

PanVIEW



Evercore Pan-Asset's Global Asset Allocation and Investment Review

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Asset Allocation Overview John Redwood

The last decade has been an unrewarding one for all those who bought and held shares in the advanced economies. It began with the hi-tech bubble, leading to an early collapse in share prices and a long-lasting reappraisal of the true worth of technology stocks, and ended with the Credit Crunch bringing a generalised decline in share values.

Some think this means today is a buying opportunity for shares. Traditionally shares in western companies have overall made investors good money. There may be the odd year or two when prices fall sharply, but over the longer-term the combination of rising dividend income and capital gains has given the share investor a clear lead over the buyer of bonds. The optimists argue that the Credit Crunch is gradually easing. The determination of the US and UK authorities to print money, to rescue banks and to run large deficits will once again create conditions for good profits and for rising share values.

In a way the optimists are right. This is yet another cycle, brought on by moving from easy money and encouragement of banking excess, to tight money and restraint on banks. As the authorities relax their squeeze, you should expect asset values to start rising.

The pessimists however, also have some points to make. What if, they argue, the West has now become like Japan after their credit bubble burst in 1990? Their stock market has never got back to anything like the highs it reached at the top of their boom. Japanese growth has been fitful and much slower than it was in the glory years from 1950 to 1990.

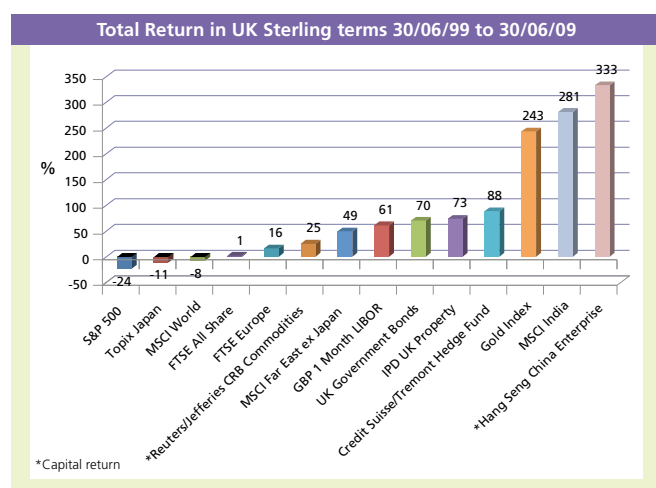
Despite these shorter-term worries, we think that India and China are still likely to be the big winners of the coming decade, as they were of the last. As more and more of their people experience rising incomes so their companies should be able to make higher profits and their share markets advance further.

The US will have to face the reality that it is living beyond its means at some point. Its position is easier than other countries doing the same thing, because the dollar remains the world's reserve currency. There are noises from China, Russia and others that they wish to diversify their foreign currency holdings and they are not happy with the dollar's role, but the truth is there is no serious alternative available and to some extent they are locked in by their own large dollar holdings.

The UK is closer to having to adjust its position. The huge budget deficit has been financed by quantitative easing so far, but has still led to a rise in gilt yields. When quantitative easing stops, as it may do by the autumn, there will be more obvious financing strains. The large balance of payments deficit will be eased by the big fall in sterling last year, but the UK is still a long way from balancing its books. The weakened position of the banks, the need for individuals and companies to repay debt, and the difficulties created by the public finances all point to lower growth and more stresses in the system. We continue to recommend avoiding both shares and government bonds in the UK.

Sterling corporate bonds continue to offer high yields compared to other asset classes. We think the gloom has been overdone, and that fewer companies will go bankrupt than the bond markets are implying. These bonds can provide a useful compromise between equity investing and government bond purchase. If the economy improves more quickly the bonds will be re-rated as bankruptcy fears recede. If it doesn't the owner will still enjoy the good income.

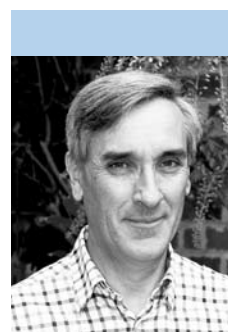
Times remain difficult for longer-term investors. We recommended 100% in cash in 2008 to avoid the worst of the crash. During the first quarter of 2009 we moved to fully invested positions in a mixture of corporate bonds and equities, especially in Asia. Today we propose a bit more caution, as we think we have seen the best of the quantitative easing rally. We expect better buying opportunities to emerge over the summer, as people reflect on the continuing difficulties of the world economy.



Source: Thompson Reuters.

The world still suffers from huge economic imbalances. China, Japan and Germany export too much and save too much. The US, UK, Spain, Ireland and some others borrow, spend and import too much. Whilst the politicians are busily denouncing protectionism, the main countries are engaged in a round of competitive devaluations. Some governments and trade blocs do favour more restrictions on the free movement of goods, people and capital.

China is reporting some unrest in western provinces, and has worrying levels of unemployment in the cities as the export boom is hit by poor world demand. India is overheating and has just set a budget which does not inspire confidence in markets.



John Redwood held senior investment roles at Robert Fleming and NM Rothschild in the 1970s and 1980s. Since, he has been a Pension Trustee, Investment Committee member for an Oxford College, Chairman of an investment company and a non-executive Director of a hedge fund and an Investment Trust. An early advocate of tracker funds, he has written extensively on economics and investment.

Market and Investment Overview Christopher Aldous

After three months of heady optimism, during which a lack of tangible signs of recovery was largely ignored, western markets have now taken stock of the discouraging economic outlook and entered a period of uncertainty about the future. Asian markets remain more sanguine, driven by evidence of continuing strong growth rates in the region. With dividend yields similar to the US equities and superior rates of underlying growth, China, Asia (ex-Japan) and emerging markets currently represent the majority of our equity holdings. However, India has appeared overheated for some time and government action to bring growth and inflation under control is likely following the recent election. After a rise in the NIFTY of around 29% in the first half of the year we have reduced our exposure.

In terms of fixed income, exaggerated fears of an early return to inflation have subsided, causing US and UK government bond yields to fall back somewhat and allowing our corporate bond investments to perform well. Corporate bonds feature in most of our client portfolios at the moment as they offer attractive yields with the possibility of producing useful gains as fears of corporate failure decrease. We believe that capital values of government bonds on both sides of the Atlantic will inevitably suffer as governments issue more and more bonds to finance the large deficits they have built up.

The next few months may bring difficult market conditions, but our portfolios still hold some cash as well as substantial positions in corporate bonds and are defensively positioned. We look to commit further to risk assets as and when signs of global recovery become clearer.

	Strategic View	Tactical View
Economic Growth	The forces that have combined to generate strong global economic growth in recent years have been globalisation, rapid technological progress, disinflation, moderate interest rates and the entry of populous China and India into the global economy. The Credit Crunch has damaged this but these forces remain intact for the longer-term and in most cases probably still have a long way to run, particularly in Asia. We foresee an increasingly Pacific-centric world economy, with Continental Europe in particular in relative decline. For the foreseeable future, the UK is badly placed to handle the Credit Crunch due to the combination of too much borrowing in the public and private sectors. Both the US and the UK need to cut borrowings and this will prove painful. Geo-political risks will persist, imparting volatility and requiring higher risk premia in capital markets from time to time.	Markets have been lively, speculating about the timing of recovery. This is evidence of monetary easing having an impact on asset values. There will however be a continuing bad recession in the West with no global economic growth in 2009. The UK is awkwardly placed due to high government borrowing and overdependence on its weakened financial sector. Recent figures from both sides of the Atlantic show that the downturn has spread beyond the financial and property sectors. It is now severe throughout manufacturing and has hit exporting countries badly. The high-borrowing countries have done more to de-stock than the high-saving countries and are nearer some modest bounce in the economy. Whilst property in the UK has fallen substantially, there is more bad news to come. We anticipate signs of recovery in the US by the end of 2009 and would expect US and Asian property to rebound when recovery is clearer.
Inflation	The forces that have combined to keep inflation subdued in recent years have been the increasing participation of the developing world's population (especially the Chinese and Indians) in the global workforce, and internet-influenced retail price erosion. In the short-term western inflation rates are falling sharply, but the reflationary action being undertaken could sow the seeds of future inflation once the recession has been overcome. The UK inflation figures have been poor owing to the impact of falling sterling and substantial public sector price and charge increases. All now rests on how quickly the authorities manage to mend the banking system.	The inflationary impact in the West, especially in the UK, is reinforced when the Asian currencies also rise. In a country like the UK with a weak currency and an open economy some inflation will be imported even in these conditions. The sharp rally in commodity prices did rekindle some inflationary fears and showed there was investment opportunity in commodities very early in the cycle. The big problem ahead is how and when authorities start to withdraw the substantial quantitative easing and start to put up the rates again to normal levels. We should expect several more months of falling prices in most economies.
Bonds	The current price of government bonds is demanding. Medium and long-term global government bond yields are very low by historical standards due to a greater pre-disposition by portfolio investors to hold bonds, unprecedentedly large flows of trade surplus liquidity in bond markets and the wish of many investors to invest in higher quality assets. The Chinese have built large positions in US bonds. Over the longer-term, equities are still likely to produce better returns as lending to governments borrowing large sums at 1-2% is unlikely to prove a good investment.	The US and UK have cut interest rates as much as they can, the ECB may still cut further. Although inflation risks seem low at the moment, holding index-linked gilts can be viewed as a longer-term insurance policy. The Bank of England has largely completed a programme of buying gilts and corporate bonds which is helping offset the high volume of issues. At some point, the high level of US, UK and Italian government borrowing may become an issue, especially for longer duration bonds. With tentative signs that the worst of the credit crunch is easing, we find 6-7% on high quality corporate bonds a relatively attractive yield.



Guy Davies was until recently Head of Charities at Barclays Wealth in London. After a commission in the Army he began his career in investment management at Barclays Private Bank in 1994, followed by roles as private client and charities Director at UBS Warburg, Lazard and Barings. He is a Trustee and Investment Committee member of the Army Benevolent Fund and Army Central Fund.



Jane Bransgrove worked as an investment manager at Sarasin Chiswell (formerly Cantrade) for over 13 years with responsibility for private clients, charities and investment strategy implementation. She is an Associate member of the CFA Society of the UK and holds a degree in Accounting and Financial Management from Loughborough University.

	Strategic View	Tactical View
Equities	Equities passed through a golden era for company profitability between 2003 and 2007 without enjoying a re-rating. We are likely to experience further months of poor corporate earnings, dividend cuts and substantial share issues, but markets will look ahead to recovery. Many equity markets offer good income yields after allowing for dividend cuts and represent excellent long-term value for the patient and strong-nerved investor. Long-term we favour Chinese, Indian and Far East equities. We only like UK equities to the extent that they are a play on global businesses and recognise that some companies will enjoy a windfall from currency appreciation on their overseas businesses. On a 5 year view it is very likely that reflation action will work and equities will benefit.	Equities have increased sharply from the lows in March. Credit Crunch worries, slower profits growth, less takeover bid support and poor sentiment will all hinder longer-term recovery but we have accumulated positions in our preferred markets. Worldwide governments are now fighting recession by monetary and fiscal stimuli. It is more important than ever to invest globally – the UK faces some difficult local problems in the next couple of years. Equities will only make sustained progress when monetary authorities are effective in easing credit conditions by encouraging more bank lending. Equities rallied strongly in the second quarter benefitting from bank bailouts and quantitative easing. The coming quarter is likely to see a pause as investors realise the fundamentals are a long way behind recent price action.
Property	Property is a core, income-generating asset class that offers many attractions yet remains under-represented in most institutional and private investment portfolios around the world. The long-term outlook remains attractive based on economic growth translating into rising tenant demand, with capital values assisted in some territories by land shortages or planning delays. Asian commercial property is underpinned by the long-term growth prospects of the respective Asian economies and should be a feature of diversified portfolios.	UK valuations have adjusted sharply downwards on grounds of poor valuation and sentiment. The residential market has been falling after a period of low volume with people waiting on events. Some price surveys have produced better news in recent months but we do not see this as the beginning of a new upward movement in prices. Asian and US property REITS are now discounting a lot of the bad news and we have made some investments in Asia. We are now looking at the attractive yields on US property because the cycle is more advanced.
Hedge Funds	This sector is going through a major shake-out and period of turbulence in these difficult and volatile market conditions. Style and fund selection is therefore crucial. Shortcomings in liquidity, transparency and regulation, allied to concerns about fees, levels of gearing and the absence of an income yield, continue to argue for avoiding hedge funds. We expect many to conclude that the 2% plus 20% fee model can no longer be justified.	The Credit Crunch has highlighted the risks in choosing individual hedge funds. Heavy redemptions may force some funds to close over the coming months. A few funds of hedge funds protected capital in the downturn and have provided a decent real rate of return over most time periods. Most lost money during 2008, albeit by less than stock markets, when they were meant to be uncorrelated. We continue to avoid the sector during this period of shake-out.
Private Equity	The good times for private equity are over. Capital will no longer be provided so cheaply to private equity firms, the economic backdrop will be less supportive to successful operational performance in the short-term, debt burdens will be more onerous and political scrutiny will increase. Once the dust has settled the stronger players will benefit from new vulture opportunities and increased global opportunities. However, shortcomings in liquidity, transparency and regulation plus the absence of an income yield, will continue to argue for limiting private equity investment to a modest part of portfolios.	The general outlook for private equity has deteriorated for operational, financial and sentiment reasons. Risks to this view are more on the side of weaker private equity returns if slowing growth unmasks unsustainable loadings of debt. The credit crunch means far less gearing in private equity deals, lower returns and poorer exit prices. It is still too early to buy into private equity. There have been some recent severe mark-downs among high-profile funds, but some private equity houses will need to shift valuations from cost to realistic views of realisable values. There will be more bankruptcies amongst the companies in their portfolios.
Commodities	Rising demand in the developing world, physical shortages, long-term dollar decline and the emergence of a new pool of financial buyers are all likely to result in continuing longer-term upward price pressure in many commodities. Longer-term, the sharp cut-backs in capital investment which resulted from this correction are likely to result in constrained supplies and further upward pressure on prices.	We were impressed by the rally in oils and industrial metals and established positions for clients. It is clear that easing of money is leading investors to buy commodity positions as an early inflationary hedge. Commodity prices have been very linked to quantitative easing and we expect some retrenchment as investors reappraise the lack of underlying demand for energy and industrial metals. We currently prefer agricultural commodities.
Cash	A better asset class than many assume, provided that real interest rates continue to be available by virtue of being used by policy-makers as a primary tool in containing inflation. Reserve diversification and a persistent trade deficit are likely to mean secular dollar weakness. Relative economic progress will result in persistent upward pressure on certain currencies in the developing world, notably the Chinese Renminbi.	The sharp move down in interest rates on both sides of the Atlantic makes cash much less attractive despite its safe haven status. We have committed most cash to better yielding opportunities. We have entered a dangerous era in foreign exchange markets where many countries would like their own currency to be lower even though they will not all be able to achieve this.



Christopher Aldous has been involved in wealth management since joining Cazenove in 1981. He has since been a Director of Barclays de Zoete Wedd, an Executive Director of UBS and a Managing Director of Robertson Stephens, the US technology investment bank. He co-founded Absolute Fund Management in 2001, where he managed a fund of hedge funds and was Chief Executive Officer until 2007.

Evercore Pan-Asset believes in **Keeping it Simple**. We say, don't take the risk of individual stocks, buy the index. That way you can keep costs down and avoid taking too big a bet on a share which lets you down. Remember what you are trying to achieve and just pick the degree of risk and income you need. We can do the rest.

You cannot avoid having an asset allocation. Everyday markets trade a portfolio has to stand up to the market test. So why not have someone watching it every day, making changes when necessary? That's **Big Picture Investing** - concentrating on the decisions that make a real difference.

Active Asset Allocation Models using Index-Tracking Funds

PanDYNAMIC Models offer a powerful new range of low-cost investment solutions to a wide range of investors.

PanDYNAMIC Models provide Financial Advisers with an innovative discretionary management solution.

The four Models employ Evercore Pan-Asset's dynamic asset allocation process coupled with low-cost investment in carefully selected Exchange Traded Funds. This provides investors with day-by-day stewardship of their money by investment professionals concentrating on the big picture. Ascentric provides the custodian and dealing service for the client and the Adviser retains full control of the client account and responsibility for the relationship.

Benefits

- Reduced cost to the client
- Clearly defined risk and return targets
- Dynamic asset allocation process including holding cash to preserve capital
- Simple to use and highly liquid
- Clear reporting and investment support

Our Investment Approach

Getting the big decisions right determines how much your clients make on their money. We take asset allocation decisions to choose whether to be in cash or property, equities or government bonds, or in a mixture.

We concentrate on the big picture and take long-term views about the likely performance of an asset. We do move more into cash if there is substantial economic and market disruption. If an asset class becomes unattractive we will sell it and if we cannot find enough attractive assets to buy because markets are difficult we will temporarily hold cash instead to avoid losses and preserve capital.

Our investment universe covers over 30 asset classes across all geographic regions. The asset allocation team constantly monitor each asset class to find the best investment opportunities around the world.

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The Model Funds

The four Model Funds offer a complete range of risk and return options. Risk appetite is measured in terms of maximum tolerance of loss (based on results from simulations using central portfolio asset weightings over the past ten years) while return targets are linked to multiples of cash returns.

The portfolios are carefully constructed using appropriate asset classes for each Model Fund's stated risk level. Detailed back-testing and performance simulations are used to verify that the model is suitable for the investor's requirement. The full range of asset classes and sub-classes includes bonds, equities, listed property, funds of hedge funds, private equity and commodities and, of course, cash. We will seek to mitigate risk in difficult markets by holding more cash and avoiding riskier assets. The Model Funds target real rates of return over the longer term, aiming to experience a lower risk of loss than comes from remaining fully invested at all times. Therefore their performance will not necessarily track the rise (or fall) of any specific index.

How PanDYNAMIC Model Funds work for the client

With Model Funds your clients do not put money into an independent structure. Instead they link money in their Ascentric account to one or more Model Funds. The Ascentric platform automatically populates their account with the appropriate underlying investments to replicate the selected Model Fund. These investments, normally low-cost Exchange Traded Funds, are automatically adjusted each time the appropriate Model Fund is updated or rebalanced. Changes to the portfolio will usually be made monthly, but may take place more frequently in extreme market conditions. The client can hold the chosen Model Fund(s) within a range of available tax wrappers.

Costs

Evercore Pan-Asset charge an annual investment management fee of 0.25% of assets for providing the Models and monthly support. The Ascentric platform also charges 0.25% plus additional moderate annual charges if certain tax wrappers such as SIPPs and offshore bonds are required. Low dealing charges of £1 per transaction are available for an annual fee of £60. This dealing concession is only available within the Model Portfolio Tool on the Ascentric platform.

Please contact Christopher Aldous on 020 7398 5840 if you would like to receive a brochure about PanDYNAMIC Models or would like to discuss them in more detail.

About Evercore Pan-Asset

We are an independent firm providing an asset allocation advisory service to pensions, charities and private wealth. This can be part of an integrated investment management service or as a stand-alone consulting service. We use Exchange Traded Funds extensively to implement our asset allocation views. Apart from our PanCONSULT service we offer six contrasting investment strategies, each of which can be tailored to the needs of the individual client.

- PanBALANCED
- PanCASHPLUS
- PanGROWTH
- PanPACIFICSHIFT
- PanOPPORTUNITIES
- PanALTERNATIVES

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