

BARRATT & COOKE

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Dear

Stockmarket Update

As you may be aware, global financial markets have fallen sharply since the turn of the year:

	<u>02/01/2008</u>	<u>22/01/2008</u>	<u>% Fall</u>
FTSE 100	6457	5740	-11.1%
FTSE 250	10658	9613	- 9.8%
Dow Jones (US)	13265	11971	- 9.8%
Shanghai A (China)	5521	4786	-13.3%
Nikkei Dow (Japan)	15308	12573	-17.9%
S&P ASX (Australia)	6421	5222	-18.7%

whilst UK markets have suffered their worst start to a calendar year since records began in 1935, fuelled by fears that the US economy is falling into recession.

There is an old Stockmarket saying:

'When the US sneezes, the world catches a cold'

but ironically, the largest falls in the global indices occurred on a day when US markets were closed (for Martin Luther King Day).

Why have fears of a US recession arisen?

Fears of the US economy sliding into recession have mounted over recent weeks in response to weak economic data as the US unemployment rate climbed to a two year high of 5%.

The impact of this poor economic data has been compounded by negative news flow from:

Major US banks - where Citigroup announced their first ever quarterly loss and accompanied the announcement with the write-down of as much as US\$18.1bn of assets.

The US housing market - where conditions are forecast to deteriorate and there are no signs of recovery.

However, there is more to the story, as not only have global Stockmarkets fallen in reaction to negative news flow, but such falls have been magnified by:

Rumour, fear and sentiment

Indeed, we have already witnessed the fallout from:

Collateralised Debt Obligations (CDO's)
Subprime Mortgage losses

but there are now *fears* and *rumours* about:

'Credit Default Swaps' (which effectively resemble an insurance policy where debt owners 'hedge' against credit events)

further impacting *sentiment* in the financial sectors.

In addition to this, soaring commodity prices in 2007 have stimulated concerns over inflation levels, whilst at the same time worries remain about a consumer slowdown in the indebted US and UK economies.

The impact of such fact and fiction has subsequently snowballed, as fears of a US recession (impacting financial and property markets) stoked fears of a global recession. This caused a sharp sell-off in global equity markets with the FTSE 100 closing down 324 points on Monday 21st January 2008.

What has been the response?

The US Federal Reserve unexpectedly cut interest rates by 0.75% to 3.5% yesterday, the biggest cut in more than 25 years, in a bid to fend off recession and support tumbling Stockmarkets. Previously President Bush had announced a US\$150bn fiscal package of tax cuts and other measures to stimulate the economy.

The benefit of these actions was initially felt in financial markets, where, on Tuesday 22nd January 2008, a day of dramatic swings, the FTSE 100:

- 1) **fell 239 points**
- 2) **recovered 425 points to be up 186 points**
- 3) **before slipping marginally to close up 162 points at 5740.**

Similarly, US shares (the Dow Jones Index):

- 1) **opened down over 400 points**
- 2) **but rallied to eventually close down 128 points at 11971.**

Such intraday swings in Stockmarkets are unusual, and are compounded by the powerful impact of *sentiment*. However, the medicine of a looser monetary policy takes time to rehabilitate an economy, and it is almost certain that this first dose will be followed by further doses of tonic as 2008 progresses.

Where does this leave Stockmarkets?

Trading updates for the festive season have signalled a slowdown in the UK retail sector (witness Marks & Spencer). However:

- a) General corporate profitability remains on an uptrend with UK GDP growing 3.3% over the past year, although growth is forecast to slow to 2.0% for 2008. UK unemployment remains at historically low levels.
- b) UK inflation remains under control with:

RPI (retail prices index)	4.0%
CPI (consumer prices index)	2.1%
- c) UK base rate has fallen from a peak of 5.75% to 5.5% with further reductions expected.
Gilt yields are low at 4.4% making equities more attractive by comparison.

d) Corporate activity is continuing with recent bids for:

Biffa
Friends Provident
Xstrata

in addition to ongoing takeovers for:

Kelda
Rio Tinto etc

- e) Emerging economies such as China and India continue to grow as they industrialise, which will boost the World Economy.
- f) Sovereign Wealth Funds with massive cash reserves (eg Qatar Investment Authority) continue to inject huge amounts of capital into Western Economies.

For these reasons we feel the current UK market valuation more than discounts concerns over slowing economic growth and therefore offers a medium term buying opportunity.

Conclusion

Whilst the ongoing economic uncertainties persist, global markets will continue to see periods of increased volatility which, although unnerving and headline grabbing, should not be allowed to cloud the importance of investing for the longer term.

Indeed, it remains Barratt & Cooke's policy to advise clients to invest for the longer term and maintain a well balanced spread of:

- 1) Cash (outside their portfolio for contingencies)
- 2) Gilts and Fixed Interest (for income, safety, and liquidity)
- 3) Equities (giving diversified exposure to global economies)

This policy allows investors to ride out the peaks and troughs of volatile stock market movements.

For this reason we recommend clients to look beyond these short term market swings, maintain focus on the underlying company fundamentals, and retain existing portfolios.

As always we will continue to monitor the position and contact you if we feel further action is required. However, if you would like to discuss your investments please do not hesitate to contact me.

Yours sincerely