



INDEPENDENT FINANCIAL ADVISERS



Investment Review: June 2008

~ STRAIGHTFORWARD ADVICE..... IN BLACK AND WHITE ~

About Hurst Financial Consultancy

Hurst Financial Consultancy was founded in 1997 by the Managing Director, Michael Hurst. The company has operated successfully in Salisbury from inception serving clients locally, nationally and internationally.

The company focus has always been on excellence.

We have also developed a strong focus on state of the art information technology being aware of its significant value in not only collating data, but managing the performance of investments. We have our own in-house IT department and use its services constantly to develop the service that we give to our clients to ensure it is always “leading edge”.

As Independent Financial Advisers we have access to the full range of products and services available in the UK as opposed to a Tied Agent or Company Representative who may only advise and offer products from the company they represent. This means that we are able to give you impartial advice and recommend the most appropriate products for you, so that you will enjoy choice, value for money and our high-quality service.

Markets continue to be very turbulent with continued difficulties being witnessed in banking and housing stocks, all symptomatic of the “credit crunch” that has been such a significant feature of this year’s stock market.

During May markets showed their potential to stage recovery and it is because, in our opinion, this potential demonstrates itself that we continue to say that the best approach we can take now is to stay invested and to ride out this storm. This has been a consistent theme that we have put forward and pundits now write regularly as to the necessity for an investor to stay brave. I appreciate that the psychological effect that seeing investments turn downwards can on occasion be quite compelling. To reiterate some focus I am laying out below an excerpt which was a feature of an earlier investment review (February 2008 Investment Review, page 7 for full chart [click here to see Feb 08 review](#))

Returns over five years - effect of missing best days

Market	Index	Fully invested	Missing best 10 days	Missing best 40 days
UK	FTSE All Share	63.4	40.0	3.9
US	S&P 500	56.4	11.6	-39.2
Global	MSCI World	63.7	21.6	-26.2

Source: Bloomberg/Datastream. Returns from 01/09/02 to 28/08/07.

This shows very clearly that coming out of markets and trying to step back in when they are going up can see us missing the best individual days of growth in a market. Normal psychology is to sell when things go down and to watch the market recover and then reinvest – investment psychology has to be quite the reverse of this for ultimate success but what must not happen is a panic sale. Losses only occur when sales actually take place. It is a widely appreciated fact that the stock market’s very best days often follow its very worst and this serves as the simple justification for staying invested.

It is also important to remember that we are investing and not gambling and as such we are placing funds into an environment for growth over the longer term. Part of our continued monitoring process is to review all of the investment funds available within various investment products to ensure that their inclusion continues to be valid. For this we use an analytical tool that allows us to filter against set criteria all of the investment funds available. Only funds that meet the criteria get used. It is therefore with some confidence that we can say that the investment funds currently within our selection are “most fitting”.

Current economic themes influencing markets

Inflation

Most of us will not need telling that inflation – benign for so many years – is back with a vengeance and is likely to stay with us for a while. Recently we learnt that annual CPI inflation hit 3.3% in May and is way above the 2% target set for the Bank of England (BoE). As **The Sunday Telegraph** pointed out, oil prices averaged \$75 per barrel [pb] last year – so far this year the average is \$108pb and last week oil hit another record high of in excess of \$140pb, suggesting that the related rises in gas and electricity prices mean higher inflation is inevitable. Of course one needs to put current events into perspective, and **The Times** argued that 30 years ago inflation was 25% and 20 years ago it was 10%, so today’s levels are mild in comparison. However, as **The Daily Telegraph** was quick to point out, the official CPI figures exclude fuel, mortgage and council tax costs which are a heavy cost to many and, by including these expenses, the paper calculated that the real cost of living index is nearer 9.5%.

It's not just higher energy costs which are a problem, food inflation is rising too, as **The Financial Times** discussed. The paper said that the rise in farmers' costs are feeding through to the supermarket checkouts, with inflation in the dairy sector well into double figures and with milk production falling in the UK, industry leaders are concerned about the impact of the increased demand currently being witnessed. But it's not just the West which is suffering – inflation in the Far East and particularly China is worrying politicians. Last week, China unveiled subsidies for fuel users in an effort to prevent unrest and soften the blow of large increases in energy prices that were announced last week. Having held retail fuel prices steady since last November, the government announced a 17% price rise for petrol – it costs the equivalent of \$0.85 a litre in China compared to \$2.33 in the UK. India too is suffering, with rising energy costs pushing the country's inflation rate to 11.05% - a thirteen year high. According to **The Financial Times**, the latest figure is double the "comfort level" set by the central bank of less than 5.5%. With elections expected before May, the government needs to bring inflation under control but this could, said the paper, hurt growth prospects.

Oil

So with inflation clearly at the fore and high oil prices seen as the single largest contributor, Gordon Brown headed for crisis talks in Jeddah where an emergency meeting of oil producers and consumers was being held. The summit was expected to see politicians exerting pressure on Opec to increase output to ease the strain on global supply. Ahead of the meeting Saudi Arabia, the world's largest producer, announced it will raise output by 2% next month (equivalent to 200,000 barrels a day) although, as **The Daily Telegraph** pointed out, the country produces 'heavy' crude oil as opposed to 'sweet' crude which is in greater demand. Whilst agreement may be reached, the overall situation was not helped recently with news that Nigerian militants blew up a Chevron pipeline which halted shipment of 120,000 barrels a day. Not to miss an opportunity, the Prime Minister is likely to ask oil rich states such as Saudi Arabia to invest in the next generation of British nuclear power stations and, in exchange, Britain and other Western economies should open up their economies to sovereign wealth funds.

Interest Rates

Recently the governor of the BoE Mervyn King used his annual Mansion House speech to City grandees to predict that "the squeeze on real income growth is likely to mean that both house prices and consumer spending will weaken together". The Chancellor, also present, conceded that his budget forecasts would not be met, accepting that inflation would be higher than predicted. Mr. King also made it clear that he would not allow higher pay deals to result in ingrained inflation – a clear hint that the Bank would raise interest rates if necessary, thought **The Financial Times**. Fears of higher rates were raised following the publication of the minutes of the last MPC meeting and sent money markets on a rollercoaster ride. However, according to **The Sunday Times**, in an effort to calm nerves, sources close to the Bank said the message on interest rates was intended to be neutral and not taken as a signal that the BoE was contemplating raising rates.

Many analysts that we have heard from have suggested that interest rate reductions may feature towards the end of this year but the expected summer cuts appear unlikely in view of inflationary pressure.

Investment perspective

With all the talk of inflation, **The Sunday Times** posed the question "Can you inflation-proof your finances?" From an investment perspective equities have, in the past, been a good way to protect capital against inflation over the long term. The paper commented that a well-diversified portfolio of equity funds remains a good hedge against inflation – dividends have historically risen faster than inflation and re-invested, account for the lion's share of total returns from equities. Readers were reminded that equity income funds have long been a favourite – aiming to deliver a dividend stream 10% higher than the FTSE100 average while also aiming for capital growth. Over the last five years some of the best-performing funds have doubled investors' money.

One sector that has become the darling of investors is commodities, where prices have risen several fold in the last two to three years. However it seems, according to **The Financial Times**, that investors are calling time, despite continuing record prices – some £1.2bn left the sector last month. Any falls in commodity related stocks could have a big impact for investors, according to **The Sunday Times** - mining, oil and gas companies now account for an astonishing 50% of the FTSE100's capitalisation, with seven out of the top ten stocks either mining or energy related companies. The paper said it was very reminiscent of the technology bubble, when high-tech and telecom stocks accounted for 35% of the market by value. Fund manager John Hodson of THS Partners commented "We have been reducing our holdings in the mining sector – I think growth will slow in China in the months ahead and demand for many commodities will be affected".

The balance of our portfolios only has small exposure relative to other holdings in the commodities sector because of concerns cited by analysts along these lines, i.e. a potential bubble. We risk rate this sector as the highest risk for investors and so limit exposure but feel that its inclusion is at the moment relevant given its hunger for uphill investment returns.

Market view

Out of all of the market news that we gather in assessing what action may or may not be necessary with investments, the view below of Nick Purves of Schrodgers seems to sum up most succinctly our view and I am including it in this review so that you can see that this is not only a view held here and is in fact held by many other fund managers from whom we gather data on a daily basis.

On the face of it the market feels pretty sick with investors in a nervous state of mind, concerned about the outlook for the US and UK economies, with the companies most exposed having been hit hard. Commodity prices are still strong which is feeding higher inflation and restricting central banks' ability to cut interest rates. So the markets are worried about slowing growth. It is very important to separate-out the outlook for the economy – which I agree looks poor – from that of share prices: these are very different things. A huge amount of bad news has already been priced into current share prices, for example, banks, house builders and other consumer related sectors are down 50% or more. So one needs to be clear about firstly the economic outlook and, on the other hand, stock market values.

You may be surprised, but actually the message is very positive. Firstly the portfolios have very little exposure to the vulnerable sectors mentioned and in fact, after months of relatively little activity, I am now aggressively putting money into these areas. Of course, I read the papers and see the same gloomy news, but when owning equities one needs to relate everything back to value. You need to remember that when valuing a share you are looking at the return of an investment, in cash-flow terms, over a fifteen year period. The market is obsessed with the short-term, mainly down to hedge funds, and is only focusing on the next twelve months which makes up a small proportion of a company's long-term value. The question I have to ask is whether it's just next year that is going to be difficult or whether a company's value is permanently impaired.

These are pretty exciting times because the market is too pessimistic and the best investment returns are made when sentiment is poor. So we've been buying companies like Lloyds TSB which yields over 10%, and Daily Mail Trust which trades on a p/e of just six which is ridiculously low - in fact, there are many good companies that yield 6-7% and trade on similar p/e ratios. Hedge funds and their ilk are very short-term and will smash up anything which disappoints or may disappoint in the immediate term. Fortunately this provides wonderful opportunity for medium term investors like myself and market undervaluation is now widespread. So right now I own thirty or so stocks, the yield on the portfolio is over 5% and I'm positive looking ahead."

Conclusion

For fear of being repetitious this market has been extremely challenging at every level with every asset class and every sector suffering. This is now almost a national obsession and we need to focus on the fact that this is a function of markets and periodically they unwind to these kind of levels. History suggests that they recover and we need to be conscious that we are investing for the medium term and that our objectives are unchanged, i.e. we are seeking returns that over the medium term better cash and contribute to our wealth ahead of the erosive effects of inflation. We should not be selling out of investment markets that have shown what appears to be a stable low point. Of course markets can continue to disappoint and decline further but all intelligent information that we could possibly gather suggests that we stay put.



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