BARRATT & COOKE

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Stockmarket Update
16th August 2007

	Date	High	16/8/2007	% Fall
FTSE 100	15/06/2007	6732	5859	13.0%
FTSE 250	21/05/2007	12220	10462	14.4%
FTSE All Share	13/07/2007	3479	3029	12.9%
Dow Jones US	19/07/2007	13994	12846	8.2%
Nikkei Dow (Japan)	09/07/2007	18262	15274	16.4%

July and August has often been called ‘the silly season’, while Fund Managers and Bankers desert their desks to play ‘sand castles’ with their often forgotten families (though poor Gordon Brown could only manage 4 hours holiday this year).

Fortunately Barratt & Cooke forecast a ‘blip from the highs in June’ and advised most Discretionary clients and Advisory clients (where appropriate) to:

> ‘Hold at least 5% cash, together with Gilts’

should a blip take place in July/August.

Our clients are still holding this cash and Gilts.

What Has Happened to Stockmarkets?

Quite simply:

1) Bankers and Hedge Fund Managers have not been living in the ‘real world’.

   With ‘financial instruments’ such as derivatives, financiers have been able to ‘gear up’ and vastly over lend.

   This over lending has been used:

   a) To lend ‘willy nilly’ on property with no regard to collateral.

   b) By Hedge Funds and Venture Capitalists to borrow ‘willy nilly’ for speculative ‘mergers and acquisitions’.

2) Inflation throughout the world has been driven up by this 'apparent surplus of cash'.

3) Governments and the Bank of England, on behalf of the UK, have had to raise interest rates (UK to 5¾%) to reduce borrowing, to reduce the 'apparent surplus of cash', thereby endeavouring to reduce inflation back to acceptable levels.

4) With interest rates rising:

   a) There has been a disaster in the 'US sub prime lending market'
   (ie Where US mortgages have been defaulted on due to higher interest payments and insufficient collateral).

   b) This has caused an old fashioned 'liquidity squeeze' on bank lending.

   c) Which means that Hedge Funds and Venture Capitalists can no longer borrow cheaply, or in some cases borrow at all - meaning that they must attempt to close their 'open speculative positions'.

5) This has caused 'panic fire selling', which has become contagious amongst heavily borrowed Hedge Funds and Venture Capitalists, which in turn puts pressure on banks.

<u>Where Does This Leave Stockmarkets?</u>

It is a fact that industry in the UK is doing extremely well with:

a) Rising profits.
b) Rising dividends.

With average share prices in the FTSE 100 looking low on fundamentals:

a)	PE	=	11.4x
b)	Net yields	=	3.2%
c)	Dividend cover	=	2.8x

But, profits are bound to be affected by:

a) Higher interest rates.
b) The lack of confidence caused by turmoil in the financial markets.

In my July Newsletter I talked about Tesco, Carpetright etc experiencing a slow down.

World companies are now warning of slow downs:

Wal Mart, UBS etc etc

These continuing profits warnings are bound to have an affect on share valuations.

<u>Advice</u>

We understand that the fall in Stockmarkets is justified by a very real, and very severe, liquidity squeeze. This squeeze has its root cause from 'financiers' previously getting away with too much lending.

Confidence has been lost in world financial markets and while confidence has been lost Stockmarkets will remain very volatile.

However:

1) Inflation has started to fall as shown in the August announcement:

CPI has fallen from a high of 2.9% to 1.9%
RPI has fallen from a high of 4.8% to 3.8%

(We do not quite believe these figures, and expect food prices to go up again following a disastrous UK wheat harvest, fears of foot and mouth, and floods).

2) We do not feel that interest rates will rise above 6% and could even have peaked at 5¾%.

3) UK industry is running on an even keel.

Investment Policy

1) Most Advisory/Discretionary clients have liquidity from:

a) Approximately 5% Cash Deposits.
b) Approximately 15% Fixed Interest (Gilts)

(Of course all client portfolios are different, but this has been the general Barratt & Cooke policy.)

2) Barratt & Cooke will be lining up to invest the:

5% cash

at the appropriate time, starting with:

3% into property shares (REITs)

which have fallen too sharply and the tax benefits look very attractive.

3) As we feel:

a) Interest rates are peaking

and:

b) Inflation is coming under control

we shall be looking at, and advising on:

a) Switching into slightly longer dated Fixed Interest Stocks.

b) For ‘gross funds’ looking at switching out of Index Linked into Conventional Stocks.

4) For new money to be invested, our policy continues of:

   a) Cash balance:
   b) Gilts (Fixed Interest).
   c) A wide spread of top quality Equities.

   We shall be working out investment programmes with 'limits', so that we can 'press the buy button' when we feel appropriate.

   This is very important as it gives the discipline to 'buy low', but not miss a 'recovery in markets'.

Conclusion

This 'liquidity squeeze' is very real and self afflicted.

It will hurt speculators and financiers, and will have reverberations in world financial markets for some time, but we feel:

a) Interest rates have now peaked.

b) Inflation is coming under control.

b) The recent 13% fall in Stockmarkets gives a very good buying opportunity for top quality Equities.

Pause For Thought

As my readers will know, I have studied Hedge Funds and Derivatives at length. The more I have studied them, the less I have understood them. I have therefore avoided advising these products to clients.

It does worry me that some in the Hedge Fund/Derivative industry do not understand these products as well as they should. I pray that they do not just turn into a 'pack of cards'. Underlying companies and Fixed Interest Stocks look good value, but it will take time for confidence to recover.

C W L Barratt
16th August 2007

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