EQUITIES

	Valuation P/E 2010	Valuation ERP*	Valuation Div Yield	Earnings growth 2010	Earnings growth 2011	Volatility
	%	%	%	%	%	%
S&P 500	13.1	4.7	2.1	18	17	19
FTSE 100	10.3	6.4	3.9	31	20	19
EURO Stox 600	11.5	6.2	4.1	36	21	23
Topix (Japan)	16.6	4.9	2.1	84	15	19
China	14.3	3.5	2.2	26	20	28

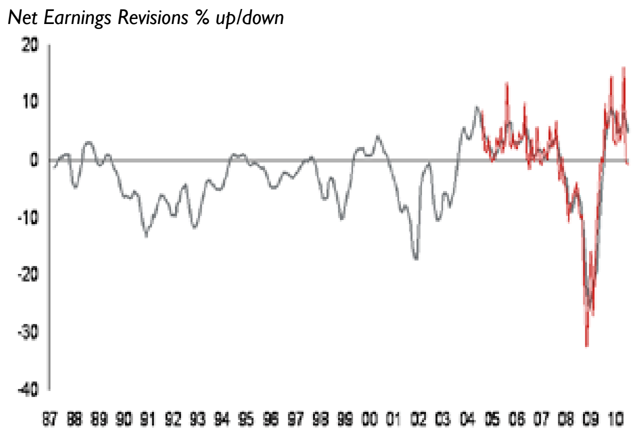
* Equity Risk Premium = (earnings / price) * 100 - 10yr bond yield

Global Equities

In a severe economic dislocation of the kind we have experienced in the past two years, markets tend to swing from excessive pessimism to excessive optimism. This has happened and markets are now adjusting to the uncertainty of whether the proposed cutbacks from Western governments will inspire confidence and renewed investment or will instead do the opposite. It is too soon to judge the outcome of this experiment, so we have positioned portfolios close to benchmark weightings with a relatively high cash holding ready to take advantage of the opportunities that we expect will arise.

Although forecasts for economic growth are still positive, expectations for company earnings growth are being pared back, as the chart below of global earnings

World Earnings Revisions Balance



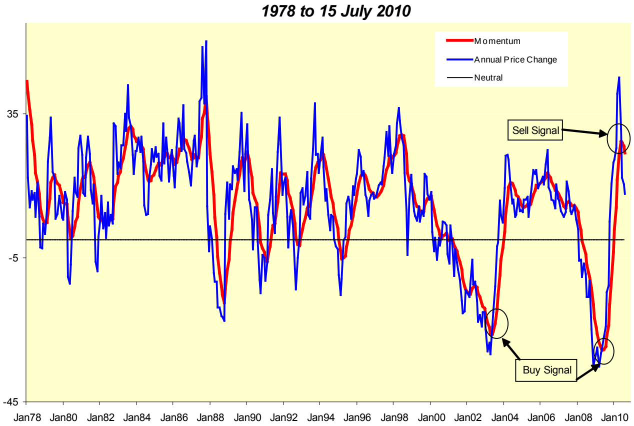
Source: Nomura

revisions shows.

In the UK, for example, earnings growth forecasts for this year have been cut from 45% to 31% over the past quarter. As is typical, it is those areas where optiimism was greatest that the biggest declines have been seen. Thus, Pacific Basin companies have seen the largest downward adjustments to earnings expectations, which partly explains why we currently have a zero exposure to this region. As regards industry sectors, all areas except utilities, which are highly defensive, have

Equity Price Momentum - United Kingdom

1978 to 15 July 2010



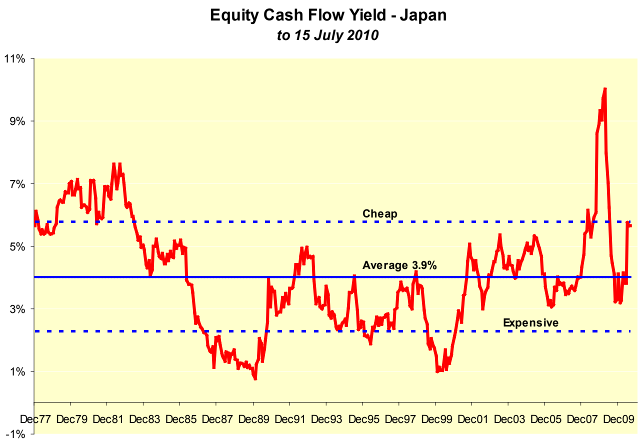
Source: Valu-Trac

seen sharp downgrades to earnings forecasts. Only the insurance sector, which was a poor performer last quarter and where we are overweight, is showing early signs of reversal from previous downgrades.

There is a high risk that these downturns to earnings revisions will lead to a more sustained decline rather than being merely an adjustment to excessive optimism. Other signs are similarly ambiguous. Business confidence surveys have turned down from their highs, but remain in positive territory. The same is true for consumer confidence. Job creation has been insipid, though it is perhaps too early in the cycle to expect a large change to unemployment, especially as small businesses are still finding it difficult to access finance from the banks, despite the exhortations by politicians for bankers to lend money.

With these conflicting signals we place greater emphasis on market momentum and valuation. The chart above shows price momentum for the UK equity market. Momentum has clearly turned down in a classic sell signal, warning that at best we are likely to see a sideways moment in UK equities and at worst a significant further correction over coming months. Other regions show similar characteristics, with Japan and the Pacific Basin showing the most pronounced downturn.

The sell-off we have seen so far, combined with increases in earnings, has left a wide variation in the valuations for different equity markets. If we use the



Source: Valu-Trac

price / earnings ratio as the measure of value, the UK is the cheapest market at just 10 times this year's earnings, compared to an average of 13 times. If we use our favoured cash flow yield as a measure of value, Japan is the cheapest market. The chart above shows that Japan has reached a level of value that has not been seen outside the extremes of 2009 and the late 1970s. The US continues to have a relatively expensive cash flow yield, though the government's commitment to stimulus rather than austerity may provide support for the stock market. Europe is divided between Germany, where the export orientated economy is prospering as the euro depreciates and the economies of Spain, Portugal and Greece , which are mired in debt and high unemployment.

In conclusion, company earnings forecasts are being revised down and the impact of austerity in the UK and Europe is uncertain. We are therefore holding higher than usual weightings in cash, expecting lower levels at which to buy.

UK Stock Comments

As a result of holding a higher proportion of cash, the number of UK holdings has been reduced to 20. Nevertheless, we have stocks in each of the major sectors, with the exception of utilities, so the portfolio remains well-diversified.

Our strategy has not changed greatly from the last quarter. As always, we focus on stocks that have attractive valuations but also we have selectively underweighted those sectors that are most vulnerable to an economic setback. As such, we are modestly underweight in the energy and mining sectors, even though companies in these areas appear attractively priced based on high, and perhaps too optimistic, earnings growth.

Our biggest overweighting is in telecommunications, where growth is expected to be in line with the market and relatively stable. We remain underweight in banks, in expectation that regulation and taxation will constrain future profitability. This is offset by an overweighting in insurance, where valuations are particularly attractive.

The service sector appears vulnerable in the light of government spending cuts, but our holdings in this area, Carillion and G4S, are expected to benefit from higher volumes of outsourcing, even if margins are reduced.

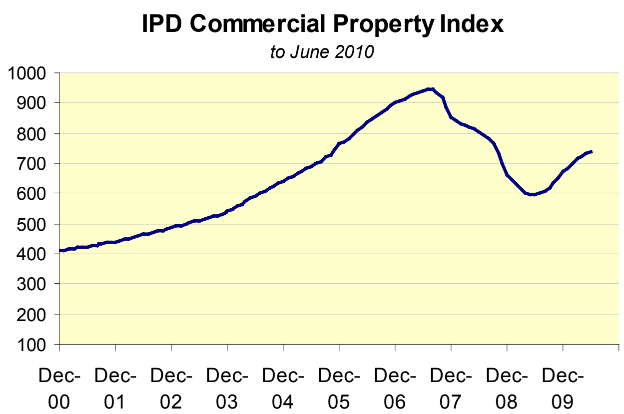
Lastly, we have retained our holding in BP, despite the problems faced by the company, as we have been reluctant to sell a company that has assets of £7 per share on the basis of entirely unpredictable events. For the higher risk Alpha portfolio, however, we did buy an additional holding in BP at 362p.

Alternative Investments

Commercial Property

Prime property prices rose strongly from the depressed levels of Spring 2009 as investors made opportunistic purchases and the fall in sterling attracted overseas buyers. Prices appear to have stabilised and some sectors, such as retail, are coming under pressure as consumer confidence weakens. Non-prime property remains depressed.

Our property investment, through the Aviva Property Trust, is well diversified in prime assets but would be vulnerable to a renewed downturn. As with other



Source: IPD

areas of the economy, it remains to be seen whether the current slowing in price appreciation is a harbinger of a renewed downturn or a pause in an upward trend. We are poised to sell the property exposure if we see evidence of an incipient correction.

Commodities

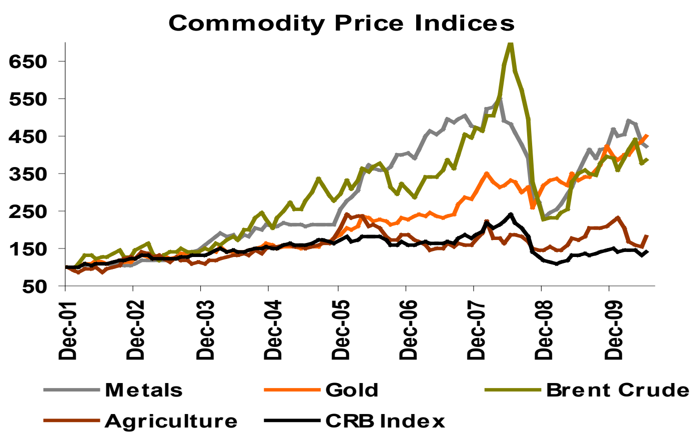
Oil seems to be range-bound at the moment and base metals have fallen back from recent highs to more sustainable levels. The trend from here will depend on the extent to which China takes action to rein in growth to control inflation. Given the increasing social pressures there, it is unlikely the authorities will tighten monetary policy excessively and demand for commodities should therefore remain close to current levels. We expect to maintain our commodity exposure as a diversifying asset for the present.

Gold has fallen back from a high of $1250 as the risk of a material rise in inflation in the West has diminished. For gold to rise again, inflation or a renewed crisis induced "flight to safety" is needed. Both events have an above average probability so we are looking for an appropriate time to buy into gold.

Hedge Funds

Our Valu-Trac hedge fund is short equities and long bonds at present, but has no particularly large positions. This reflects an environment where the market indicators they use for decision-making, namely value and momentum, are not sending convincing signals.

Matthew Hunt 0207 392 2811



Source: Bloomberg

Asset Allocation For July 2010*

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

		Strategic Benchmark Min %	Strategic Benchmark Benchmark %	Strategic Benchmark Max %	Q3 2010 Tatical weights %	Weighting vs Strategic Benchmark %
Cash		0	0	10	5	+5
Bonds:	UK Government	20	50	60	20	-30
	UK Corporate	0	0	30	26	+26
	Total Bonds	40	50	60	46	-4
Equities:	UK	20	30	40	28	-2
	US	0	6	16	7	+1
	Europe (ex UK)	0	3	13	2	-1
	Japan	0	2	12	4	+2
	Asia / Emerging	0	2	12	0	-2
	Total Equities	33	43	53	41	-2
Alternatives:	Property	0	3	13	3	0
	Commodities	0	2	12	2	0
	Hedge funds	0	2	12	3	+1
	Total Alternatives	0	7	17	8	+1
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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