

BARRATT & COOKE

MEMBERS OF THE LONDON STOCK EXCHANGE

5 OPIE STREET, NORWICH, NR1 3DW

Tel No: 01603 624236

Fax No: 01603 665757

E-mail: admin@barrattandcooke.co.uk

October 2008

	<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>1/1/08</u>	<u>5/4/08</u>	<u>1/7/08</u>	<u>5/10/08</u>
FTSE 100	6930	6222	5217	3940	4477	4814	5618	6220	6457	5947	5625	4980
FTSE All Share	3242	2983	2524	1894	2207	2411	2847	3221	3287	3039	2856	2522
Dow Jones (US)	11452	10786	10022	8342	10454	10783	10717	12463	13265	12609	11345	10325
S&P 500 (US)	1469	1320	1148	880	1112	1212	1248	1418	1468	1370	1277	1099
Nikkei Dow (Japan)	18934	13785	10543	8579	10677	11489	16111	17225	15308	13293	13514	10938

Leading Growth Equities

AstraZeneca
BHP Billiton
BG Group
Johnson Matthey
Prudential
Standard Chartered
Tesco
Whitbread

Leading Income Equities

BP
Centrica
GlaxoSmithKline
National Grid
Rexam
Scottish & Southern Energy
Vodafone

Smaller Companies

Cobham
De La Rue
Fenner
G4S
Halma
London Stock Exchange
Northumbrian Water
Petrofac
VT Group

Overseas Companies

PepsiCo
Roche
SAB Miller
Syngenta

Investment Trusts/ Overseas Funds

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

15th September 2008

“It doesn’t really matter as long as they are making money, does it?”

Let nobody be under any misapprehension, the 15th September 2008, the day that Lehman Brothers was allowed to go into voluntary bankruptcy, was the most monumental and profound day of my 40 year Stockbroking career. My father started Stockbroking in 1928 and the 15th September 2008 had all the hallmarks of Dad’s early days Stockbroking in the 1929 Wall Street Crash, followed by The Great Depression to 1934.

There are similarities, but there are differences. My readers will know that I have always been a ‘cautious optimist’, but on the day that banks could no longer be trusted with our money, like a lady’s prerogative overnight I have turned even more ‘cautious’ in the short term, but even more ‘optimistic’ in the long term.

It is important to chronicle the exact events leading up to the 15th September 2008, and those immediately following, so that these are recorded in the annals of history for posterity.

From the eerie silence of dealing rooms, the world watched in total disbelief as the world money markets dried up and leading world Investment Banks collapsed like a pack of cards. We shall all remember the scenes of the pilgarcic Hank Paulson (the US Treasury Secretary) pleading to congress on one knee; the scary President Bush warnings of weapons of mass destruction in Wall Street; Magpie Darling wittering on; and the utter amazement on the faces of the world as one financial institution after the other collapsed into its own ‘Bonfire of the Vanities’.

It is now obvious that these seismic events were brought on by ‘the greed of Wall Street and other City Financiers’, once called the ‘Masters of the Universe’.

They were carried away by their own wealth, using the 'smoke and mirrors' of all kinds of financial instruments from Derivatives to Hedge Funds from SIV (Special Investment Vehicles) to CDO (Collateralised Debt Obligations).

With this great wealth, geared many times over, these 'Masters of the Universe' lent to the US property market, which 'could not fall in value' - until it did. And when it did, it did so nationally, and these contracts for billions were not worth the paper they were written on.

It then transpired that nearly every bank in the world had invested in the 'holy grail' of Collateralised Debt Obligations, which 'just could not go wrong', until Pandora's Box was opened and found to be worthless.

At this point I feel it right to diarise the events, so that they are recorded in the annals of history, never to be forgotten and no doubt broadcast in the next major epic series on BBC1 (after The Tudors on Friday nights).

2004-2005 Unscrupulous lenders in the US offered mortgages to people who could barely afford them, assuming that if householders defaulted on loans, then properties could be repossessed and sold at a profit. 'House prices never go down.'

2005-2007 To raise more money to sell as mortgages, the lenders would parcel up thousands of loans and sell 'single parcels of mortgages' to a bank who receive the mortgage repayments.

These parcels of mortgages were known as Collateralised Debt Obligations and could be sold on to other banks. The estimated value of these sub prime loans in circulation is £1,000,000,000,000 (£1 trillion). These were safe, as 'house prices never fall'.

In order to protect themselves, banks bought CDS (Credit Default Swaps), a form of insurance.

Early 2007 The US housing bubble burst.

Properties became 'negative equity'. As repossessions started, property values tumbled and sub-prime mortgages became a liability. Banks had bought those 'packages' without knowing what was really in them, but 'they knew they were good because everybody said so.'

Mid 2007 Hedge Funds and Banks who had gambled heavily in the 'holy grail' of CDO's and in turn CDS' suddenly realised they would lose billions and these became 'toxic debt'.

September 2007 As Banks around the world realised that CDO's and CDS' had become 'toxic debt', too dangerous to touch, Banks stopped lending to each other for fear of each other's risk exposure.

As 'lending dried up' the first casualties were Banks/Building Societies who relied on 'World Money Markets' to fund their lending business models, eg Northern Rock who depended on World Money Markets rather than depositors.

Northern Rock has the first run on a UK Bank for 140 years and is rescued by being nationalised by the UK Government.

March 2008 Bear Stearns, the 5th largest Investment Bank becomes the first major casualty (rescued by JP Morgan supported by the US Government).

July 2008

Fannie Mae: the Federal National Mortgage Association.
Freddie Mac: the Federal Home Loan Mortgage Corporation.

2 vast US mortgage corporations receive \$200,000,000,000 support from the US Fed. Both of these companies had been set up by the Fed in 1938 and 1970, to provide cheap foreign debt, to provide cheap mortgages for US citizens.

These two firms guarantee \$5,300,000,000,000 worth of US home loans, representing 46% of the US national debt.

‘And then all hell let loose.’

September 2008

Monday 15th

Lehman Brothers go into voluntary bankruptcy.

Tuesday 16th

HBOS shares crash, spurred on by ‘short selling’ and there is ‘a run on the bank’.

Wednesday 17th

Merrill Lynch - rescued by Bank of America.

AIG - once the world’s largest insurance company, rescued by a \$85,000,000,000 package from the US Government.

Thursday 18th

HBOS forced into a proposed takeover by Lloyds TSB.

Barclays cherry pick Lehman’s US assets.

Friday 19th

Hank Paulson, the US Treasury Secretary, proposes a \$700,000,000,000 (\$700bn) rescue plan to buy ‘toxic debt’ from the US banks.

The UK Government, in conjunction with the FSA, prevents the practice of ‘short selling’ of 32 financial companies for 3 months.

These 2 factors caused the FTSE 100 to jump 450 points in the day and rise to 5351 (only 1.5% down on this traumatic week).

Monday 22nd

Fears that ‘The House of Representatives’ will not accept the Hank Paulson \$700bn package bring the markets back down.

Tuesday 23rd

The last 2 major US investment banks left:

Goldman Sachs
Morgan Stanley

agree to become ‘Commercial Banks’ taking deposits and regulated by ‘the US Fed’ rather than ‘Investment Banks’ regulated by ‘the Securities & Exchange Commission’.

Wednesday 24th

The Japanese purchase 20% of Morgan Stanley.

Nomura cherry pick Lehman’s European assets.

- Thursday 25th Washington Mutual (WaMu) becomes the biggest bankruptcy in the world, as JP Morgan cherry picks the best bits.
- The US begins to ridicule President Bush and Hank Paulson's US \$700 billion package.
- Monday 29th Bradford & Bingley is nationalised by the UK Government (the shareholders are unlikely to receive anything) and Santander cherry pick the branches.
- Fortis, the Netherland's largest bank, has to be rescued by the Benelux Governments. Glitnir, the Icelandic Bank is nationalised.
- Late in the evening the House of Representatives reject the US \$700 billion packages on the grounds 'why save the fat cats in Wall Street, what about the poor US sub prime residents losing their homes?' I think we all have some sympathy, though it seems an extraordinary decision.
- The FTSE 100 falls to 4818, a 4 year low.
- Wall Street falls 777 points to 10365.
- Tuesday 30th Citigroup steps in to rescue Wachovia, the 6th largest US bank.
- The US Treasury starts working on a US \$700 billion compromise plan.
- Fears start that Lloyds TSB could be over paying for HBOS, and HBOS shares slip.
- Wednesday 1st October The Senate agree to the US \$700bn package by 74 - 25 votes.
- Ireland guarantees all bank deposits for 2 years, to save Irish banks haemorrhaging money following the property crash.
- Thursday 2nd UK house prices down 12.7% on the year, as new mortgages fall by 98%.
- Greece also guarantees 100% deposits.
- Friday 3rd The US \$700bn plan is passed in the House of Representatives and Wall Street falls by 157 points!
- Saturday 4th Icelandic Banks are in serious trouble and Iceland looks like defaulting on its debt.
- Hypo Real Estate, Germany's second largest mortgage bank, goes into receivership.
- Mandy is back! Peter Mandleson is reappointed to the Labour cabinet as Secretary of State for Business (showing how bad things really are).
- Sunday 5th Europe lines up for 'summit meetings' to discuss the credit crunch and reduce interest rates.

And so the saga goes on.

The enormity of the figures is too big to comprehend, but trying to put them into perspective:

	<u>Toxic Debt</u>	<u>Population of the US 305m Per Capita</u>
CDO market	US \$1,800,000,000,000	US\$ 5900
	<u>Bail Out</u>	
Fannie Mae/Freddie Mac	US \$200,000,000,000	US \$655
AIG	US \$85,000,000,000	US \$280
US Government plan	US \$700,000,000,000	US \$2295
New level of national debt	US \$11,300,000,000,000	US \$37,040

2 months ago who would have believed that the only major Investment Banks left on Wall Street would be:

Morgan Stanley (supported by Japanese)
Goldman Sachs (supported by Warren Buffet)

Who would have believed:

HBOS has had to be rescued by Lloyds TSB?
Bradford & Bingley nationalised?

Who would have believed the UK citizens dare not put more than £50,000 into individual banks and some term deposit accounts frozen?

The financial world has never seen anything like this. In 1929 every individual in New York was gambling 'on margin' and was quickly wiped out, but this time around it is toxic debt and nobody yet knows the implications. The US Government is trying to 'draw a line in the sand' with the US \$700 billion package and we must all pray that it works.

What Are The Consequences?

For many months, even years, the trust in the Banking sector will be tarnished.

- 1) Depositors will only have **£50,000** guaranteed per customer, per bank (recently increased from £35,000).

(Beware, if Barratt & Cooke has £50,000 deposited for you in HBOS and you have HBOS deposits elsewhere, or in one of their subsidiaries ie Halifax, Bank of Scotland, Birmingham Midshires, Intelligent Finance, AA or Saga, only £50,000 is guaranteed in total).
- 2) Depositors will spread deposits more and purchase 'Gilts' (Government Stocks) which are guaranteed by the Government in full.
- 3) Banks will be very reluctant to lend to other banks, drying up the banking system. This will affect the flow of cash to the mortgage market, affecting:
 - The Housing market
 - The Building market
 - The Property market
 - The Furnishing and Carpeting market
 - The Financial Services Industry

This feel bad factor will affect the:

The leisure and hotel industry
The motor industry
The retail industry

and so on through the UK and world economy, though the defensive sectors will continue to grow, such as Supermarkets, Utilities, Pharmaceuticals, some household goods.

'Cautious'

We have become extremely 'cautious', building up most Discretionary client's portfolios to:

Cash deposits	5% - 7% (up to £50,000)
Gilts	15% - 20%

and have slightly reduced Equities, including some banking shares, but have maintained a wide spread of top quality equities.

Shareholders must be prepared for:

- 1) Liquidity to dry up on loans from banks.
- 2) Some dividends to be reduced, especially from the banks.
- 3) There will be a slowdown in profits and dividends growth in the immediate future.

Optimistic in the Long Term

But never forget, 'the darkest hour is just before the dawn'.

We are not there yet, but it will come, and it will come from a historically very low level, such as the recent low on 30th September of:

FTSE 100 4671	(a 4 year low)
PE 9.6	(historically very low)
Dividend yield 4.9%	(the first time to have a reverse yield gap with Gilts since 2003)

The defensive sectors of the economy will continue to perform as we still have to live - holding up the Supermarket sector, Utility sector, Pharmaceutical sector and in some cases, the Drink sector and Tobacco sector (ugh).

This serious shakeout will weed out the weak, but the strong will survive, and will get stronger and grow.

Surprisingly, I am hugely optimistic for the future of Barratt & Cooke.

Though the past few weeks have been a 'nightmare', it is very rewarding for all the advisory team, when clients say "we do understand world markets are down, but thank God you are looking after us".

I really do believe we do a good, honest, sensible job, with an efficient personal service, which clients do appreciate.

The younger team are maturing with 'the experienced old'. Like Dad in 1928/1929, me in 1970/1974, the present young coming through are having the experience of a lifetime. I have no doubt that those experiences in 1928/1929 and in 1970/1974 had a profound effect and influence on my father and then me.

The experiences of 2008 will be engraved on to the 'present team's' hearts, like Calais being engraved on the heart of Mary Queen of Scots - they will never forget the importance of:

Cash
Gilt
and a spread of quality Equity

Conclusion

My readers will know that over several years I have been like 'John the Baptist - crying out as a lone voice from the wilderness' about the dangers of the new financial world of 'sophisticated investment vehicles' such as:

Derivatives	
Hedge Funds	
SIV's	Special investment vehicles
CDO's	Collateralised debt obligations
CDS'	Credit default swaps
CFD's	Contracts for difference

but the more I studied them, the less I understood them (perhaps I understand them too well).

It is these 'Sophisticated Investment Vehicles' that have destroyed Wall Street.

I have been called naive by a leading solicitor.

Some clients might say "well if you were so worried about them why didn't you liquidate clients portfolios earlier". The simple fact is that I had no idea of the enormity of the problem.

I have been told by an employee of a leading Investment Bank "there will not be a crash, you just cannot comprehend how much we have to invest".

And most dangerous of all, when I sat next to a respected, aged, doyen of the private capital industry in the City at a lunch on the same day as Northern Rock was being nationalised, I timidly asked "Do you think Barclays and the other major banks know their liabilities with all these 'sophisticated investment products'?"

The reply came back, gruffly:

"I shouldn't think so, but does it matter as long as they are making money?!!"

End of conversation.

"Does it matter, as long as they are making money?!!"

This says it all - and please God may this attitude in the investment world now stop.

Further Points

Discretion

With these very volatile markets, we have been able to make decisions for clients instantly and act on these instantly, eg:

- a) Reducing bank deposits to the guaranteed level (now £50,000, previously £35,000)
- b) Dealing in HBOS and Royal Bank of Scotland when very volatile.

In hindsight some decisions are right, some decisions are wrong, but the important thing is being able to make that decision in an emergency, and being able to act on the decisions.

All advisory clients should now question why they prefer Advisory to Discretion, where the advice is similar, but there has to be a time delay.

Capital Gains Tax - VERY IMPORTANT

The rules on capital gains tax for private clients have been changed:

- 1) Only 31st March 1982 prices may be used for stocks held before that date.
- 2) No indexation between 1982-1998.
- 3) No taper relief 1998-2008.
- 4) All stocks are now pooled (no longer 'last in first out' - LIFO).
- 5) All capital gains tax charged at 18%.
- 6) Capital gains tax allowances is £9,600 (£4,800 for most Trusts).

This will simplify capital gains tax in the longer term, but the new base costs are extremely complicated to work out removing indexation etc.

We shall include an extra valuation with 5th October 2008 valuations for you to send to your accountants to check the cost values and then return to Barratt & Cooke.

Barratt & Cooke will only change 'base costs on valuations' when we are told to by the client, or the client's accountant.

Barratt & Cooke will always consider capital gains tax when giving advice, but cannot guarantee figures to be correct. In some instances with capital gains tax only 18%, it will be better to pay 18% capital gains tax and have a well balanced portfolio.

Royal Dutch Shell

Royal Dutch Shell have announced an extremely complicated 'compensation scheme' for shareholders who dealt in:

Shell Transport & Trading Company

between 8th April 1999 - 15th June 2004.

This 'compensation scheme' is due to the incorrectly reported oil reserves between these dates.

Royal Dutch Shell has used the old register of shareholders. The compensation is likely to be very small. The details on the forms are extremely complicated.

For your information we shall be writing to all clients who dealt in Shell Transport & Trading between 8th April 1999 - 15th June 2004:

- 1) To confirm deals 8th April 1999 - 15th June 2004.
- 2) Details of how to fill up the forms.

This is extremely complicated, extremely old and 'tiny'. We shall give the relevant details, but on this one occasion cannot do more.

Company Visits

William Barratt and William Mellor regularly attend company and fund meetings, in order to generate new investment ideas and monitor the progress of stocks previously recommended. Below is a brief summary of their most recent company meetings.

Please note, these are not investment recommendations and may not be suitable for your investment objectives and risk profile.

BG Group

BG Group is one of the world's largest oil and gas exploration and production companies, with operations in over 25 countries across all five continents. The group has an impressive portfolio of assets in some of the world's most prolific oil regions, evidenced by the recent successive oil finds in the Santos basin offshore Brazil. With production volumes forecast to grow by approximately 6-8% per year to 2020, BG is uniquely positioned to benefit from sustained high energy prices.

Fenner Group

Fenner Group is the world's largest manufacturer of conveyor belts for mining and industrial application, with a particular emphasis upon use in the coal industry. More recently, the group has expanded into higher margin markets, where their 'Advance Engineered Products' division manufactures products ranging from seals for industrial machinery to precision polymers used as dressings and tubing in cardiovascular surgery. Fenner is well managed, has been prudent in its diversification and is well positioned to benefit from the increasing demand for coal as an alternative source of energy to oil.

CVS Group (AIM Listed)

Due to the risks involved with investing in AIM companies, Barratt & Cooke advise that clients diversify their risk by investing in a 'basket' of AIM stocks.

CVS Group is one of the leading providers of veterinary services in the UK, operating a practice division, which comprises over 45 small animal practices and one equine practice and a diagnostics division. The UK veterinary market is currently experiencing rapid consolidation, driven by demographic changes in the profession as the industry moves from a fragmented partnership structure towards a more corporate-owned structure. Although the company is generating reasonable organic growth, we feel it is their acquisition policy within this fragmented market which will provide the stimulus for accelerated growth.

M&G Corporate Bond Fund (Nominee clients only)

Managed by the excellent Richard Woolnough, the M&G Corporate Bond Fund invests in Gilts, investment grade and non investment grade (higher yielding) Corporate Bonds. The remit is not only of providing income (currently approximately 5%), but also growth, as the manager takes advantage of bonds which represent a discount to their true value.

The fund is currently focussed towards investment grade bonds, but has a 10% exposure to the 'exciting' non investment grade end of the market, mainly focusing on recovery stories. The Fund offers individuals the opportunity to invest in another asset class, while benefiting from the diversity of a fund rather than direct investments and utilising the experience, expertise and time of the manager and his team at M&G.

We have chosen this particular fund because the manager's benchmark (to outperform UK Government Gilts on a total return basis) is achievable rather than 'shoot the lights out' - therefore his investment strategy sits well with our investment ethos of looking for good, sound opportunities rather than chasing returns at greater risk.

Dividends

In view of the huge losses that Banks have made in the credit crisis, several banks have decided to pay dividends in shares, or to reduce dividends, ie:

Royal Bank of Scotland/HBOS shares
Lloyds TSB reduce in due course

A few other companies have:

Reduced dividends
or even cut dividends completely

However, on the whole, dividends continue to be increased, and we feel comfortable to say that most portfolios will still receive a small increase in income this year, though there could be a decrease for those portfolios heavily weighted to the banking sector.

Corporate Actions

Since the last Newsletter in July there have been some Corporate Actions. These include:

Return of Capital to Shareholders	United Utilities De La Rue
Nationalisation	Bradford & Bingley
Takeover	Alliance & Leicester (by Banco Santander) Thus (by Cable & Wireless)
Proposed Takeover	HBOS (by Lloyds TSB)

We have kept clients fully informed of these corporate actions and will continue to do so in the future.

Compliance

MiFID

Some clients may have very recently received a reminder letter and 'prior consent form' to be signed and returned to us.

If you are in receipt of this letter please sign and return it as soon as possible.

Boiler Rooms

Over the last year many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. These operations are commonly known as 'boiler rooms'. These 'brokers' can be very persistent and extremely persuasive.

Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount, or offers of free company reports.

How to recognise a boiler room

- They may have written to you by email or post offering a free research report into a company in which you hold shares, or a free gift or a discount on their dealing charges.
- You will then receive a phone call from a well trained, highly professional sounding salesman. They often use a script to help them answer your questions or ward off your objections.
- You may be told that you have already entered into a contract to buy the shares and are under an obligation to pay. This is not the case as such contracts are unenforceable under the UK law.

More detailed information on this or similar activity can be found on the FSA website www.moneymadeclear.fsa.gov.uk. Alternatively report the matter to the FSA direct on 0845 606 1234.

Email Orders

A very small number of clients send dealing instructions electronically via email.

When sending emails (particularly including dealing instructions) please be aware that your advisor may not read this immediately (occasionally emails are restricted by the 'network' and are never actually received by the intended recipient), **we therefore strongly recommend you do not use e-mail as a form of communication for time sensitive instructions.**

If you do use this facility your order **will not be executed by Barratt and Cooke until we have sent acknowledgment of the receipt of the e-mail.** We therefore recommend you telephone for all instructions of a time sensitive nature, and if you do use e-mail and haven't had a response, telephone your advisor to ensure he has received the instruction.

In Conclusion

Though this chronicle has been dedicated to the 2008 'banking crisis', there is still a tremendous amount of good in the world, highlighted by Team GB's great Olympic Games with the outstanding performances from swimmer Rebecca Addington, cyclist Chris Hoy, runner Christine Ohuruogu and Norwich's own Emma Pooley to mention just a few. The Paralympics made one proud to be British and humble to be alive.

It is best to forget 'The Ryder Cup' and Nick Faldo (at last) until Celtic Manor in 2010 - come on GB and Europe'!!

The Archbishops described 'short sellers' as 'asset strippers and bank robbers'. When they visit Barratt & Cooke's offices I hope they will describe our advisors as 'the Good Shepherds'.

C W L Barratt
5th October 2008

Final thought from Churchill:

"The Americans will always do the right thing in the end, but not until they have exhausted every other option".

PLEASE NOTE: This newsletter is provided solely to enable clients to make their own investment decisions. The information within this Newsletter does not constitute advice or a personal recommendation, or take into account the particular investment objectives, financial situations, or needs of individual clients. It may therefore not be suitable for all recipients. If you have any doubts as to the suitability of this service, you should seek advice from your investment adviser. The past is not necessarily a guide to future performance. The value of shares and the income from them can fall as well as rise and investors may get back less than they originally invested. Certain Investment Trusts will permit using gearing as an investment strategy. Gearing is a strategy which involves borrowing money to increase holdings of investments or investing in warrants or derivatives. Such a strategy is likely to result in movements in the price of the relevant security being amplified significantly and may be subject to sudden and large falls in value and investors may get back nothing at all. Any tax reliefs referred to are those currently applying. All estimates and prospective figures quoted in this newsletter are forecasts and are not guaranteed. Barratt and Cooke is the trading name of Barratt & Cooke Limited. Registered in England No. 5378036. Barratt & Cooke Limited is authorised and regulated by the Financial Services Authority, who are based at 25 The North Colonnade, Canary Wharf, E14 5HS.