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	<u>1/1/00</u>	<u>1/1/01</u>	<u>1/1/02</u>	<u>1/1/03</u>	<u>1/1/04</u>	<u>1/1/05</u>	<u>1/1/06</u>	<u>5/4/06</u>	<u>1/7/06</u>	<u>5/10/06</u>	<u>1/1/07</u>	<u>5/4/07</u>
FTSE 100	6930	6222	5217	3940	4477	4814	5618	6044	5833	6005	6220	6397
FTSE All Share	3242	2983	2524	1894	2207	2411	2847	3086	2968	3076	3221	3332
Dow Jones (US)	11452	10786	10022	8342	10454	10783	10717	11240	11150	11867	12463	12560
S&P 500 (US)	1469	1320	1148	880	1112	1212	1248	1312	1270	1353	1418	1444
Nikkei Dow (Japan)	18934	13785	10543	8579	10677	11489	16111	17244	15505	16436	17225	17491

Leading Growth Equities

Anglo American
BHP Billiton
BG
Bunzl
Diageo
Experian
Hanson
Johnson Matthey
National Grid
Reckitt Benckiser
Tesco
United Business Media

Leading Income Equities

Alliance & Leicester
Aviva
Barclays
BP
BT Group
GlaxoSmithKline
Lloyds TSB
Royal Bank of Scotland
United Utilities
Vodafone

Smaller Companies

Biffa
Caledonia Investments
Close Brothers
Cobham
Group 4 Securicor
Halma
Melrose
Mothercare
Northumbrian Water
VT Group

Overseas Companies

ExxonMobil
Procter & Gamble
SAB Miller
Total

AIM Stocks

Dobbies
Domino's Pizza
Majestic Wine
Worthington Nicholls

Overseas Funds

Baillie Gifford Japan
Edinburgh Dragon
JPM American
JPM Indian
Jupiter Emerging European

The Shanghai Shuffle

Many of my readers enjoyed my last Chronicle entitled 'Letter from China', but even I had no idea how profound it would be and I take the liberty to quote a few of those lines regarding the Shanghai Stockmarket:

Chinese Stockmarkets are 'rigged' by:

- a) *The communist Government retaining large stakes in all quoted companies.*
- b) *Only the Chinese people may deal in most domestic stocks.*

(I even visited a Shareshop in Shanghai, which was very similar to a seedy backstreet bookmakers, where none of the investors looked very prosperous!)

The Stockmarket is more open through Hong Kong, and now one or two world class companies, such as Bank of China, are becoming quoted on national Stock Exchanges.

None of the investors seem to believe the propaganda figures released by the Communist Government who still drive round in 'blackened, flagged, Mercedes' of the politburo, and every day one reads in the local newspapers of yet another local official on enormous fraud charges, where the figures make the eyes boggle.

It is George Orwell's 'Animal Farm' all over again.

In conclusion:

- a) *There really is a huge boom taking place in China and this will last until at least the Olympic Games in 2008.*
- b) *But I have huge concerns about the lack of basic commodities and the most important of these being Water.*
- c) *And I shall remember my dear wise old Father's expression when referring to the continuous UK Government's economic cycles of 'boom and bust':*

"Charlie, remember, the bigger the boom, the bigger the bust".

It therefore surprised none of my readers that on 27th February 2007 the Shanghai Stockmarket crashed 9% in the day (having risen 100% over the previous year). This sent shock waves round the world, causing all global Stockmarkets to fall sharply, largely led by 'the Emerging Economies' and 'leading Mining Shares'. There was nonsense being spoken about 'the end of the Chinese boom' and 'that Chinese demand for minerals would dry up'. Burnt fingers could be smelt all over the world, but my readers knew this was caused by a few Chinese punters speculating in the back streets of 'The Bund' (another name for 'The City Area of Shanghai').

A few weeks later there was another major shake out in world Stockmarkets when it was announced on 9th March 2007 that 'the US Sub-Prime Lending Market' was in serious trouble. The second largest Sub-Prime Lending Bank, New Century Financial, is likely to go into liquidation, and HSBC's recently acquired subsidiary, Household, caught a serious cold. These losses have affected most other leading Banks, particularly Barclays in the UK.

It must be remembered that 'Sub-Prime Lending' is a confusing expression. It really means 'lending to the very bottom of the pile in the house mortgage market'. The less well off US citizens had borrowed money at very low rates of interest (US Federal Funds Rate stood at 1% until June 2004, it is now 5¼%) and had secured these loans against 'rubbish property'. It is not surprising that when interest rates rose to normal levels, there were tears.

Rather than this episode being a financial catastrophe, we consider it just another example of the age old phenomena of:

- a) Greedy banks
- b) Sucking in unsuspecting customers on low rates of interest
- c) Taking little concern over the quality of collateral
- d) and when it starts raining the banks take the umbrella back (ie when interest rates rise the banks fore-close the property).

These events of the Shanghai Shuffle and the Sub-Prime Lending Crisis have caused Stockmarkets to be extremely volatile over the past 3 months:

	<u>FTSE 100</u>	<u>Date</u>
UK Stockmarkets were performing well on good figures:	6419	19/2/2007
but during the Shanghai Shuffle fell to:	6058	5/3/2007
Stockmarkets recovered to:	6245	9/3/2007
but then fell again on the Sub-Prime lending crisis:	6000	14/3/2007
Only to recover again to its present level:	6397	5/4/2007

This therefore proves that world events cause:

- 1) The UK Stockmarket to remain volatile
- 2) but there is still a strong 'undercurrent' from quality earnings rising through the UK economy.

There is concern that such a 'mortgage crisis' could occur in the UK, but we are not so concerned about this.

- 1) Though interest rates are rising, they never fell as low as US rates did, and therefore borrowers understand their commitments.
- 2) In most cases there is 'strong collateral' to secure mortgages.
- 3) Consumer spending will slow down before mortgages are called in.

WE HAVE DISCUSSED THE 2 BLIPS, NOW LET US CONSIDER WHY THE UK STOCKMARKET HAS A STRONG UNDERCURRENT, RECOVERING TO TODAY'S 6397.

At this stage it is useful to quote the old adage:

"Buy on fact, sell on rumour".

The FACTS are:

- 1) UK 'corporate profitability' rose to its historically highest level ever at the end of 2006, as manufacturing and service sector companies benefited from strong sales growth, together with lower energy prices and relatively stable wage pressures. Even though a further rise in interest rates would damage corporate profitability, the fall in energy prices will more than compensate for this.

Companies are so 'cash rich' that there are very few 'Rights Issues' and many companies are now able to:

- a) Pay large 'special dividends'
- b) Arrange large buy backs of shares

with surplus cash, which they have no other ways of spending.

- 2) With the rise in corporate profitability, this justifies the rise in the FTSE 100 Index to 6397, whereby:

Average PE ratio	= 12.6
Average dividend	= 3.0% net
Average dividend cover	= 2.6

(Rising profits means rising dividends, which means PE's and yields have kept in line with historical formulae ratings, indeed present ratings look relatively cheap.)

We are slightly more concerned by ratings in the FTSE 250 of:

Average PE ratio	= 18.8
Average yield	= 1.9% net
Average dividend cover	= 2.8

- 3) There is a huge amount of M&A (Mergers and Acquisitions) taking place, largely led by the world's major Private Equity Funds (such as KKR, Macquarie, Blackstone etc). There are also mergers in the Bank, Building, and Utility sectors:

FACTS: Scottish Power, Alliance Boots, Taylor Woodrow/Wimpey, Cadbury Schweppes (are all in merger or demergers talks)

and:

RUMOURS: ICI, Scottish & Newcastle, Unilever, Next etc (have all been rumoured for takeover)

The factual bids have led prices up and will cause cash to be washed back into the Stockmarket causing further rises.

The rumoured bids cause Stockmarkets to rise, as a few will come off, but an awful lot will fail. It is a fact that many of the companies now rumoured are companies that we have avoided over recent years due to lack-lustre profit performances.

We shall now be looking carefully into the merits of 'assets', 'brand names', 'carve up prospects', as Private Equity Funds devour their victims and become even more hungry.

- 4) Along with the Private Equity Funds there are the wretched Hedge Funds gambling in everything they can lay their hands on. This has now spilt over to the 'grain markets', where this week:

Maize has crashed
Wheat has firmed
and Oil seed rape has boomed

(How a Norfolk farmer is meant to understand the Chicago Futures Market defies me - but like investing in long term shares, it must be right to take the average price for the commodity you grow, and leave others to play around with daily movements.)

The FACTS are therefore:

- 1) Corporate profitability in the UK is the best ever.
- 2) The FTSE 100 at 6397 actually looks low on fundamental historical formulae.
- 3) M&A (Mergers and Acquisitions) will support Stockmarkets.
- 4) Speculation from Hedge Funds/Private Equity Funds will keep Stockmarkets volatile.
- 5) With phenomena such as 'the Shanghai Shuffle' or 'the Sub-Prime lending crisis', this will again continue to keep Stockmarkets volatile.
- 6) But fundamentals will bring Markets back to true levels.

RUMOURS:

- 1) There is a rumour of the next stock to be taken over every day. Some will come off, an awful lot will not. Barratt & Cooke will be listening to everything and come to their own conclusions.
- 2) If Stockmarkets rise too high on rumours, eg above 6500, we shall be ready to take some profits and hold the 'cash' on deposit and then endeavour to re-purchase lower down - or when the market settles.

Interest Rates and the Fixed Interest Market

As clients will know we have been predicting 'higher interest rates' for several years.

Bank base rates have now risen from 3¾% to 5¼% and are expected to rise to 5½% within the next 3 months. We feel certain that base rates will rise to at least 5½% and with house price inflation out of control we are one of the few forecasters who predict interest rates will rise even higher than 5½% (5% has been the 200 year average!).

At long last 'Fixed Interest Rate Stocks' are beginning to look more attractive:

	<u>Gross Redemption Yields</u>	
Short Dated Gilts	5.5%	
Medium Dated Gilts	5.25%	
Eurobonds	6.2%	
	<u>Equivalent Gross Yield</u>	<u>Net to 20% Tax Payer</u>
Preference Shares	7.5%	6.0%

RPI has risen to 4.6% year on year. Even though RPI will fall with falling energy prices, if RPI fell to 3%, Index Linked Gilts still look outstanding value to higher rate tax payers.

Gordon Brown's measure of inflation is CPI, which is now 2.8% and is predicted by him to fall to 2%.

Our advice is therefore still to:

- Stay in short dated Fixed Interest.
- Higher rate tax payers should buy Index Linked.
- But at last we are beginning to think about going medium/longer dated. We shall advise clients when we feel this is the case.
- Cash deposits are still attractive. In conjunction with the Bank of Scotland, Barratt & Cooke clients receive ½% below base rate = 5¼% - ½% = 4¾% gross with instant access.

Overseas Markets

All world Stockmarkets have been volatile during:

- The Shanghai Shuffle
- The sub-prime banking crisis

and of course some more volatile than others, but it is a fact that world markets have mostly been moving in the same direction, proving the globalisation of Stockmarkets.

Europe	Still bogged down by regulation, but buoyant with UK markets generally.
US	Worries concerning the 'sub-prime banking crisis' and the weakness of the US \$, but all large portfolios should have some US exposure. 'Never underestimate the US'.
Japan	Recovering and now stands at 17491. There will be problems with the 'Yen Carry Trade', but this is compensated for in Stockmarket values and Japan now looks good value.
Australia	Doing well with the rising commodity prices.
Emerging Markets	The 'Shanghai Shuffle' says it all. 'Caveat Emptor'.

The Budget

I am now totally convinced that Gordon Brown is the greatest con man of our time, except he now cons nobody else but himself.

His Budget headlines were:

- 1) CORPORATION TAX CUT FROM 30% TO 28%

but this is only for large companies and this is paid for by scrapping various capital allowances and increasing corporation tax from 19% to 22% for smaller companies.

- 2) INCOME TAX CUT FROM 22% TO 20%

but this is paid for by scrapping the 10% band and increasing National Insurance contributions.

- 3) CAPITAL GAINS TAX ALLOWANCE DOUBLED FOR MARRIED COUPLES

Nonsense, each spouse was allowed £8,800 each anyway.

- 4) INHERITANCE TAX ALLOWANCE INCREASE TO £350,000

but not until 2010.

- 5) INFLATION PREDICTED TO FALL TO 2%

Yes, this is CPI now standing at 2.8% (which only has in it what the Chancellor wants).

RPI, which we all understand to be inflation, stands at 4.6% (announced the morning before the Budget).

He has totally forgotten about RPIX, which does not suit him any more.

At last the 'Pensions crisis' has quite rightly come back to haunt him, where he abolished tax credit reclaims from Pension Funds, which we all thought were sacrosanct. We now know that the Prime Minister and the CBI advised him against this move at the time he made it.

Perhaps in a few months time we shall be saying "Come back Tony, all is forgiven. Gordon RIP."

From an investors point of view the main points to mention in the Budget are:

- 1) **ISAs**

2007/2008 £7,000

2008/2009 £7,200 (of which a maximum of £3,600 may be in cash ISA)

*2008/2009 PEPs/ISAs may be amalgamated

* At this time cash ISAs can be transferred into Equity ISA, but not vice versa.

(Many clients have sent forms to us regarding amalgamating PEP/ISA, which we shall not be allowed to do until April 2008. However, we shall be contacting all clients who have written to us regarding consolidation of PEPs and ISAs, to get everything set up ready for April 2008).

2) **Capital Gains Tax Allowance**

2007/2008 Increase from £8,800 to £9,200 for individuals
Increase from £4,400 to £4,600 for most Trusts

3) **Inheritance Tax Allowance**

2007/2008 Increase from £285,000 to £300,000
2008/2009 Increase from £300,000 to £312,000
2009/2010 Increase from £312,000 to £325,000
2010/2011 Increase from £325,000 to £350,000

4) **VCT and EIS Schemes**

Will be very restricted, restricting schemes to:

- a) Raising under £2,000,000.
- b) To companies with employees of less than 50.

5) **Life Insurance Policies**

Restricting the repayment of commission in restricted cases.

6) **AIM**

This is probably the most worrying point in the 2007 Budget to investors.

The Chancellor announced that:

“The Commissioners of HMRC are allowed to designate as a recognised Stock Exchange any UK Investment Exchange that is designated a recognised Investment Exchange by the FSA.”

This convoluted statement really refers to AIM, ‘Alternative Investment Market’.

As AIM is not considered a ‘recognised Stock Exchange’ at the moment (which of course it is) some stocks quoted on AIM are treated as ‘business assets’ for tax purposes, ie if stocks are held for 2 years in some cases:

- a) Capital gains tax is 10%.
- b) There is no inheritance tax
(these rules are extremely complicated and certainly do not apply to all AIM stocks).

If AIM is considered a ‘recognised Stock Exchange’ then these tax advantages could be lost.

The Treasury certainly states that this is not the intention, but I do not believe one word Gordon Brown says.

As the law now stands, AIM stocks are particularly attractive when planning for inheritance tax.

Barratt & Cooke can arrange a basket of AIM shares for clients doing inheritance tax planning, but beware the tax laws could change.

End of Year Predictions

In the 1st January 2007 Newsletter I made various predictions (for fun).

Two of these have come off so far:

- 1) Interest rates to rise to at least 5¼%.
- 2) House prices have continued to rise.

The others have not come off yet:

- 1) Tony Blair's departure and Gordon Brown creeping in like Dickens' Uriah Heep.
- 2) The FTSE 100 to rise over 6600 at some stage.
- 3) Prince William to become engaged to Kate Middleton (perhaps a year too early).
- 4) Teofilio to win the Derby (June 2007).
- 5) Leona to have another number 1 hit.

(I just wonder if after the cons of the Budget the electorate will let Gordon Brown RIP and elect David Miliband instead).

In Conclusion

The 'Shanghai Shuffle' and the 'sub-prime banking crisis';
the Private Equity Companies and the Hedge Funds;
RPI, Bank Base Rates and the Budget;
all go to prove what a complicated worldwide jigsaw the financial markets are becoming.
But amongst this jigsaw there will always be
'fact and rumour'/'investment and speculation'.

Barratt & Cooke will stick to fact and investment.

C W L Barratt
5th April 2007

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