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ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

The long string of mainly positive investment returns came to an abrupt halt this quarter as equity markets reacted to the fallout in financial markets from the problems in the US sub-prime mortgage market and, latterly, the losses at Société Générale caused by unauthorised trades. For sterling investors, some relief was at hand as the currency weakened significantly. In this environment, bond yields moved lower.

The tables below detail relevant movements in markets:

International Equities 31.10.07 - 31.01.08

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-15.5	-14.9	-18.6	-20.4
Finland	-14.3	-8.4	-12.3	-14.3
France	-16.7	-10.9	-14.7	-16.7
Germany	-15.3	-9.4	-13.3	-15.3
Hong Kong, China	-18.8	-15.6	-19.3	-21.1
Italy	-14.6	-8.7	-12.6	-14.6
Japan	-16.5	-5.4	-9.5	-11.6
Netherlands	-18.5	-12.8	-16.6	-18.5
Spain	-15.6	-9.8	-13.6	-15.6
Switzerland	-15.3	-5.4	-9.5	-11.5
UK	-12.2	-12.2	-15.9	-17.9
USA	-10.4	-6.3	-10.4	-12.4
Europe ex UK	-16.3	-10.2	-14.1	-16.0
Asia Pacific ex Japan	-18.0	-16.2	-19.8	-21.6
Asia Pacific	-17.2	-11.0	-14.8	-16.8
Latin America	-8.7	-5.3	-9.4	-11.4
All World All Emerging	-15.8	-13.4	-17.1	-19.0
The World	-13.0	-8.8	-12.7	-14.7

Source FTSE World Indices

FT Government Securities Index All Stocks (total return) : +3.9%

International Bonds – Benchmark Ten Year Government Bond Yields (%)

Currency	**31.10.07**	**31.01.08**
Sterling	5.00	4.53
US Dollar	4.46	3.64
Yen	1.61	1.45
Germany (Euro)	4.29	3.93

Sterling's performance during the quarter ending 31.01.08 (%)

Currency	Quarter Ending 31.01.08
US Dollar	-4.3
Canadian Dollar	+1.6
Yen	-11.7
Euro	-6.5
Swiss Franc	-10.5

Other currency movements during the quarter ending 31.01.08 (%)

Other Currency	Quarter Ending 31.01.08
US Dollar/Canadian Dollar	+6.1
US Dollar/Yen	-7.8
US Dollar/Euro	-2.3
Swiss Franc/Euro	+4.4
Euro/Yen	-5.6

Significant Commodities (US dollar terms) 31.10.07 – 31.01.08 (%)

Significant Commodities	30.10.07 – 31.01.08
Oil	+1.7
Gold	+16.8

Markets

The last quarter witnessed an abrupt reversal in the long uptrend in equity prices. In local currency terms, the FTSE World Index showed a negative return of 13.0%, in sterling terms 8.8% (sterling was very weak during the quarter), in US dollar terms 12.7% and in euro terms 14.7%. In local currency terms, the USA held up better than areas with the relevant FTSE World Index returning -10.4%. The UK returned -12.2%, Europe ex UK -16.3% and Japan -16.5%. Asia ex Japan, which had performed very well for a long time, underperformed this quarter at -18.0%. However, although it showed a negative return for the quarter, Latin America held up better than any area, returning -8.7%. Sterling based investors with substantial overseas assets received a useful measure of protection from sterling's weakness during the quarter. This reduced the negative return of the FTSE World Index to -8.8% as sterling weakened against all the major currencies except the Canadian dollar.

The turmoil in the financial markets pushed down bond yields significantly as there was a perceived flight to safety. Taking ten year government bonds as a yardstick, the gross redemption yield on sterling bonds fell by 47 basis points to 4.53%, on US dollar bonds by no less than 82 basis points to 3.64% as the Federal Reserve aggressively cut interest rates, on yen bonds by 16 basis points to 1.45% and on euro denominated German government bonds by 36 basis points to 3.93%.

In the currency markets, sterling was in the line of fire during the quarter. It was particularly weak against the yen (-11.7%) and the Swiss Franc (-10.5%) but also against the euro (-6.5%) and the US dollar (-4.3%). Only against the Canadian dollar did it rise (+1.6%) after a long period of extreme weakness against that currency which had been buoyed by its natural resources advantages.

In commodity markets, oil was slightly higher but gold was significantly higher, +16.8%, on inflation fears.

Economics

- *Dramatic news from France* ...... Société Générale is the victim of unauthorised trading costing the bank € 4.9 billion.
- *Instability in the market on 21 January may have been caused by Société Générale unwinding its positions* ...... the bank felt it had no option but to close out its positions to limit the loss.
- *Banks continue to report heavy write offs* ...... sovereign wealth funds step in to the breach in a number of well known cases to provide additional capital and also to accelerate their policy of raising their long term equity content.
- *Sovereign wealth funds have the capability of driving long term equity prices higher* ...... this is an obvious class of asset for them to hold if they wish to raise the rate of return on their reserves.
- *The need for cash has, at least, temporarily stifled the protectionist lobby* ...... before the latest problems, protectionist sentiment was on the increase against these funds.
- *Problems in the financial markets caused the Federal Reserve to act decisively* ...... in January, within the space of eight days, it cuts the target federal funds rate by 1.25% to 3%. Further easing may come.
- *Problems in the money market ease* ...... before Christmas inter bank rates were significantly above base rates, or equivalent, but central banks' action has caused rates to move to their expected level relative to base rates.
- *Difficulties in the credit markets will have a contractionary influence on the world economy* ...... it will be more difficult for companies and individuals to borrow money and, where they can, the criteria may be tougher and the margins larger for the bank. Reduced interest rates from the central banks will help.
- *The ECB and the Bank of England are more tardy* ...... the ECB has not cut interest rates and still hints at raising them whilst the Bank of England has reduced them by only 0.25%, although further cuts are expected.
- *There is only room for limited fiscal stimuli* ...... the USA plans a significant stimulus because its public finances just about allow it. This is the not case in the UK because of the poor state of public finances. The IMF gives limited support to fiscal reflation in certain countries.
- *Various international organisations cut their forecast for economic growth this year* ...... for example, the IMF has just cut its growth forecast for the world economy to 4.1% in 2008 compared with 4.9% last year and its previous forecast last October for this year of 4.4%.

USA

- *A disappointing final quarter for the US economy* ...... the first estimate of fourth quarter annualised growth is 0.6%. A rundown in inventories contributes to this disappointing result.
- *The Federal Reserve, in cutting interest rates aggressively, changes its stance* ...... whereas, until recently, it was concerned about inflation and placed emphasis on this danger, now it takes second place to using monetary policy to avert recession.
- *The IMF now forecasts economic growth for the USA of 1.5% in 2008* ...... this contrasts with 2.2% in 2007.
- *The housing market, the root of the present problem, is still very depressed* ...... nearly all indicators show weakness whether in respect of prices or volumes.
- *Inflation is higher than the Federal Reserve would like* ...... its favoured measure is 0.2% above its maximum target level but, because of the Federal Reserve's wider remit, it can take a much broader view of the economy than, say, the ECB or Bank of England.

Japan

- *New short term economic data point to weakness ......* industrial production, housing starts and retail sales are just some examples.
- *The strengthening of the yen and weakness in the economy, plus events in financial markets, are likely to stay the Bank of Japan's hand on raising interest rates ......* in fact, there is some pressure to reduce them but the Bank of England, as a longer term policy, is keen to get back to a more normal monetary policy.
- *Energy price increases are impacting on headline inflation ......* the year on year rate is now 0.8% but, excluding volatile food and energy prices, its stands at -0.1%. It is difficult to see the Bank of Japan moving in the short term.
- *The Governor of the Bank of Japan concedes that growth will be lower than its earlier forecast ......* he now says that, for the fiscal year ending in March, it would be in the "low 1% range" against an earlier forecast of 1.8%.

Europe Ex UK

- *The eurozone seems to be doing relatively well although slowing down ......* there was an upward revision to third quarter GDP figures to show quarter on quarter growth of 0.8% compared with the previous estimate of 0.7%. The annual rate of growth was 2.7%.
- *The IMF reduces its growth forecast for 2008 ......* its latest estimate is 1.6%.
- *There are some individual causes for concern within the eurozone ......* political situation in Italy, weakness in the Spanish construction section and populist economic moves in Germany give food for thought for the ECB.
- *The ECB is the most hawkish of the central banks ......* inflation stands at 3.2% a year against its target of just below 2%. It will find it hard to ignore this.
- *The ECB watches money supply more closely than most ......* money supply is still growing rapidly with the annual rate in December up 11.5%. Private sector loan growth is still strong at 11.1%. Business loan growth is also strong and accelerating. Germany performed well in 2007 but there are clouds on the horizon in 2008. Hard won reforms which appear to have had some success in contributing towards the good performance of the German economy are threatened with reversal. Independent experts are horrified at what is going on and that includes a former member of the SPD, the junior coalition partner.

United Kingdom

- *Northern Rock has drawn unwelcome attention to the UK ......* as one of the world's leading financial centres, the troubles of the bank have become an embarrassment for the UK.
- *Public finances are a real concern ......* for a long time we have been concerned about the level of government borrowing given the stage of the cycle. Public finances are deteriorating rapidly and there is no room for offsetting reflationary action to counter more difficult economic conditions. Independent experts are even calling for substantial tax increases although that would not be the normal policy to follow in the circumstances facing the country.
- *There is evidence that the economy slowed towards the end of 2007 ......* in the final quarter GDP grew by 0.6% over the quarter compared with 0.7% in the previous quarter.
- *Sterling has weakened considerably ......* this comes as no surprise. The economy is imbalanced and the current account deficit revealed for the third quarter was a shocking 5.7% of GDP. It would come as no surprise if sterling weakened further.

- *The housing market is very important for the UK* ...... upon it depends a lot, including consumer spending. There is strong evidence, both from house prices and new mortgage lending and commitments, that there is a considerable slowdown and possibly a reverse. This could have significant economic implications for the UK.
- *The inflation situation is confused* ...... although the official measure, the consumer price index, shows an annual rate of 2.1%, most people feel it is not their own inflation rate and the former retail price index measure at 4.0% seems nearer to the mark. This is an important influence on wage claims and the government is desperately trying to keep down public sector pay, not only for inflation reasons but also because of the poor state of public finances.

China

- *The problems are the other way in China* ...... the economy, although it may be slowing slightly, is still booming with growth of 11.4% in 2007, the fastest pace for thirteen years.
- *The Chinese authorities continue to try to restrain the economy* ...... in an attempt to prevent it overheating, banks have been asked to raise the proportion of deposits held in reserves again in January, the eleventh time since the start of 2007. This has gone hand in hand with interest rate increases.
- *The vast current account surplus causes inflationary pressures* ...... the build up of liquidity which arises is inflationary. The authorities are moving to encourage private investors to place more money in overseas investments as one way of damping down the inflationary pressures.
- *The era of ultra cheap Chinese imports to industrialised countries may be coming to an end* ...... new employment laws will raise the cost of producing goods in China.

Summary

- *Investors should concentrate on policy initiatives* ...... it is important to look to the probable beneficial results of the easing of monetary and, probably, fiscal policy in the USA.
- *Shares look reasonably valued* ...... modest p/e ratios and attractive dividend yields should attract investor attention as the background becomes less unsettling.
- *Sovereign wealth funds can have a beneficial effect* ...... the recycling of current account surpluses to assets like equities which should give a better longer term return than cash or bonds should help to sustain equity prices.

The quarter has been dominated by the problems in the international credit market caused by the US sub-prime lending problems. We sent out a note to clients on the 17th August regarding the situation and our conclusions remain as stated at that time.

Stock markets do not like uncertainty and the way in which these loans found their way onto banks' books around the world was unsettling because it was not certain where they would turn up next. In the old days, a bank would make a loan and it would stay on its books, so the problems could be isolated and known as far as investors are concerned. Nowadays, loans and other receivables are packaged up and sold on in the form of asset backed securities and could end up anywhere. We have seen high profile casualties in the banking and hedge fund markets but, so far, no really major player and it is likely that the situation can be contained even though some banks have taken major losses. Investment is like a game of chess because investors should be looking ahead to the next stage of the game. If the world economy does get into trouble because of the sub-prime loan situation, central banks, in particular, will act to try to alleviate the situation by lowering interest rates and, so far, we have seen two cuts amounting to 0.75% by the Federal Reserve. We have also seen action in the money markets to try to relieve a seizing up of markets as banks were initially unwilling to lend to each other. Although the situation is still very difficult, the mechanism by which central banks provide funds to the market one way or the other seems to be working. As we said in our note on the 17th August, it has never been our policy to invest in the type of securities where problems have emerged and our indirect exposure would be through holdings in the financial sector where it is our policy to stay with high quality names although, obviously, some of those have taken losses.

There will obviously be macro economic effects from the fallout from the US sub- prime crisis. Credit will become more difficult as banks tighten up lending criteria and, although stock markets have performed relatively well, there will be negative wealth effects in certain areas. The City of London is a case in point. The demand for highly paid financial personnel will be lower than it would otherwise have been and this will have a multiplier effect in the housing market and on those businesses which provide services to these people or their companies. The government will also suffer because tax revenues will be less than they would otherwise have been and the UK is particularly vulnerable in this respect because of the importance of financial services.

Takeover activity, a support for markets in recent times, will also be more subdued. It will be more difficult for private equity vehicles to raise finance for takeover bids but those takeovers with solid commercial reasons will still proceed. Although companies are generally in a very strong financial position, many will feel more cautious about buying back their shares, also an important source of support for markets in recent times. Nevertheless, holders of equities should, in our view, hold their nerve for reasons we outlined in the 17th August note. The world economy is likely to continue to grow and this will provide a support for share prices as profits and dividends rise. This will be at a lower pace than recently but the figures should still be positive and, in our view, share prices are not expensive at present. Earnings yields in most markets are well above bond yields and, unless one sees a major fall in profits, which we do not at present, we do not think markets look overstretched. Although this bull market has longevity, having been going for nearly five years, corporate earnings have been very strong, so much so that, in some cases, shares are more lowly rated than they were at the start of this market recovery. Companies remain very shareholder conscious both in regard to their dividend policy and other means of adding value for shareholders, like share buy backs. Then, of course, there is China and India and much of the rest of Asia, the economic drivers for international growth. They have been relatively unaffected by the sub-prime crisis and remain on a very strong growth path which is providing impetus to the world economy. It is, therefore, less important what happens in the USA than before, although, of course, in absolute terms, the USA remains very important as the world's largest economy. Although growth is likely to be more subdued than would have been the case had there not been a sub-prime crisis, the International Monetary Fund in its latest forecast is still fairly sanguine about growth prospects for next year, as the following abridged table shows:

The quarter ended with the dramatic news from France that one of its premier banks, Société Générale, had been the victim of unauthorised trading which, together with other losses had eliminated most of 2007's profits and necessitated a rights issue to raise €5.5 billion to bolster its balance sheet. At the time of writing, it is not clear if the bank's unwinding of the positions, once discovered, contributed to the high level of stock market volatility on 21st January. There is even a suggestion that the unscheduled meeting of the Federal Reserve on 22nd January which led to a 0.75% cut in US interest rates was the result of the movements in markets on 21st January which may have been artificial as Société Générale unwound its positions. The Federal Reserve denies that it had any knowledge of the losses incurred by Société Générale at the time it cut interest rates so sharply. At the time of writing, we do not know the full story, and may not for some time, but it would be disturbing if the actions of a rogue trader indirectly influenced economic policy or the course of an individual country's or the world's economy.

Were it not for this specific event, the main news would be unsettling events in financial markets which originated with the US sub-prime mortgage problems but which spread to many financial institutions as they held various types of asset backed securities which were not as secure as they thought. This has led to substantial write offs by many banks in a number of countries which were far removed from the USA. In fact, with the announcement of the €4.9 billion loss from unauthorised dealings, Société Générale also announced a further €2 billion loss from the US sub-prime mortgage problems in addition to the €375 million of write downs taken in the second quarter. A whole host of illustrious names has incurred losses as a result of what has happened in the USA. One of the themes of our previous reviews, well before the sub-prime problems became headline news, has been the prospective influence of sovereign wealth funds on international markets. At the time, we were really concentrating our attention on China which had indicated that it was going to set aside US$200 billion, less than a sixth of its massive foreign exchange reserves, the world's largest, to try to raise the return on its reserves. Equities, property and private equity were obvious vehicles. Whilst China caught the eye, because it has the world's largest foreign exchange reserves, sovereign wealth funds have been in existence, in various forms, for a long time. These sovereign wealth funds represent in part the transfer of power from the West to the Middle East and Far East. This is a generalisation, because there is energy and mineral resource wealth in certain areas of Europe (Norway, for example), Canada and certain countries in Latin America. Also, not all countries in the East are resource rich. China, for example, with its enormous competitive advantage and decision to let its currency rise only slowly against the US dollar has allowed its foreign exchange reserves to balloon to somewhere around US$1.4 trillion. As a result of the rise in oil prices some of the Middle Eastern oil and gas producers with small populations like Abu Dhabi and Qatar have accumulated fabulous wealth as has Saudi Arabia, with the world's largest oil reserves, and Kuwait. Obviously, there are others in the Middle East. Dubai, soon to exhaust its oil reserves, planned well ahead a long time ago and is well known on the foreign acquisition front not to mention the evolution of the country into a tourist, financial and transport hub.

Before the sub-prime issues made headlines last August, our concern about sovereign wealth funds and China, in particular, which we felt would have a positive long term influence on markets, was that they would attract protectionist sentiment in the USA and Europe. The UK is one of the honourable exceptions. Its liberal attitude to the foreign acquisition of UK companies and assets does it credit and will benefit the UK. However, elsewhere, populist sound bites from politicians against foreign acquisitions generally represent shameless populism. There are, of course, a very small number of strategic industries (defence, for example) where it may be necessary to restrict foreign ownership but these are exceptions. However, so far, events have turned out in an unexpected way. The need for some US and European banks to repair their balance sheets has provided an unexpected opportunity for sovereign wealth funds in their various forms to provide capital in an environment where it is difficult for protectionists to gain much traction. After all, those banks needed to boost their capital ratios and immediately available funds on a large scale are not always available in the way that they are from sovereign funds.

Provided that they invest in a transparent way, and there is still a lot of secrecy involved, the recycling of funds from countries which usually have large current account surpluses to those in current account deficit as a bloc (but not necessarily at individual country level, i.e. Switzerland where UBS is to have an infusion of funds), reflects what has happened in the past but in a different way. As investors know, equities, over the long term, have provided better returns than cash and bonds. Raising their exposure to equities (some, of course, are already substantial equity investors) makes sense in the context of their long term aspirations to raise their returns on their funds. Given the vast sums at their disposal, the ability to commit funds quickly when the opportunity arises, as it has done recently as a result of some banks' urgent need for more capital, satisfied both parties' needs. The sovereign wealth funds have the ability to be stabilising influences on world markets in times such as the present and a positive influence for equities in the medium and long term.

If we turn from the specific problems of financial institutions, which are in some high profile cases being addressed by sovereign wealth funds' infusions of capital as described above, to look at the macro economic picture, we see a varied pattern of reaction amongst the major economic powers but before considering what they are or are not doing, it is worth considering the economic implications of what has happened in the financial system as a result of the US sub-prime mortgage market problems.

The term "credit crunch" has been used quite widely recently and often in a general way to describe what has been happening in financial markets. But, strictly speaking, it relates to the seizing up of financial markets in such a way that it becomes difficult to obtain credit at all. We saw this towards the end of last year when banks hoarded cash and were reluctant to lend to each other. Inter bank rates in the major markets soared above the level which would have been expected given the relevant central banks' target rates at the time. For example, in the UK, one month and three month inter bank rates were, at their most extreme, about 100 basis points above base rate and this type of situation also obtained in US dollars and euros. Substantial central bank intervention to free up the money markets was eventually successful and now we are back to a more normal relationship between inter bank and the central bankers' base or equivalent rate. Whilst the abnormal relationship lasted, those businesses and individuals whose borrowing rates were tied to inter bank rates experienced a very sharp increase in their cost of borrowing. In this aspect of their role, central banks have been successful in restoring some normality to money markets through their operations.

However, another of the consequences of what has happened in financial markets is that many borrowers can expect to pay more relative to base rate than before. Banks, with the benefit of hindsight, underpriced risk and will react accordingly. They have already done so and will continue to raise lending margins. On the rebound from what has happened, lending criteria will obviously be tightened up, the obvious area being in the housing market. Some loans, which might have been made previously, will not now be made. These moves will have a contractionary effect on the world economy through the effect on individual economies. The effects will ripple through economies to touch almost every part of them.

But, as we have often said before, it is necessary for investors to look ahead rather than be unduly influenced by what is happening now. What will be the reaction of the authorities in terms of monetary and fiscal policy?

The most aggressive moves have come from the USA both on the monetary and fiscal front. We have often noted that the Federal Reserve has a much wider remit than the Bank of England or the ECB and so, taking the broader picture of the US economy, it has aggressively cut the target for the federal funds rate in five quick steps from 5.5% to 3.0% with the latest reduction on 30 January. Furthermore, as we have noted, it has made these two latest very aggressive aggregate 1.25% cuts within a few days of each other. The Bank of England and ECB, which concentrate more narrowly on their inflation targets, have either done very little (a 0.25% cut from the Bank of England) or nothing at all, the ECB. The Bank of England looks likely to reduce interest rates further at its next meeting, perhaps by 0.5% to 5.0%.

Before discussing why the Bank of England and the ECB might be more tardy about cutting interest rates, it is worth looking at the transmission mechanism whereby lower interest rates will be helpful in providing a stimulus for an economy. Here, we are assuming that the benefit of a lower official interest rate will not be offset by higher bank lending margins. For individuals, who have borrowings, lower interest payments improve disposable incomes which might lead to higher spending. Some offset to that may occur as a result of savers not receiving as much interest income and therefore not being able to spend as much but the former influence should be greater on the economy. Lower interest rates may eventually help to stabilise or improve the housing market helping to lead to a positive wealth effect. Lower interest rates will probably, though not always, improve other asset prices, notably shares, also helping to create a positive wealth effect. For companies which have debt, the interest rate of which is tied to base rate, there will also be some benefit to cash flow and profits which may find its way into increased business spending. After a lag, easier monetary policy should, in these ways, provide a stimulus to the economy.

In the USA, the Administration has moved very quickly to try to assemble a fiscal package to stimulate the economy. Because of the improvement in the federal finances in recent years, this should be possible. They are not in nearly as good a shape as they should be given the period of extended growth but neither are they in a serious position as is the case in the UK. President Bush is proposing a US$150 billion stimulus package which has been agreed between the White House and congressional leaders. It is proposing to concentrate its tax cuts on business and individuals. Such moves will put money in the hands of individuals and businesses with the aim of stimulating economic growth albeit at the cost, at least initially, of a higher budget deficit.

For investors, it is very easy to concentrate on and be influenced by scaremongering headlines. It is, as we always emphasise, important to look ahead. The influence of the twin US stimuli should be positive for its economy and, gradually, investors will begin to understand this. It is interesting to note that the new Managing Director of the IMF, Dominique Strauss-Kahn, has supported what the US Administration proposes and is encouraging some other countries to give a stimulus also where there is room. Not every major country can do so because of the state of their public finances but it is significant that the normally fiscally austere IMF is giving its support to fiscal stimuli.

Banking systems which are stable are crucial to the economic success or otherwise of a country. If banks' balance sheets are weak, those who depend upon bank finance will find access to it more difficult. After the savings and loan crisis in the USA, the Federal Reserve pushed down short term interest rates so that banks could effectively recapitalise themselves by playing the yield curve, borrowing short and lending longer and, in the process, pushing up their net margins. Something similar could happen this time.

The outlook for the world economy has obviously been affected by recent issues in the international financial markets and growth forecasts have been downgraded compared with the results from last year. For example, the World Bank, in its latest forecast, is now expecting world growth to slow to 3.3% this year compared with 3.6% in 2007. Within that, it is expecting growth in higher income countries to be 2.2% and in developing countries to be 7.1%. In expecting developing country growth to weaken only modestly, the World Bank points to a risk of a much sharper slowdown in the USA which would affect growth in those areas. One reason for being reasonably optimistic about growth prospects for the world economy as a whole is because of the momentum in developing countries. For example, the World Bank forecasts that GDP in East Asia and the Pacific will increase about 9.7% in 2008 compared with 10.0% in 2007. This is only a very modest slowdown. In Europe and Central Asia, the World Bank is expecting growth of 6.1% in 2008 compared with 6.7% in 2007. In Latin America and the Caribbean, it is expecting growth of 4.5% in 2008 compared with 5.1% in 2007. Here, it remains quite positive on Brazil where it expects growth to remain robust and it is expecting Mexico to rebound from a weak 2007. In the Middle East and North Africa, helped by high oil prices, the World Bank forecasts an acceleration in economic growth to 5.4% in 2008 compared with 4.9% in 2007. In a survey of the world economy, the United Nations is expecting global growth this year of 3.4% compared with 3.7% in 2007 but points out risks to the downside arising from a deep housing slump in the USA. The President of the Asian Development Bank was reported, in the Financial Times, as saying that when the next set of economic forecasts are published in March, they would put regional growth, including China but excluding Japan, at "slightly less" than 8% compared with last September's forecast of 8.2%. Right at the end of January, the IMF cut its growth forecast for the world economy to 4.1% compared with 4.9% last year and its previous forecast of 4.4% in October. It may be necessary to change these forecasts as we gain more experience of the effects of the problems in the financial markets but, at present, these forecasts look satisfactory in the environment which we have witnessed. But central bankers and politicians will react to the unfolding news as they think fit. There are constraints on both the actions of central bankers (inflation prospects) and politicians (a country's fiscal position) but they will do what they can to improve the prospects and this is the situation on which investors should concentrate rather than what is exactly happening at the moment. Reacting to scary headlines does not make good investment policy; rather, investors should look ahead to see the policy reaction that is likely to occur and the effects which this may be expected to have on medium term prospects for the world economy.

So, against this background, we turn to look at individual areas of the world, starting with the USA where the first estimate of fourth quarter GDP growth was a rather disappointing 0.6% annualised, representing, unless it is adjusted in the next forecasts, the slowest growth rate for five years. Following strong growth in the third quarter, a sharp reduction in business inventories contributed to the low level of growth.

Quite early in January, the Chairman of the Federal Reserve, Ben Bernanke, had indicated a change in stance by the Federal Reserve towards the possibility of taking significant action to improve the economic outlook. We have mentioned earlier on in this review that the Federal Reserve has a wider remit in determining monetary policy than, say, the Bank of England or the ECB and Ben Bernanke's statement was quite positive. He indicated that the Federal Reserve was prepared to cut interest rates aggressively to support growth prospects. He referred, at the time, to the housing market weakening more than expected and the negative effect on consumer spending of various factors such as energy prices, the housing market and the stock market. He indicated that all of these posed a negative influence on the outlook for economic growth. He also referred to difficulties in obtaining credit and the softer than expected jobs market in December. Inflation was mentioned but it did not have the high emphasis that it had had in earlier Federal Reserve statements. Mr Bernanke was not complacent because he mentioned the effect on oil prices but, clearly, economic growth had a higher priority at this stage. So it was that, on 22 January, after a difficult day on 21 January in world stock markets, which we now know was possibly caused by Société Générale unwinding its positions, the Federal Reserve made a significant 0.75% cut in interest rates, in between its regular meetings, with the hint that there would be more to come which proved to be the case with its 30 January decision. The latest reduction in interest rates on 30 January takes them down to 3.0% and this represents a low, or even negative, real interest rate, depending upon which measure of inflation one takes. The accompanying statement after the first cut of 0.75% on 22 January emphasised the negative factors which had caused it to act. It said that "appreciable downside risks remained". The negative factors emphasised were the deteriorating financial conditions and difficulty of businesses and households obtaining credit. It again emphasised the weakness in the housing market and the recent signs of weakening in the labour markets. On the positive side, it referred to the fact that conditions in money markets were more normal following central bank intervention over the turn of the year. In the statement after its 30 January cut of a further 0.5%, the Federal Reserve again emphasised the downside risks to the US economy, giving it more emphasis than the risks to inflation. In its latest economic forecast, the IMF suggests that US economic growth this year will fall from 2.2% to 1.5%.

Policy changes do not work immediately but the cumulative effect of the monetary stimulus given to the economy and, in due course, the fiscal stimulus, assuming it occurs, should be quite substantial. In the short term, sentiment may be helped by the return to very low interest rates and it also improves the attraction of other asset classes like equities.

The problems in the financial systems started in the US housing market and although a year ago we may have hoped for stability towards the end of last year, this did not occur. Most of the news continues to be negative and, as we have seen above, the housing market is one influence causing the Federal Reserve to be aggressive on interest rate reductions. A number of the indicators coming out in January make the point about the weakness of the market. Pending home sales in November fell by 2.6% compared with the previous month and were 19% lower than a year before, according to the National Association of Realtors. The Mortgage Bankers Association has forecast that US mortgage lending will fall by 16.2% in 2008 compared with last year. Construction on new homes in 2007 was 24.8% down on the previous year, according to official figures, and was the second largest annual decline on record. Sales of new homes in December fell by 40% compared with a year earlier and the number of houses sold for the whole year was 26% lower than in 2006. The Case-Shiller index of house prices suggested that, in twenty large cities, house prices in November were 7.7% lower than a year previously.

The issue which concerned the Federal Reserve most, prior to the recent problems in the financial markets, was inflation. The core personal consumption expenditure deflator, the Federal Reserve's most favoured measure, shows a year on year increase of 2.2%, above its target of a maximum of 2%. However, in the present circumstances, whilst it will pay important attention to that figure, it may give greater weight to taking measures to ensure that the economy continues to grow. Other measures of inflation show that the consumer price index in December was 4.1% higher year on year and, excluding energy, was 2.4% higher. The relevant month on month increases were 0.3% and 0.2% respectively. The producer price index show a fall of 0.1% in December but the year on year increase was 5.3%. The relevant figures, excluding food and energy, were 0.2% and 2.0%. So there is some concern with these figures and the Federal Reserve has to maintain a delicate balance but it has chosen, rightly in our view, to give greater weight to trying to sustain some momentum in the economy.

Most of the other short term news from the USA has tended to be negative. In December, only 18,000 new jobs were added to the payrolls and the unemployment rate climbed to 5.0% from 4.7% in November. According to the ISM survey of the services sector, there was a slight decline in activity with the index reading 53.9 in December against 54.1 in November, still, however, pointing to growth. Retail sales fell by 0.4% in December which was the biggest fall for six months, suggesting that consumer sentiment was fragile. But there were positive indicators for the US economy released in January. December's big ticket factory orders rose by 5.2% which was the biggest monthly gain for five months. The University of Michigan reported that its consumer confidence index rose to 80.5 in January up from 75.5 in December. The Conference Board's consumer confidence index, although it fell in January to 87.9 from 90.6 in December, was better than expected.

But it is in the financial sector that the worries have been most pronounced. Large US financial institutions, which have suffered significant write downs in the value of their assets, have been able to call on new sources of capital from various sovereign wealth funds. Action is at hand to help the bond insurers, an arcane area of the market which is very important, so significant activity is taking place to stabilise the position. Lower interest rates of themselves will not immediately improve the situation but they should provide the background for confidence to grow again to the benefit of economic growth. Meanwhile, many American companies continue to perform well and those with significant exposure to overseas markets, especially perhaps in this environment, emerging markets, are well placed to benefit from rapid growth in those areas. Leading consumer goods and manufacturing companies come to mind.

Japan remains out of favour. According to the Bank of Japan, consumer sentiment fell to its lowest level in nearly five years in its latest survey. The latest industrial production figures show a decline of 1.5% over the previous month with the year on year figure up by 2.9%. Housing starts year on year were down by over 27%. Retail sales, year on year, are up by just 0.2% with the latest month on month sales down by 0.8%. Furthermore, the Bank of Japan faces a more difficult decision than expected on interest rates. Year on year inflation has been pushed up to 0.8% because of the rise in oil prices so with the official rate of interest at 0.5%, on that measure, there is a negative real interest rate. Excluding volatile food and energy prices, there is still a slightly negative year on year figure of 0.1% but the effect of energy can be seen and if we take the same index, excluding only fresh food, the index is up 0.8%. It is always difficult for the authorities to decide whether to exclude volatile items but the strength of energy prices seems to be more of a fixture and that may have an increasing weight on the thinking of central bankers. The Governor of the Bank of Japan has conceded that growth in fiscal 2007, which ends at the end of March this year, would be in the "low 1% range" against an earlier forecast of 1.8%. But he was not keen to cut interest rates as the Bank of Japan has been keen to follow a more normal monetary policy. It is easy to be gloomy about Japan because the market has been so disappointing relative to others and one can see from the figures that foreigners have been coming out of the market and Japanese investors have been investing overseas. But, that of itself, is not sufficient reason to ignore the second largest economy in the world, one with such latent potential and with significant benefits coming from its strong trading relationships with China. It remains a market where we think it right to have a modest exposure.

Turning now to the eurozone, it is generally considered that this area is holding up relatively well. Some of its financial institutions have also had to make big write downs, as in the United States, as the asset backed securities have found their way outside the USA and indirectly on to their balance sheets. Looking backwards, there was an upward revision to third quarter GDP figures to 0.8% compared with 0.7%, these on a quarter on quarter basis. The annual rate of growth was 2.7%. The last European Commission forecast for growth in 2008 of 2.2% is now generally considered in senior circles within Europe to be too optimistic. People are talking about a range of growth this year between 1.5% and 1.8% and the latest IMF revised forecast is 1.6% growth for 2008. In its latest monthly economic survey, the EC sees just a gradual deterioration in prospects although it is concerned about Spain. The mood in Spain is quite negative and this was one of the eurozone economies which grew very rapidly and had interest rates unsuitably low under the euro regime. Now, although inflation is quite high, they may be considered too high as Spain's construction and housing market weakens and the monetary tool is not there to provide some offset. There was a very slight decline in the EC's economic sentiment indicator in December, down to 104.7 from 104.8 in November but, in absolute terms, not a bad figure.

Nevertheless, the ECB remains the most hawkish of the central banks. The reason is its concern about inflation which is standing at 3.2% year on year compared with the upper end of its target of just below 2%. This is a significant difference and the ECB has emphasised its anti-inflation credentials by not cutting interest rates. So far, its biggest gesture towards the international financial situation is to delay raising interest rates. In leaving interest rates unchanged in January, the President of the ECB, Monsieur Trichet, said that the option of a rate cut was not considered. The ECB is very concerned about wage inflation, especially in Germany, where politicians have taken action which the ECB finds disturbing in terms of the imposition of a sectoral minimum wage in the postal sector and a belief that pay increases should be used to stimulate the economy after several years of being suppressed. This is not the language that the ECB likes to hear. The ECB is also a central bank which follows money supply growth closely. This is still growing rapidly within the eurozone. The annual rate in December was 11.5%, slightly lower than November's 12.3% but still quite a rapid rate. Private sector loan growth was still strong at 11.1% but lending for housing is slowing down with the annual rate 7.1% in December against 7.6% in November. Only in the area of business loans where there was a slight increase to 14.4% from 14.0% was there an acceleration. But these are still strong figures which will influence the ECB's thinking on interest rates and they do suggest some relative buoyancy in the eurozone economy. However, there is evidence that the situation will change. According to an ECB survey, tightening credit standards are making borrowing by businesses and individuals much tougher and so we might well see a significant slowdown in figures which come out over the next few months.

As might be expected, even though growth appears to be holding up relatively well, there have been some negative indications from the eurozone. There has been a slight weakness in the service sector activity, according to the RBS / NTC purchasing managers index. December's reading fell very slightly to 53.1 from 53.2 in November but still in positive territory which suggests growth. November's retail sales were weak. They dropped by 0.5% compared with the previous month to leave an annual increase of just 1.4%. Industrial production weakened in November, falling by 0.5%, to give an annual rate of increase of 2.7% compared with 4.1% in October. Italy was a particularly weak spot with industrial production down by 0.9% and 2.4% lower year on year.

There are three countries which may be giving policymakers in the eurozone some concern. We have already mentioned Spain and the recent political troubles in Italy will almost certainly mean policy making will become more difficult than ever. Because of its level of debt, Italy will always be a concern for the ECB and political direction is hard to achieve with the political set up in Italy. More immediately, however, as we touched upon above, events in Germany will make the ECB quite depressed. In a move to the left by the SPD, the Christian

Democrats seemed to be following suit. In one of the most widely criticised measures, a sectoral minimum wage was imposed on the postal sector which will have the effect of making Deutsche Post's position much stronger against competitors, one of which has had to lay off staff. This is a blatantly protectionist measure which has rightly been widely criticised. Sectoral minimum wages seem likely to spread and the government's top economic advisor, Mr. Rurup, Chairman of the Advisory "Committee of Wise Men", has said that there could be massive job losses if minimum wages become a reality and that measures by the two parties in the grand coalition were "protectionist" and could increase poverty. According to the former Economics Minister, Mr Wolfgang Clement, a member of the SPD, the German government and the SPD are conducting a "lethal economic policy that could inflict substantial damage on the country". He said that his party was "gambling away the dividends of past reforms".

For the present, there is some good news in Germany to offset the bad news. In December, unemployment registered its twenty first consecutive monthly fall. The 78,000 fall was twice the average monthly fall of the past year and, in 2007, more than 500,000 people came off jobless benefits. The jobless rate as measured by the internationally comparable measure was 7.9% in November, the lowest for six years. Business confidence was surprisingly strong in January, according to the Ifo business climate index. The index rose to 103.4 from 103 in December. The German consumer sentiment index, as measured by GfK, was unchanged in January. On the negative side, industrial output fell by 0.9% in November, exports by 0.5% and retail sales by 1.5%. Whilst consumers and businesses were relatively sanguine, investors were not and the ZEW survey of investor sentiment in Germany fell to -41.6 compared with -37.2, this being the lowest level since January 1993.

However, the overall position for 2007 was good for Germany even though signs of a tail off in growth are now appearing. Perhaps, most encouraging of all, was the improvement in public finances. Germany recorded its first public sector surplus since unification in 1990, with the exception of 2000. GDP rose 2.6% last year, only slightly lower than in 2006. Exports, up 8.3% in 2007, were a particular feature and business investment has been rising. However, Germany needs to see increased consumer confidence feeding through to sales because this area of the economy is weak and helps to account for the large current account surplus which Germany runs, the function of its high savings ratio. This rose to its highest level since 1995 at 10.8%. Those in government arguing for more significant wage increases point to the need to boost consumer spending but the resulting higher inflation would have unwelcome effects all round the eurozone.

Having done all the hard work, the danger for Germany is that populist politicians will undo the good that has been done in recent years and which has helped to account for the success of the Germany economy. That a senior minister of the previous SPD government should make such a strong statement as Mr Clement shows how alarming the situation has become.

Following the industrial strife late last year in France, there has been an uneasy peace while negotiations have continued and some progress does seem to have been made on public sector and welfare reform. France's public sector is the largest in the eurozone and the government has correctly identified that this, together with taxation and regulation, all need to be reduced if France is to regain competitiveness. The Prime Minister has indicated that the country is planning to freeze public spending for five years. The Prime Minister, Monsieur Fillon, has said it wants to eliminate its budget deficit and reduce spending as a share of national output. This will not be easy in France but the government does have some momentum behind it and there seems to be some acceptance that change must occur. Meanwhile, consumer confidence, according to Insee, stands at a twenty year low in January.

We move on now to the UK where economic conditions are becoming increasingly difficult. Whilst the Northern Rock affair has captured the headlines and is deeply embarrassing for the UK, given its importance as a financial centre, we think, as we have done for some time, that the bigger story is the state of public finances and the lack of room for manoeuvre which the government has to offset an economic slowdown. For many months we have been writing about the fact that, at this stage of the economic cycle, government finances should be in much better condition but the rapid growth of public expenditure, way beyond the potential growth rate of the UK economy, was bound to lead to a very difficult situation and that is where we are now. During an economic upturn, which is what the UK has enjoyed in recent years, the government should be strengthening its finances and running a surplus or, at the very least, balancing the budget so that it would be able to make a fiscal offset in the event a slowing economy. As it is, the economy has grown rapidly and public finances have continued to deteriorate so that there is a significant structural deficit. Public sector net borrowing in 2007 was £41.4 billion, 2.9% of GDP compared with a figure of just under 1% in 2006. Government borrowing for the first nine months of the current financial year is at record levels. The government's stance has been widely criticised. The OECD estimates that the structural position of the UK deteriorated from a surplus of 0.6% of GDP in 2001 to a deficit of 3.1% in 2007. The deterioration in public finances explains why the Treasury is looking at all possible means of raising extra taxation, even though the means by which it plans to do so could cause significant economic damage to the UK in the medium and long term. At a time of deteriorating economic conditions, the last thing any government should be doing is to raise the taxation of business yet the moves on capital gains tax, although modified, are still planned to raise an extra £700 million. Just when businesses should be encouraged, measures are being taken which will have completely the opposite effect. Similarly, the action on nondomiciled UK residents, while it may seem a good populist move, is likely to cause significant damage to the UK economy, perhaps particularly in London, as those affected choose to move to more inviting financial destinations. Once this business and these people have gone it will be very difficult to recover the situation. The UK is particularly dependent on the financial sector and is, therefore, more exposed as a result of what has happened so the moves look particularly ill timed. The independent Institute for Fiscal Studies has said that the state of public finances is so precarious that the Chancellor of the Exchequer should raise taxation by £8 billion to ensure that the longer term outlook for the budget in what he thought prudent last October. The rise suggested is equivalent of 2p on income tax at the basic rate or 0.5% of GDP.

By the end of 2007, the UK economy was slowing. In the final quarter, GDP grew by 0.6% compared with 0.7% in the previous quarter. Whilst this may, in normal circumstances, make the Bank of England more inclined to reduce interest rates in the light of the present environment, at its January meeting, the MPC voted by 8 to 1 against a 0.25% cut in interest rates. The Bank of England acknowledged the downside risk to the economy but also pointed out that short term inflationary risks had risen. However, it is only a matter of time before interest rates are cut, but they are very unlikely to be cut as aggressively as in the United States, for reasons we discussed earlier.

We have often mentioned the imbalances in the UK economy. Both the government and individuals are overborrowed and this has its counterpart in a large current account deficit which has always had the ability to undermine the pound. Until recently, the pound has been very stable, but a combination of circumstances has caused the currency to weaken sharply and we would not be at all surprised if this weakness continued. One of the catalysts for the weakness in sterling was a sharp upward revision in the third quarter's current account deficit. Against an earlier estimate of £13.7 billion, it was raised to £20 billion, representing 5.7% of GDP, worse than the USA's current account deficit. One of the necessary adjustments to the UK economy should come through a lower exchange rate which will ultimately make exports more competitive but, in the meantime, the weakness of sterling is one more reason for the Bank of England to be very cautious about cutting interest rates.

The housing market is an important influence on the UK economy with its performance affecting many aspects of it, mostly in the field of consumer spending. As in the USA, the various items of news are watched very closely. According to Land Registry figures, house prices based on completed sales during December fell by 0.4% on the month to give a year on year increase of 6.7%. The Halifax figures for December show that average house prices rose by 1.3%, offsetting the fall in November and against declines in September and October. Halifax reported that, over 2007 as a whole, house prices had risen by 5.2%. The latest Financial Times house price index showed that, in December, prices rose by 0.1% compared with a rise of 0.2% in November. For the year as a whole, it shows a rise in prices of 7.9%. According to the Department of Communities and Local Government, house prices fell by 0.8% in November to leave the quarterly rate of increase at 1%. The RICS said that 49.1% more surveyors questioned reported that house prices were falling in December than said they were rising, compared with 40.6% in November. This was the worst reading since November 1992. The online estate agent, Rightmove, said that the average asking price for a UK house fell by 0.8% in December, taking the annual rate of increase to 3.4%. It did report some increase in activity over the turn of the year. There is evidence, on the financing side, of weakness in the market. The Bank of England reported that mortgage lending, net of repayments, rose by £7.8 billion in November, against £7.66 billion in October, but that was the lowest figure for two years. Home loan approvals fell in November to the lowest level for almost three years. The Council of Mortgage Lenders said that the value of new home loans agreed by lenders fell in November to its lowest level for seven months. The number of loans agreed also fell. The Council of Mortgage Lenders said that mortgage lending hit a two and a half year low in December. The amount lent during December, £22.6 billion, was 25% down on November. The British Bankers Association said that the number of new mortgages approved by banks fell in December to the lowest level for ten years. According to the Bank of England, mortgages approved in December for new home buyers fell to its lowest level since May 1995. Looking at all these figures, it is clear that, although one or two indices point to some continued strength in house prices, the trend is weakening and, on the lending side, it is clear that demand is falling but it is also a function of it being becoming more difficult to borrow as a result of what has happened in credit markets. Because UK house prices are dictated to some extent by very tight supply conditions, it is unlikely that the market will fall precipitously, as has happened in the United States in some areas, but it is, of course, a concern for the British economy because of the negative wealth affect which it creates. This will have a ripple effect throughout the UK economy and the troubles of some UK retailers emphasise the point. Consumers are very cautious at present and surveys show people to be rather gloomy about the outlook.

On inflation, which is the main reason for the Bank of England's reluctance to push interest rates down too far, the figures vary quite widely, depending upon which measure is taken. The government's preferred measure, the consumer price index, rose sharply in December by 0.6%, month on month, to keep the annual rate at 2.1%, slightly above the Bank of England's target. The previous preferred measure, the Retail Price Index, one which is widely used for pay negotiations and is more representative for many people, showed a year on year rise of 4.0%, down from 4.3% in November. RPIX inflation, which excludes mortgage interest costs, was 3.1% higher on the year. At the factory gate level, the situation looks worse with a 0.5% rise in prices in December taking the annual rate to 5%, which is the highest rate since August 1991. Producers input prices rose by 0.5% in December also and the annual rate of increase was a very high 11.2%. Price increases are being driven by food and energy costs. The government has two worries. The first is that high inflation will stay the Bank of England's hand on interest rates and, secondly, with government finances in a very poor condition, it cannot afford large pay increases. This is the reason the government seems prepared to risk great opprobrium for interfering with the police pay award, independently adjudicated. But public sector pay is likely to be a problem for the government with public sector unions pushing hard for large increases. They are planning to demand increases of up 7% for more than one million employees. In the private sector, according to Incomes Data Services, pay rises are running at an average of 4% with higher inflation triggering big increases. The headline growth of pay was 4% in the three months to November but the annual pace of increase in November rose to 4.2% compared with 3.7% in October and, excluding bonuses, headlines earnings growth was steady at 3.6%. Unhelpfully for the Bank of England, the latest CPI quarterly industrial trend survey shows that a balance of 21% of manufacturers have said that their prices will increase in coming months. The public sector pay round is going to be crucial for the government in terms of inflation and public finances and it will be a very difficult situation to resolve. Evidence all around us in the form of increased energy charges and food prices suggests that the Bank of England is right to be very cautious about cutting interest rates, even in the present environment. Its regular survey of inflationary expectations shows the public expect inflation to be 3.3% this year. 2008 promises to be a very difficult year for the UK economy.

But, in China, they have the problems of success. In 2007, the economy grew at its fastest pace in thirteen years, by 11.4%, although with some modest signs of a slowdown from a very high level towards the end of the year when the annualised rate of growth was 11.2% compared with 11.5% in the third quarter. The Chinese authorities continue to do everything they can to counter overheating in the economy and, yet again, in mid January, they ordered banks to raise further the proportion of deposits held in reserves, the eleventh time they have done so since the start of 2007. This has been done in tandem with steady rises in interest rates. One of the reasons for the need to dampen down the economy and bear down on inflation is the liquidity pressures in the economy arising from the very large current account surplus. In December, the part of the current account surplus relating to the trade surplus, fell slightly to US$22.7 billion compared with US$26.2 billion in November but, for the whole of 2007, the trade surplus rose by almost 50% to US$262 billion. One of the measures the authorities are using to try to relieve the pressure is to allow individuals, in certain strict circumstances, to invest overseas and this is a trend that we might expect to continue. As with the part of the foreign exchange reserves which has been earmarked to try to achieve higher returns, this promises to have a gradual impact on world markets. We are probably beginning to draw to a close the period of ultra cheap Chinese imports. A toughening up of employment laws at the beginning of January will make it more expensive to do business in China and this has gradual long term implications for the world economy in the area of inflation. Meanwhile, China continues to be an increasingly powerful influence on the world economy and with this magnitude growth rate, which is not likely to be greatly different this year, even if a bit lower, it is providing some offset for weaker economies in the West. In all sorts of ways, China is an important investment influence.After a long run of mainly positive quarters, investors have had a jolt this quarter. As always, investors should be mindful of the fact that there will be volatility in markets during an uptrend. It is important to look ahead. As we have seen above, a very powerful stimulus is being administered to the US economy. It will not work immediately but in due course it should have a positive effect in accelerating economic growth after the disappointing fourth quarter GDP figures. We may expect to see moderate monetary easing in the UK but not on the scale of that administered by the Federal Reserve. As we have pointed out before, shares are not expensively rated. Although they have risen strongly in recent years so have corporate earnings. There are some attractive dividend yields available. As long as the world economy does not deteriorate in a way that cannot presently be foreseen, the value available in many shares should in due course result in a recovery of growth lost in the last quarter and an upward movement beyond that. There will be volatility but it is important that investors are not intimidated by markets into selling equities at low valuations. There will be many more negative headlines but it is important to concentrate on the policy measures being taken to offset the current slowdown in the world economy. We have seen in the tables at the beginning of this review that bond yields fell this quarter but the absolute level of yield offered looks poor value against the current and prospective yields offered by equities.