

BARRATT & COOKE

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	<u>1/1/99</u>	<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>
FTSE 100	5882	6930	6222	5217	3940	4477	4814	5618	6044	5833	6005	6220
FTSE All Share	2674	3242	2983	2524	1894	2207	2411	2847	3086	2968	3076	3221
Dow Jones (US)	9181	11452	10786	10022	8342	10454	10783	10717	11240	11150	11867	12463
S&P 500 (US)	1229	1469	1320	1148	880	1112	1212	1248	1312	1270	1353	1418
Nikkei Dow (Japan)	13842	18934	13785	10543	8579	10677	11489	16111	17244	15505	16436	17225

Leading Growth Equities

Anglo American
Aviva
BHP Billiton
BG
Diageo
Experian
Hanson
Johnson Matthey
Reckitt Benckiser
Tesco

Leading Income Equities

Alliance & Leicester
Barclays
BP
BT Group
Friends Provident
HSBC
Lloyds TSB
National Grid
Royal Bank of Scotland
United Utilities
Vodafone

Smaller Companies

Biffa
Bunzl
Caledonia Investments
Close Brothers
Cobham
Halma
Mothercare
Northumbrian Water
Northgate Information
Southern Cross Healthcare
United Business Media

Overseas Companies

ExxonMobil
Procter & Gamble
SAB Miller
Total

AIM Stocks

Domino's Pizza
Glisten
Majestic Wine
Worthington Nicholls

Overseas Funds

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

Letter From China

For once in my life I applauded the death penalty, but haunted by the grotesque images of Saddam Hussein going to the gallows, I realise that the gutter press have fallen to the depths of depravity and would therefore prefer to leave this unmemorable year of 2006 and move straight on to 2007. Indeed, the only memorable point of 2006 has been another excellent performance of Stockmarkets, having shown 4 continuous years of growth.

Looking forward to 2007 I can see in my 'crystal ball' Tony Blair's departure, going out with a whimper similar to celebrating New Year's night on 1st February. I can see Gordon Brown creeping into the seat of Prime Minister, but like Dickens' Uriah Heep, never taking his fingers off the tiller of the Exchequer and yet 'always remaining humble'. Sadly there is bound to be world terrorism, which we all pray will not affect us personally and hopefully there will be no more flare ups in Northern Ireland.

My 'crystal ball' predicts that: the FTSE 100 will rise to over 6600 at some point (though there will be buying opportunities on scare mongering in the early summer); interest rates will rise to at least 5¼%, and though house prices are historically too high on 6¼ times earnings they will continue to rise on another simple economic rule of 'the law of supply and demand'; Prince William will become engaged to Kate Middleton; Teofilo will win the Derby; and Leona will have another No. 1 hit.

The one certainty in 2007, and which I am thrilled about, is that my 28 year old son William will be joining Barratt & Cooke in July after completing his '6 year apprenticeship' with Stockbrokers in Edinburgh and London (he certainly has it 'in his blood').

China

As the readers of these chronicles know I visited China in late October 2006.

Caroline and I were tourists, but we were extremely lucky to travel China with great friends Johnny and Josie Reed, who regularly visit China, with a flat in Shanghai and can speak fluent Mandarin. This gave us the opportunity to reach the other parts that the average tourist does not reach, and of course I treated it as a fact finding tour of the fastest growing economy in the world.

I enclose the prologue to my 'letter from China' which clients may enjoy reading and if you would like the whole 'letter', then you only have to ask your adviser and we shall be delighted to send it.

What were my lasting economic impressions?

- 1) A very well educated, hard working, well mannered, honest work force, where China is definitely:
 'long on labour and short on basic commodities'.
- 2) The building of roads, airports, skyscrapers, indeed the whole infrastructure has to be seen to be believed. Though incomprehensible, it is true.
- 3) Strict and accepted 'right wing' laws of:
 - a) One child families (with exception for success).
 - b) Minorities (openly talked about and accepted, but still treated as minorities).
 - c) Tough laws on crime (where the death penalty is a regular feature).
- 4) And yet there is the paradox of:
 'An old fashioned communist Government running the country.'
 'While the country is dominated by wild west capitalism.'

This can be explained by Deng Xiaoping's (the leader after Mao Tse-Tung) famous phrase:

"It does not matter whether the cat is black or white provided it kills mice"

literally meaning:

"It does not matter whether the economic system is communism or capitalism provided it suits China."
(Perhaps the same could be said of Russia.)

Yes, China is booming, causing world commodity prices to rise. This boom will certainly continue until after the 2008 Beijing Olympics, which I have no doubt will be outstanding.

But:

- a) Who is going to pay for all this infrastructure?
- b) Who is going to live in all these new skyscrapers (certainly not agricultural peasants from the country who have come into the towns to do the building work)?
- c) There is a lack of basic commodities such as Metals, Oil and Coal, and much of industry has to run on a 4 day week due to the lack of power.
- d) Agriculture is outdated, but the greatest worry of all is the 'lack of water', where we witnessed empty reservoirs just outside Beijing'.
- e) Pollution is rife, and even though Autumn is always the 'cleanest time of year' Xian was shrouded in smog.
- f) Stockmarkets are 'rigged' by:
 - i) The communist Government retaining large stakes in all quoted companies.
 - ii) Only the Chinese people may deal in most stocks.

(I even visited a Shareshop, 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 politbureau, 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 is right to invest in companies trading with China, but I certainly would not advise investing in individual Chinese shares.

Perhaps this report should be followed by 'letter from India, Russia and Uzbekistan' (if I can find it on the map).

I hope you enjoy 'the prologue' and for those who wish to, by all means ask for the full version.

Stockmarkets

The enclosed chart gives the performance of the basic economic indices since 1st January 2004.

Looking back on 2006, it is always interesting to compare indices:

	<u>1/1/2004</u>	<u>1/1/2005</u>	<u>Annual Change</u>	<u>1/1/2006</u>	<u>Annual Change</u>	<u>1/1/2007</u>	<u>Annual Change</u>
FTSE 100	4477	4814	+ 7.5%	5618	+ 16.7%	6220	+ 10.7%
All Share	2207	2411	+ 9.2%	2847	+ 18.1%	3221	+ 13.1%
US Dow Jones	10454	10783	+ 3.1%	10717	- 0.1%	12463	+ 16.3%
Gold \$	417	437	+ 4.8%	513	+ 17.4%	632	+ 23.2%
UK 10 Year Gilt Yield	4.5%	4.5%	-	4.1%	- 0.4%	4.8%	+ 0.7%
US \$/Pound	1.79	1.92	- 7.3%	1.72	+ 10.4%	1.96	- 14.0%
Pound/Euro	71p	71p	-	69p	+ 2.8%	67p	+ 2.8%
Base Rate	3¾%	4¾%	+ 1.0%	4½%	- ¼%	5%	+ ½%
Gross Domestic Product			+ 3.1%		+ 1.6%		+ 2.9%
RPI			+ 3.4%		+ 2.4%		+ 3.9%
Average Earnings			+ 4.2%		+ 3.0%		+ 4.2%
Average UK House Prices	£135,424	£152,623	+ 12.7%	£157,200	+ 3.0%	£173,746	+ 10.5%

and taking the FTSE 100 further back:

<u>1/1/2000</u>	<u>1/1/2001</u>	<u>1/1/2002</u>	<u>1/1/2003</u>	<u>1/1/2004</u>	<u>1/1/2005</u>	<u>1/1/2006</u>	<u>1/1/2007</u>
6930	6222	5217	3940	4477	4814	5618	6220
	- 10.2%	- 16.1%	- 24.5%	+ 13.6%	+ 7.5%	+ 16.7%	+ 10.7%

(to which a net dividend yield of approximately 3.0% needs to be added for the 'real return').

Studying these figures, the following facts are quite clear and assumptions can be read into them:

- 1) UK Equities have now recorded unbroken growth for 4 years. However, they are still at exactly the same level as on 1/1/2001 and considerably lower than they were on 1/1/2000.

With FTSE 100 profits and dividends rising substantially since January 2000 this automatically brings down PE's, increases yields and therefore justifies the 4 year growth in Equity prices and still leaves scope for further share price rises.

- 2) Though the US Dow Jones and the price of Gold appears to have performed well, when one takes into account the fall of the US Dollar by 14.0% against Sterling, the returns are much less.

Though most pundits expect the US Dollar to fall below US \$2 to £1, I again remember the sound words of another elderly mentor:

“Charlie, never underestimate the US economy”.

- 3) With:

- a) RPI rising by 3.9% (which we all told the fiddling Chancellor it would)
- b) House prices rising by 10.5% ($6\frac{1}{4}$ x average earnings, where the old formula was between 3 and 5 times)
- c) Earnings inflation rising by 4.2%
- d) While Gross Domestic Product has held steady at 2.9%

we feel it certain that bank base interest rates will rise from 5% to at least $5\frac{1}{4}$ % (the highest for 6 years).

- 4) On basic fundamentals of averages:

PE's	13.6 x
Net yields	3.0%
Dividend cover	2.4 x
Profits rising	over 10.0%
Dividends rising	over 8.0%

we believe that the FTSE 100 at approximately 6220 looks reasonable value, with scope to rise further.

On top of this there is the prospect of 'Private Equity Funds' and 'Cash rich foreign companies' continuing to take over core UK companies as they did in 2006 with BAA, P&O, O₂, Associated British Ports, AWG etc, and pending bids for Scottish Power and The London Stock Exchange.

However:

- a) Above 6700 (as some pundits predict) we feel it is getting too high.
- b) Below 5800 (which it could fall to on scare mongering similar to May 2006), then it is too low.

UK Stocks

Barratt & Cooke has always looked at growth stocks in the past, but we feel 2007 could be the year for former laggards giving reasonable yields, with huge assets and brand names, eg:

Vodafone, BT, GlaxoSmithKline, Lloyds TSB (even ICI is a much 'tipped stock' for takeover)

We still like Mining Shares which have fallen back too sharply:

Rio Tinto, BHP Billiton, and have added to the list Anglo American

and Oils where the oil price still remains high at US \$59 a barrel:

BP (having its Annus Horribilis), Royal Dutch Shell (which survived its Annus Horribilis), together with Exxon, BG and Total

The oil related stocks Hunting and Petrofac are probably getting a bit high.

Fixed Interest

As stated, we feel bank base rate will rise to at least 5¼%.

While conventional 10 year Gilt yields remain below this figure at 4.8%, we feel conventional longer dated Gilts too high.

With RPI rising to 3.9% (even though it is likely to fall as oil prices fall), we still like the certainty of Index Linked Gilts.

When Conventional Fixed Interest Stocks reflect the rise in bank base rates, lock into longer dated stocks for yield then but not yet.

To sum up:

- 1) Stay short dated or Index Linked for safety and liquidity.
- 2) As interest rates rise, look to switch into longer dated stocks to secure high income into the future, but not yet.

World Stock Markets

US 'Do not underestimate the US economy' and an unexpected recovery in the Dollar would improve values further. We still particularly like Exxon and Procter & Gamble and have added:

SAB Miller and Hanson, both of which have significant exposure in the US

Europe Specialist funds continue to perform well and for speculative exposure to Eastern Europe, we have added:

Jupiter Emerging European Opportunities Fund

Japan was overhyped at the start of 2006, but following a disappointing year, actually looks good value now, with all the same fundamentals in place. We have added to the list of stocks:

Baillie Gifford Japan Investment Trust

Emerging Markets Though the Chinese boom will continue, we are more concerned about the long term and actually prefer India where the language and legal system are similar to the UK. We retain on the list:

JPM Indian Investment Trust

Australia Still rich in minerals which is very advantageous to the Indian and Chinese economies. We still like:

BHP Billiton

It is a fact that so many companies now cover the full spectrum of the universe, illustrated by a paragraph that amused me recently:

‘The Indian-born and London-based billionaire Lakshmi Mittal who built his Dutch-listed Mittal Steel into the world’s biggest steel company by purchasing old steel mills in places like Kazakhstan and Poland before negotiating a US \$4.5 billion purchase of International Steel Group from the American investor Wilbur Ross’ (wherever he came from!).

Corporate Actions

2006 will go down in history as one of the greatest years for corporate activity.

It is a fact that The London Stock Exchange listed new stock worth £27.9 billion, more than the New York Stock Exchange and Nasdaq added together.

Helped by activity from ‘Private Equity Funds’, aggressive ‘foreign companies’ and UK companies trying to become even more financially efficient by distributing special dividends and gearing up balance sheets, the list of ‘corporate actions’ seems endless.

There have been takeovers and mergers for O₂, P&O, Boots/Alliance Unichem, Pilkington, Alliance/Second Alliance Trust, BAA, BOC, Associated British Ports, DX, AWG etc.

There has been special dividends and demergers from Pennon, London Stock Exchange, Caledonia, Whitbread, Vodafone, Severn Trent, GUS, Candover etc.

There are still pending takeover bids for:

Scottish Power	Likely to take place in March/April 2007. We shall send our advice in due course, but are being very careful on capital gains tax considerations.
The London Stock Exchange	Most sane people would sell in the Stockmarket at 1300p with Nasdaq's bid at 1243p. However, having reduced nearly all clients holdings on the past bids we feel it now right to 'ride it out to the end with Clara Furse'. The London Stock Exchange is doing exceptionally well in its own right and I cannot believe that Clara Furse has not got a 'Plan B' up her sleeve. I am certain it was right to take some gains earlier, but we have taken no harm sitting with the balance.

Barratt & Cooke Portfolio Service

2006 was an exceptionally good year for Barratt & Cooke clients, with the vast majority of Equity portfolios outperforming the FTSE 100.

As all clients know, Barratt & Cooke advise clients to purchase balanced, quality portfolios to provide the level of income, risk, potential capital growth that each individual client requires.

Though all portfolios are separate, the basic portfolios for 'new cash' are split:

3%	Cash
17%	Fixed Interest
57%	Leading Equities
15%	Smaller Equities
8%	Funds for overseas and special situations

We continue to 'invest new money' bit by bit, placing limits on some stocks to try to pick these up on weak days in Stockmarkets.

We monitor all Advisory Service stocks, giving individual advice on stocks when we feel alterations should be made, just as we do when corporate actions demand alteration.

We continue to 'review total portfolios' for:

- a) Balance.
- b) ISA.
- c) Capital gains tax.
- d) Clients' individual requirements for income and growth.

Capital Gains Tax

In this tax year, 2006/2007, as will probably be the case in 2007/2008, capital gains tax is inevitable in many cases due to:

- Large rises in many stocks
- Takeover situations
- Corporate re-organisations etc

We always look carefully at the capital gains tax consequences of any transactions, but clients should be prepared to pay some tax if necessary. This does highlight the advantages of tax-free PEP/ISA which clients should keep adding to.

Discretion

In view of the recent spate of Corporate Actions smothering clients with paperwork, more and more clients are now switching into Barratt & Cooke's Discretionary Service where the advice is similar to Advisory, but we deal immediately and inform clients afterwards. £215,000,000 of our managed funds are now in Discretion and are increasing rapidly.

FURTHER POINTS

Alternative Investments

Some clients continue to ask us about:

Derivatives	- highly speculative
Commodities	- highly speculative

Both are too speculative and specialised for Barratt & Cooke, but it seems that all clients who have dealt in these have ultimately lost money!

Hedge Funds	- either too speculative or extremely boring
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Absolute Funds are called Absolute as on the whole they:

- i) Show absolutely no income
- ii) Virtually absolutely no growth

and are only attractive in falling Stockmarkets.

Barratt & Cooke provides the Hedge to clients by holding Gilts/Cash.

Forthcoming Changes to PEPs and ISAs

In the pre-budget December statement the Chancellor announced future changes to PEPs/ISAs giving much more flexibility and options to transfer Cash ISAs and Tessas to investment related ISAs.

This will give the opportunity for clients to amalgamate all PEPs/ISAs/Tessas etc under 'the Barratt & Cooke umbrella' and we can then give advice on these, bearing in mind your total Stock Exchange requirements.

We enclose a separate sheet giving more details and questionnaire for clients to complete and return should they wish to consider transferring these as soon as the legislation is approved. For those clients who transfer within the first 3 months of the start date, we will not charge any purchase commission.

REITs 'Real Estate Investment Trusts'

REITs came in on 1st January 2007.

Quite simply this will be where property companies:

- a) No longer pay corporation tax or capital gains tax.
- b) Though they have to pay out 90% of income in dividends (along with other rules and regulations).

This means that the property companies will be much better off, though the shareholders will continue to pay:

- a) Income tax on dividends.
- b) Capital gains tax on the sale of shares.

REITs will be exceptional investments for gross funds such as ISAs/SIPPs and Charities, but only when the price of property is right. But beware, commercial and residential properties are now at all time highs.

Ten companies have announced conversion to REITs:

British Land, Land Securities, Liberty International, Slough, Hammerson, Great Portland Estates, Brixton, Big Yellow, Workspace, Primary Health Properties

and many more will follow.

We feel REITs will be a wonderful method of investment in due course, but not yet, while:

- a) Commercial property and residential property is so high.
- b) Property companies will have conversion expenses etc.

We shall keep clients informed on REITs, but you should not rush in at these levels.

Bogus Traders

The London Stock Exchange and FSA have asked us to warn all clients about bogus traders, mostly from Amsterdam, Spain or the US, selling dud stocks over the telephone. Apparently many individuals have been 'sucked in', though few tell their stockbrokers.

This can also be said for purchasing any other financial products over the telephone, or through junk mail.

You have been warned, but one must remember, 'there is one mug born every minute'.

In Conclusion

2006 was uneventful, but was a successful year for Barratt & Cooke clients.

We still have 'The London Stock Exchange', but it is anybody's guess if it will still be called 'The London Stock Exchange' by 2008. Whatever happens, the company is extremely efficient, extremely profitable and doing extremely well.

On financial fundamentals:

We feel the FTSE 100 at approximately 6220 reasonable value
It will be too high above 6700
It will be too low below 5800

though it will be held up by the weight of 'Private Equity money'.

China will boom until at least the 2008 Beijing Olympics, but never forget my father's saying:

'the bigger the boom, the bigger the bust'

Saddam has gone, let us all move into 2007 and look forward with cautious optimism. Happy New Year.

C W L Barratt
1st January 2007

Postscript:

- 1) Riddle: What does a Chancellor with constipation do? (Answers by postcard, email or fax)
- 2) If you would like the full edition of 'Letter From China' please ask your advisor.

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