Spring 2008 Newsletter

iimia

Wealth Management

Navigating A Safe Course Through Choppy Markets

By Phil Taylor
Investment Management Assistant, iimia Wealth Management

When markets are growing strongly, an investor with a long term view will be confident in their decision to put money in the stock market, as the value of their investments will grow appreciably quicker than if they left the money with the bank or building society.

However, when markets and share prices fall, investors' behaviour usually changes and the focus of their attention switches to the short-term fluctuations. During times of uncertainty, it is only natural to be concerned, but what is the best course of action to take?

Real statistical data shows that when markets are strong and prices high, cash flows into investment funds are positive. Conversely, when markets fall and prices are low, cash flows are weak or even negative. It is clear that sentiment is defying investment logic - buying high and selling cheap – and that cash flows generally appear to follow the market. Investors are also tempted to delay making an investment when the price indicates it would be right to do so, because this often follows a period of extreme volatility. However, there is no doubt that long-term returns will be severely affected by such a strategy.

Many experts suggest that to do absolutely nothing in periods of uncertainty, especially if the investor's long-term objectives and personal circumstances remain unchanged, is a safer strategy than to try and time the short-term fluctuations in markets. Indeed, it is very easy to miss the strongest gains, which often occur in the rebound after a sharp correction, because investors are too quick to sell when markets fall. For example, if an investor remained fully invested in the UK market over the last five years, they would have received returns in excess of 60%. If the same investor missed out on the 10 best days growth in the UK market (i.e. those bounces after a sharp fall), their return would be reduced to 40%. Furthermore, they would have received just 4% if they had missed the best 40 days in the UK market, meaning their investment would not have beaten inflation!

This demonstrates why it is so difficult to time markets and how getting it wrong can be very costly. It is also clear from the fund flows mentioned before, that private investors do get it wrong and that market timing rarely works in practice. Therefore, remaining invested for the long-term and riding out volatile markets should reap rewards.

For someone looking to invest into the markets, they will no doubt question whether the time is the right time to do so, or indeed whether equities as an asset class are appropriate. The good news is that there are many strategies that may be adopted to turn volatility to their advantage by dispersing the risk of investing.

If you look at equities over a short time-scale, there are many scary episodes in recent times that, in isolation, would deter an investor looking for long-term capital appreciation (Black Monday – Oct 1987, Long Term Capital Management – Aug 1998, Tech bubble - 2000, subprime mortgage crisis – 2007). However, when deciding whether to invest they should remind themselves of the long-term nature of investing and return to the markets with that view. It will be obvious that over the longer term, equities have always weathered the storms and delivered strong performance.

Whilst that is a comforting thought, equities do carry various types of risk. One way of mitigating this risk is to create a well-diversified portfolio, combining equities with other asset classes, such as fixed interest or commercial property, as appropriate. This is one of the basic principles of the investment process at iimia. The Investment Manager will construct a portfolio linked specifically to the investor's individual needs and objectives, using a range of funds that have been screened for their suitability. These funds cover all major asset classes and risk profiles such that in combination, they create a well diversified, risk adjusted portfolio.

Pound-cost averaging is another way that investors can build a portfolio and avoid the pitfalls of timing. The principle behind this is that money is drip-fed into the portfolio over a period of time, so that the invested cash buys shares or units at different prices. When the price is low, the investor receives more shares per pound invested and when the price rises, the investor gets fewer shares for their money, although the shares already bought will be worth more. The average price of the shares bought over the investment period may then be lower than the average share price during that time. In summary, it removes the risk of investing everything at the peak price. Investors with a lump sum may also consider using this approach to add to their portfolio in two or three smaller amounts. However, you should be aware that dealing costs may be higher than with a single sum investment using this process.

The Cofunds Platform

By Russell Cooper
Managing Director,
iimia Wealth Management

Most of our clients use our Discretionary Investment Management Services – the Discretionary Management Service (DMS) and Personal Portfolio Service (PPS). This is where our Investment Managers actively manage portfolios by using a range of our own funds as well as specialist third party investment funds. The investment manager has the discretion to make changes to portfolios as and when he sees fit, without having to refer back to the investor, thus minimising any potential delays.

Where a discretionary service is not appropriate, we have chosen Cofunds as our 'platform' on which to administer client portfolios. Cofunds is the largest independent investment platform in the UK, with assets under administration of over £14 billion, as at 29th February 2008, and access to over 1,000 funds from 70 fund managers. Using a platform such as Cofunds enables us to ensure that our 'non-discretionary' clients also receive the highest quality service.

The benefits of holding your fund investments in one place are:

- You have a convenient 'single account' type view of your fund investments,
- You receive a consolidated valuation statement twice yearly,
- You have vastly reduced paperwork to complete and receive as the investments are maintained by one central administrator,
- You can buy or switch fund quickly and easily and at low cost,
- We have immediate access to instant valuations across your Cofunds portfolio so you do not have to wait for your individual fund statement to see how your investment is performing.

Cofunds is a free service to investors via iimia Wealth Management. Normally you are able to re-register your existing investments with Cofunds, meaning that there are no tax implications and you will not pay any charges as a result of the transfer. Moreover it is possible to protect any tax wrappers such as ISAs or PEPs so that your investments remain as tax efficient as possible.

We are convinced that Cofunds provides an excellent way of holding our clients' fund investments and have been actively encouraging many of our clients during the past few months to move their portfolio to Cofunds. Our own financial planning and investment management proposition, together with excellent administration services from Cofunds, make a compelling offering. In time we envisage that all of our non-discretionary clients will invest in this way. If you would like to explore how the Cofunds platform could be of benefit to you please contact your normal Client Manager.

PEPs and ISAs Update

By David Parfett
Head of Corporate Services,
iimia Wealth Management

As you will probably already know, there have been some significant changes to tax rules effective since 6 April 2008:

CHANGES TO PEP AND ISA REGULATIONS

- Mini and Maxi ISA types have been removed
- In their place is a "Cash ISA" and a "Stocks and Shares ISA", and you can invest in both within the same tax year
- Investing in both a Cash ISA and a Stocks and Shares ISA with different providers is permitted
- The maximum Cash ISA savings per tax year has risen to £3,600
- The maximum Stocks and Shares ISA investment per tax year has risen to £7,200
- A combination of the two is subject to an overall limit of £7,200 per tax year
- Personal Equity Plans (PEPs) have become Individual Savings Accounts (ISAs)
- If you are a PEP investor, your PEP will automatically become a Stocks & Shares ISA. This will not affect your ISA subscription limits for the current or next tax year
- PEPs that become ISAs will benefit from the wider 'Qualifying Investment Regime' available. This means that under ISA rules, Investors can choose a wider range of underlying investment types.

These changes will be automatically applied by the provider and you are not required to take any action.

OTHER CHANGES

- ISAs have become a permanent savings vehicle. Previously, the Government had planned to review ISA availability and had said the ISA scheme would only last for a certain period of time. Now there is no planned review date making ISAs available indefinitely
- Since 6 April 2008 it is now possible to transfer a previous year's contribution (at their current value) from a Cash to a Stocks & Shares ISA, without affecting the current tax year allowance. Transfers can be from one provider to another.

If you have any questions relating to this, please contact your Client Manager who will give you more information.

40 Years In Stockbroking

By David Hannibal
Senior Investment Manager, iimia Wealth Management

On 26 March 2008, David Hannibal, the senior investment manager in our Bournemouth office celebrated 40 years in stockbroking. We asked him to give us a flavour of how things have changed since 1968.

"I was only a few weeks short of my 19th birthday when I walked into the offices of E B Savory Milln & Co to begin my 15 years in the City. My starting salary was a princely £575 per annum.

Back in those days, most stockbrokers operated out of offices in or around the 'Square Mile' and Savory Milln were just a stone's throw from the Bank of England and The Stock Exchange. At the time I thought it was the most exciting place on earth.

Bowler hats, starched collars and collar studs were still very much the order of the day. You were expected to wear dark suits, white shirts and black shoes. Ladies were not allowed to wear trousers to the office and a young man would be addressed by his surname.

Direct dial telephones did not exist and you had to ask the operator for a line before you made a call.

Computers were a thing of the future and we didn't even have electronic calculators. My first calculator was a mechanical device made by a Swedish company called Facit. At the time, we thought that they were the 'bees' knees.'

My first electronic calculator was an Adler, which was the size of breeze block and had to be plugged into the mains! It cost £69, which was a King's ransom in 1972.

Share prices of leading companies often didn't change from one day to the next let alone hundreds of times a minute and company announcements were posted on the Stock Exchange notice board rather than being beamed around the world via the Internet. The only way that you could check a share price other than ask a dealer to pop down on to the 'Floor' was to consult the Telex machine, which was housed in a huge wooden box and churned out what looked like Jeyes toilet paper with writing on it!

Even when screens arrived in our offices, we had a limited amount of information in black & white, which was 30 minutes out of date and you accessed the 20 individual pages via a single strategically placed part mechanical, part electrical controller. However, we regarded the grandly named Market Price Display Service (MPDS for short) as something of a revolution.

A 3/- (15p) Luncheon Voucher would buy you a fry up and a cuppa at Sidoli's Buttery in Copthall Avenue or fish & chips and a cuppa at Fiships in London Wall.

Harold Wilson was Prime Minister and no-one had heard of Maggie Thatcher, who would later become the darling of the City.

Much may have changed in the last 40 years but there is one thing that hasn't. Stock markets rise and stock markets fall and on occasion by much more than we would like.

In the past 40 years there have been three savage bear markets. One, in the 1970s, was a slow drip-drip decline. But it was sufficiently severe for many to question the future of capitalism. The second was the 1987 crash, horrendous at the time but now seen as little more than a blip on the long-term FTSE 100 Share Index (Footsie) chart. The third was the one which began at the end of 1999 with the bursting of the high tech bubble and ended in 2003.

There have been many other setbacks that at the time seemed depressingly worrying and gave the pessimists something to shout about. But they are largely forgotten, hardly registering on the Footsie Richter scale.

I had the dubious honour to witness the 80% (yes, 80%) fall in 1974 and remember only too well the suggestion that the FT Ordinary Share Index (now the FT 30 Share Index) could fall to 0! In the end, it 'bottomed' at 147 having fallen steadily from over 700.

The ferocity of the 1987 crash, which wiped a third off share values in less than two months, is now just another bad memory.

While the last bear market is rather fresher in the mind, it's still difficult to recall the dark days that we had to endure, only the relief that we felt when markets eventually began to recover.

I suspect that in a few years from now when I am enjoying a well earned retirement, I will find it hard to remember the sub prime mortgage crisis of 2007/8 and, hopefully, so will those who would have us believe that the end of the (financial) world is nigh……again! "

iimia
Wealth Management

A Darling Of A Budget

By Phil Blease
Client Director, John K Miln & Company, Falmouth

Alistair Darling gave his first budget speech on 12th March 2008 at what must be considered a very difficult time. The economy has been flirting with recession, the credit crunch is undermining market confidence and growth rates are being revised downwards.

Against this back-drop and unlike our American cousins, the budget did very little to put more money into peoples' pockets. Widely anticipated additional "Green Taxes" have been introduced, including a proposed showroom tax on new cars, along with increases in the cost of beer and wine 6% above the rate of inflation in an attempt to counter the drinking culture. Consistent with previous years, a number of these will not apply immediately, but will be phased in over a number of months.

The truly new measures announced in the Budget appear to be relatively low in economic impact, but as usual, the myriad of tax changes are hidden in the detail. HM Revenue & Customs' (HMRC) Budget Notes run to 270 pages this year.

Income Tax - As previously announced and starting from 6th April 2008, basic rate tax rate will drop from 22% to 20% which on the face of it sounds like good news for everyone. The reality is that by scrapping the 10% income tax band, many lower paid workers will be worse off as they will pay 20% tax on some earnings on which they previously paid 10%. Other potential losers will be basic rate tax payers making pension contributions, which were previously grossed up by 22% and will now only be grossed up by 20%. Higher rate tax payers will overall be unaffected, although they will also only have contributions grossed up by 20%. However they will be able to claim a further 20% tax relief, as opposed to 18% previously, through their tax return.

Capital Gains Tax (CGT) - CGT has been simplified, with a new flat rate of 18% on chargeable gains realised above the individual's annual exemption (£9,600 for 08/09). For most investors this is a welcome simplification and for many it will significantly reduce the tax payable by up to 22%. From an investor's view point it would appear to favour investments which would enable you to utilise your CGT allowance each year, such as Collectives as opposed to Investment Bonds. It is not a simple choice and there are cases where an Investment Bond might be the most appropriate vehicle and vice versa. As usual the answer is to seek professional Independent Advice to establish the most appropriate solution for your circumstances.

"If you want to minimise the Treasury's take in favour of your family, then the sooner you start planning the better. "

The budget did make some concessions to the business community who were unhappy that the previous CGT rules meant many people only paid 10% on gains made on the disposal of a business, as the proposed change to 18% was seen as an 80% increase in the tax take. The concessions are complex. However if you are considering the sale of a business, we may be able to help reduce or at least defer a CGT liability for you.

Inheritance Tax (IHT) – IHT was reformed as part of the 2007 Pre-Budget Report. This announcement, which was in response to the Conservatives' proposal to increase the IHT threshold to £1million, was very welcome, if not as generous. In essence, any unused nil rate band (£312,000 for 08/09) on a person's death can now be transferred to a surviving spouse or civil partner. Whilst very welcome and a useful planning tool, it will mean that people will need to keep more records for longer to demonstrate on second death exactly what allowance may have been utilised on first death. Again, IHT planning can involve any number of strategies and solutions depending on your circumstances. If you want to minimise the Treasury's take in favour of your family, then the sooner you start planning the better.

Please contact your usual Client Manager for further information on any of the above.

Hedge Funds: Saints Or Sinners?

By John Hockin
Senior Investment Manager, iimia Wealth Management

Hedge funds are everybody's whipping boys nowadays, being blamed by the media and some regulators around the world for most, if not all, of the troubles afflicting markets in recent months.

How much of this criticism is valid and how much is due to lack of knowledge about how hedge funds work in practice?

The major problem with the hedge fund sector is its diversity. Depending on how you define individual funds, there are thousands of possible names, managing billions of dollars of assets, and all doing slightly different things. For example, there is a vast 'long/short equity' sector where all funds, in theory, are easy to understand. But how much borrowing do they each use, are they market neutral or do they have a long bias, do they invest in large or small companies – there are many variations.

Another sector where all the funds differ in some way is 'global macro'. These funds are looking at the big picture – either regionally or globally – and investing on the back of forecasts about major economic trends (interest rates, currencies, commodities etc). They are usually indifferent to the day-to-day variations in stock markets. They take huge bets (by using borrowing) to magnify the potential returns on small changes in the levels of their underlying investment. The most famous investor of this type was George Soros and the Quantum Fund, which famously made millions of pounds of profit when sterling was forced out of the Exchange Rate Mechanism.

In recent years macro investing fell out of favour due to too many players following the same trends, but the sector has been revived with new, younger managers entering the field (the potential rewards are enormous). And the same problems, of size (the funds tend to be much larger than average) and leverage, have arisen again.

The two facts about hedge funds that most people (and certainly most press commentators) believe is that the investment managers sell shares they do not own (go short) and are highly borrowed. Both are considered to have contributed to the major falls seen in markets in the last year, and particularly in the first quarter of 2008.

It is true that all hedge funds, using the widest definition of the term, sell short, whatever the underlying asset class. It is the raison d'être of the sector. As has often been stated, there are two main reasons for buying hedge funds – preservation of capital or the hope of above-average returns. In both instances, the ability to sell short, and thus, hopefully, to provide positive returns in bad markets as well as good, is the key factor. Without this ability, the hedge fund sector would not exist.

However it does not necessarily lead to 'trash and cash'. This concept – where untrue (but, of course, believable) rumours about a company are circulated in a nervous market to force a share price down – has always existed. Today it is associated with hedge funds alone, but they are not the only investors that benefit from a sudden, and unjustified, fall in a stock price. Long only funds can be just as avid a buyer in such circumstances – the Chinese in Hong Kong and Singapore have been using the idea for years!

> "How much of this criticism is valid and how much is due to lack of knowledge about how hedge funds work in practice?"

It is also true that many hedge funds, in all sectors, use borrowing to a greater or lesser degree. In most cases, especially in the long/short equity space, gearing is small (less than 20%) and is used to 'oil the wheels' of everyday trading and to facilitate redemptions. When the press criticise gearing, this is <u>not</u> what they are highlighting.

The problem, when markets show the dislocations and volatility we have seen in the past few months, lies with those funds that use very high levels of gearing – 500% plus – to multiply returns from supposedly 'safe and boring' investments (AAA rated mortgage backed securities, for instance).

Continued....

Hedge Funds: Saints Or Sinners? Continued...

When the music stops and, for example, rates start moving in unpredicted directions, banks call in their loans and all the funds are trying to liquidate (officially, reducing their balance sheet) at the same time in falling markets.

These types of funds have been the main sinners in the mayhem we have seen recently. They have been doing nothing illegal or even unethical. In 'normal' markets they have provided their investors with above average returns for their asset class but often with low (or lower) volatility.

But we are obviously not in 'normal' markets and many of the funds' highly publicised stress-testing and risk management has been found wanting, along with the reputations of some very distinguished investment managers.

So...saints or sinners?

Hedge funds can never be classed as 'saints', for there will always be the perception amongst many investors that, in one way or another, they have an unfair advantage due to lack of regulation or transparency – and they 'don't play fair'. Unfortunately a few managers live up - or down - to this perception.

But equally it is wrong to tar the whole industry with the same brush. A set of quite extraordinary circumstances has blown some funds spectacularly off course. Yes, there have been failings – high levels of gearing in some instances, and less-than-rigorous risk management (albeit with the benefit of hindsight) – being the most blatant.

The industry will survive this storm, and continue to grow – and mavericks will yet again try to earn the extra dollar by taking more risks than their investors had anticipated. Controls will be tightened again, and extra risk management tools introduced. And then another 'one in a million' event will occur. Plus ça change! But the sector will still remain an integral part of clients' investment strategies.

Current Views & Themes

By Martin Gray
Fund Manager, Midas Capital plc

There has been much conjecture recently over 'Sovereign Wealth Funds' (SWF) taking stakes in major banks. The reality is however, that they provide the only opportunity for most banks to patch up the huge holes that have appeared (and will continue to appear for some while yet) in their balance sheets, as a result of excessive risk taking in an era of easy credit. The numbers are too big for 'national champion' bail-out measures by governments – central banks have done well with the 'sticking plaster' so far, but permanent cash is what is required now and quickly on whatever terms can be garnered from the SWF.

The rapidly rising withdrawal of money from open-ended property funds is forcing managers to sell their prime liquid assets first – not good for the valuations of their secondary holdings either. At least this will push yields up to more sensible levels and above bank base rates in due course, which will eventually result in renewed interest in the sector. China is an example of this. The Shanghai 'A' stock market has come a long way in the last two years (an 8 year low was reached in late 2005) as the overhang of stock held by state enterprises kept buyers away – many with bitter memories of the huge losses incurred after the last bubble had burst in the late 1990's. But last year, euphoria ruled once again and the market continued to hit a series of new highs until

midascapital
Midas Capital plc

recently, as the wealth being created over the last two decades looks for a home and there are few places to look outside of domestic shares, property and bank deposits.

After being in limbo for some while after the unsustained spike through $700 in 2006, the gold price has broken out of its range to breach its previous $850 all time high and despite falling back, has found strong support around the $800 mark. If this level can be sustained for a significant period, then the exploration sector must surely be the place to invest, provided those holes in the ground produce some 'yellow metal'.

Corporate profit margins have been on the decline for the last two quarters in the US and look likely to continue this downtrend for the present. The big question is, can Asia and the Emerging Markets quickly become the demand engine, rather than the supply engine of the world economy to avoid the slip into slowdown/recession? Seems an extremely big ask. There are still significant downside risks for equity markets if events get nasty. Election turmoil in Pakistan, Kenya and Thailand along with on-going risks from Iraq, Iran and Afghanistan will continue to worry the geo-political faction and potentially all investors.

Exeter Office
23 Cathedral Yard
Exeter
EX1 1HB
t: 01392 475900
e: exeter@iimia.co.uk

Northampton Office
16 Queensbridge
The Lakes
Old Bedford Road
Northampton
NN4 7BF
t: 01604 615840
e: northampton@iimia.co.uk

Bournemouth Office
Heliting House
35 Richmond Hill
Bournemouth
BH2 6HT
t: 01202 446400
e: bournemouth@iimia.co.uk

Falmouth Office
Bickland House
Bickland Water Road
Falmouth
TR11 4SB
t: 01326 377990
e: falmouth@iimia.co.uk

Plymouth Office
164 Armada Way
Plymouth
PL1 1LB
t: 01752 660282
e: plymouth@iimia.co.uk