

BARRATT & COOKE

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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>1/1/07</u>	<u>5/10/07</u>	<u>1/1/08</u>	<u>5/4/08</u>	<u>1/7/08</u>
FTSE 100	6930	6222	5217	3940	4477	4814	5618	6220	6596	6457	5947	5625
FTSE All Share	3242	2983	2524	1894	2207	2411	2847	3221	3387	3287	3039	2856
Dow Jones (US)	11452	10786	10022	8342	10454	10783	10717	12463	14066	13265	12609	11345
S&P 500 (US)	1469	1320	1148	880	1112	1212	1248	1418	1558	1468	1370	1277
Nikkei Dow (Japan)	18934	13785	10543	8579	10677	11489	16111	17225	17065	15308	13293	13514

Leading Growth Equities

AstraZeneca
BHP Billiton
BP
Johnson Matthey
Prudential
Standard Chartered
Tesco
Whitbread

Leading Income Equities

BT Group
Centrica
Lloyds TSB
National Grid
Rexam
Scottish & Southern Energy
Vodafone

Smaller Companies

De La Rue
Fenner
G4S
Halma
Homeserve
London Stock Exchange
VT Group

Overseas Companies

Deere & Co
PepsiCo
Roche
SAB Miller
Syngenta

Investment Trusts/ Overseas Funds

Caledonia Investments
Henderson TR Pacific IT
Monks IT
Murray Income Trust
Scottish Mortgage IT

Rafael Nadal

6-4, 6-4, 6-7, 6-7, 9-7

Contemplating the inevitable consequences of stagflation (inflation without growth in the economy), while knowing that the UK economy will find its equilibrium in due course, I write this chronicle with considerable anxiety, and yet, undeniable long term confidence.

I am absolutely convinced by the long term investment merit of Equities, which have reflected the long term growth of corporate Britain over the last 100 years, with steadily rising dividends reflecting profits and asset growth.

I am absolutely convinced that quality Equities, in quality sectors are undervalued on all historical formulae and one day today's values will look 'as cheap as chips' (provided potato prices do not go sky high).

And yet, we are in the midst of a serious 'old fashioned credit crisis', with all the effects of stagflation.

The easiest thing in the world to do is say "sell everything and buy back when the markets have fallen further", but life is not like that.

Sellers sitting on piles of cash seldom reinvest at the right moment and usually miss the recovery, buying back into the market when they have 'missed the boat'.

With the FTSE 100 back to 5400, a level seen in 1997 (11 years ago), investors should be saying "this is the opportunity to buy, not sell", but then it takes a brave man to go against the trend.

Therefore let us look at the situation and come down to common sense, for a sensible investment strategy that will see us through this serious storm, to the calmer waters in due course.

What Are The Problems?

Today's 'credit squeeze' has been brought on by the world banking crisis where 'chickens have come home to roost' on 'unsustainable credit'. This credit has gone through the world civilisation from:

- a) Student loans.
- b) To US and UK mortgages.
- c) To private Equity Funds for corporate takeovers (known in my younger day as asset strippers).
- d) To sophisticated financial products of SIV's (Structured Investment Vehicles), Hedge Funds etc.

The whole world seems to be on 'maximum credit', except those sensible investors who have a wide spread of investments and asset classes, who have not overexposed themselves.

Huge banking losses as credit has been called in have exposed overvalued properties. Warren Buffett described this phenomena perfectly in his great remark "You only find out who is swimming naked when the tide goes out".

Following these huge losses this has:

- a) Dried up bank lending within the credit markets.
- b) Reduced mortgage loans (no more 110% mortgages).
- c) Increased interest rates for credit.
- d) Reduced house prices.
- e) Reduced building of new homes and the values of 'land banks'.
- f) Thereby increasing unemployment.
- g) Thereby changing the 'feel good factor' to the 'feel bad factor' overnight.
- h) Reducing consumer spending in the:

Retail trade and house products (such as carpets and white electrical goods)
Motor trade (especially 4x4's and gas guzzlers which are now politically incorrect)
Media (with no buyers, why spend on advertising?)
Leisure (everybody is cutting back. Even Mrs Barratt has been told to pull in the horns)

- i) Thereby increasing unemployment further and giving a general feeling of depression.

However:

- 1) The Bank of England is making every effort to free up liquidity and support bank lending through this period, where bank deposits will eventually be guaranteed up to £50,000 from £35,000.
- 2) The UK Clearing Banks have already raised £20bn through 'rights' and 'placing' issues:

RBS £12bn Barclays £4.5bn HBOS £4bn

and have strengthened their depleted balance sheets.

- 3) There will be disasters, particularly in the speculative building trade and motor trade which are always the first to be hit, but at last one can find a 'builder' and a 'plumber'.
- 4) There will be redundancies, particularly in the 'over paid City of London', who have brought on much of the trouble themselves. But, "Those who live by the sword, die by the sword".
- 5) House prices will return to equilibrium where the 'age old formula' has been 'the value of an average house should be up to 5 times average salary'. House prices have got out of kilter, as credit has become more available - one day first time buyers will be able to afford a house again.

And so the economic world will gradually move back to equilibrium. Though it seems inevitable that one day banks will over lend against property again as they did in 1974, 1992 and again in 2008. ‘When will they ever learn, when will they ever learn?’

However, on top of these recessionary influences there are also inflationary influences, largely caused by the huge demand from China and India as their economies expand. This huge demand has pushed up the price of basic commodities to unprecedented levels:

- 1) Oil to US \$141 a barrel (where there is enough oil in the world, but not enough refining capacity).
- 2) Metals: Copper \$8550 a ton. Gold \$937 an ounce.
- 3) Food: Wheat approximately £150 a ton (together with agricultural land values).

On top of this there is the rise in mortgage rates, electricity and gas bills.

Nobody in the UK believes that inflation is really 3.3% (with a Labour Government target of 2%).

With inflation and recession (ie no growth) this is the worst of all worlds called stagflation.

I have no doubt that we are in a period of stagflation.

Why Are Equities Cheap?

Equities have been one of the best forms of investment over the last 100 years, outperforming ‘cash’ and ‘Gilts’ many times over.

Today’s share rating formulae are substantially below the sustainable averages of:

	<u>Sustainable Average</u>	<u>1/7/2008</u>
P/E	15	10.9
Net yield	3.0%	4.3%
Dividend cover	2.5 times	2.1 times

where dividends have steadily risen by a much higher rate than inflation, which is so important to investors dependent upon income from shares, especially the retired and charities, who do notice and appreciate this constantly rising income.

Some corporate profits will fall over the next 2 years, a few dividends could be reduced, but it is most unlikely that overall dividends will not increase. Past reserves and dividend cover will be used to supplement dividends before companies consider dividend cuts.

Within the above formulae, the FTSE 100 reflects a large bias towards the Oil & Gas and Mining sectors, which now equate to approximately 35% of the index.

Excluding these sectors, the FTSE 100 would be up to 10% lower, ie:

FTSE 100: 5000 points

Whilst there are established world leaders within these sectors such as BP, Royal Dutch Shell, BHP Billiton, Rio Tinto and Anglo American, there are also a number of Resource Companies that we had never heard of 5 years ago:

Eurasian Natural Resources (Kazakhstan), Ferrexpo (Ukraine), Kazakhmys (Kazakhstan), Vedanta (India)

This has frightening similarities to the Dot Com boom of 2000, where many of the new entrants to the FTSE 100 have never been heard of again.

Where Does This Leave Barratt & Cooke Clients?

Most Barratt & Cooke private clients have their own:

- 1) Bank/Building Society deposits for liquidity
- 2) Property (preferably free of mortgage)
- 3) Income (salary or pension)

before investing in stocks and shares with Barratt & Cooke. Barratt & Cooke then invest 'investment funds' into the Stockmarket and advise:

A proportion	Cash Deposit - for liquidity for investment opportunities.
A proportion	Gilts/Fixed Interest - for safety, liquidity and income.
A proportion	Leading Equity Smaller Companies Foreign/Trusts

Though all portfolios are 'tailor made' each portfolio is individual and we shall continue to:

- a) Build up cash a bit more where appropriate (particularly reducing well performing holdings which have become too large, or weeding out the few 'duds').
- b) Stick to short dated Fixed Interest Stocks or Index Linked Gilts.
- c) Take a defensive view on Equities, largely avoiding:
 - House builders
 - Retail (except Supermarkets)
 - Media
 - Leisure

We have probably added to the following sectors a bit too early:

Banks

(following their strengthening of balance sheets through Rights Issues, though we have avoided the pure mortgage banks)

REITs (Real Estate Investment Trusts)

(who are standing at approximately 40% below asset values, at today's share prices)

We like the safety of defensive stocks:

Supermarkets
Essential household products
Drinks
Utilities
Telecoms
Pharmaceuticals
Oils (though some are getting high)

We feel it is sensible to have some Mining in a portfolio, but are ready to take gains and reduce at an appropriate time.

One day it will be right to pick up the very depressed sectors of:

Builders (Barratt, Taylor Wimpey and Persimmon are totally bombed out)
Retailers (Marks & Spencer now yield approximately 10.0%)
Media (Newspaper companies fallen by up to 75%)
Leisure (pubs have fallen by $\frac{2}{3}$)

but not yet.

We remain convinced that Equities will recover and grow in due course, but this credit squeeze and economic downturn is serious and will take some time to return to equilibrium. Clients should remember:

- a) The price of a share is what somebody will pay for it (with no cash around the price will be low).
- b) The value of a share is what its earning/asset capacity will be one day (and just like the level of water, the true value will be reflected in the price one day).

Corporate Actions

Over recent months, clients have had a lot of essential information from Barratt & Cooke with:

Rights Issues and Placings from:

Royal Bank of Scotland
HBOS
Barclays
Bradford & Bingley
Melrose

Reconstructions from:

United Utilities
Cadbury Schweppes/Dr Pepper

Takeovers:

Scottish & Newcastle
FKI

This paperwork is essential and it does prove the worth of Nominees/Discretion.

BHP Billiton (by Will Mellor)

BHP Billiton announced a revised offer for Rio Tinto in November 2007, on the basis of 3.4 BHP Billiton shares for every Rio Tinto share. Since this announcement there has been considerable share price volatility, almost daily press comment and regular rumours with regards further corporate activity. For these reasons, I recently met with BHP Billiton's Chairman, Don Argus to discuss:

- BHP Billiton as a standalone entity
- The outlook for the Mining industry
- The merger and timeframes

Mr Argus was keen to point out that BHP has a tremendous pipeline of projects, ranging from early stage exploration, to those that will shortly move into production. Indeed, the company has an annual capital expenditure programme for new projects which will this year exceed US\$10bn.

He then produced some statistics to support his thesis that the demand for minerals will continue unabated, the most astonishing of which was:

‘China is currently building a new city the size of Melbourne every month’.

With regards to the merger, it is our opinion that towards the end of 2008 BHP Billiton will receive final regulatory approval from the EU, at which stage the options are:

- 1) Rio Tinto accept
- 2) BHP Billiton 'go hostile'
- 3) BHP Billiton walk away

Mr Argus made it quite clear that BHP Billiton will not be drawn into a bidding war whilst also offering sound, solid reasons to support the merger proposal. Whatever the outcome, BHP Billiton remains a strong company with an excellent record of delivering shareholder value and on that basis, at this stage, we continue to recommend BHP Billiton as a core stock within the sector. We shall contact clients as and when any action is necessary.

ISAs

In many cases we have been holding up:

- a) Subscriptions to ISAs.
- b) Transfer of cash ISAs to Barratt & Cooke ISAs.

This has been intentional while Stockmarkets have been so volatile. At these levels we shall soon start to review all new ISA subscriptions.

Compliance

As many of you will be aware, client identification and the protection of client data has recently featured frequently in the press. We have to adhere to strict guide lines imposed on us by our regulator the FSA (Financial Services Authority) and these rules are here to protect both Barratt & Cooke and our clients.

In the future we will have to record telephone conversations and may have to request further information from clients (eg dates of birth, mother's maiden name) for identification purposes. This is the case even if clients are known to us personally or socially. This may at times be a minor inconvenience for which we apologise, however it is for your protection.

Post

We are aware that the Royal Mail may have mislaid some post for Barratt & Cooke on approximately 30th June 2008. If we have not replied to correspondence from you around that date please let us know.

In Conclusion

We live in extraordinary times:

- 1) A blue Mayor of London, where Boris made a magnanimous victory speech to Red Ken.
- 2) A black leader of the Democratic Party, where Barack Obama could easily be the next President of the United States of America.
- 3) A purple winner at Royal Ascot, where the Queen led in her first Royal Ascot winner for 25 years.
- 4) A red winner of the European Cup, where Spain won their first silverware for 40 years.
- 5) Tiger Woods winning the US Open Golf with a stress fracture of the leg.
- 6) Lewis Hamilton restoring credibility in the pouring rain at Silverstone.
- 7) Rafael Nadal beating the 5 times champion Roger Federer in the greatest tennis match of all time, 6-4, 6-4, 6-7, 6-7, 9-7

Perhaps 'life' is not so bad and the 'credit crisis' will pass over one day, just as the clouds did at Wimbledon - but my goodness it took a long while and it was gloomy at times.

C W L Barratt
July 2008

ps **The Beijing Olympics 2008**

Many of my readers enjoyed extracts in my January 2007 Chronicle referring to my visit to China in 2006, which are totally pertinent as we enter the final stages before the Beijing Olympics.

Having recently read these extracts again I would urge others to, to get into the mood for the Olympics.

If any client would like a copy of the extracts you only have to ask.

Let's hope Tom Daley is our youngest gold medalist ever - we shall know by the October Newsletter.

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