meridian

ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

For sterling based investors, the strength of the pound has meant little change in the value of their international portfolios. In the sterling government bond market, prices have drifted back, but not significantly. Sterling's strength has been against the Swiss Franc, U.S. dollar and yen, although it weakened against the euro and Canadian dollar. In the commodity markets, oil was a notable gainer.

The tables below detail relevant movements in markets :

International Equities 30.06.17 - 29.09.17

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+1.0	N/C	+3.3	-0.4
Finland	-0.2	+0.2	+3.4	-0.2
France	+4.8	+5.1	+8.6	+4.8
Germany	+4.4	+4.8	+8.2	+4.4
Hong Kong, China	+2.7	+2.8	+6.2	+2.4
Italy	+9.8	+10.2	+13.8	+9.8
Japan	+4.3	+0.8	+4.1	+0.4
Netherlands	+5.2	+5.6	+9.0	+5.2
Spain	+0.7	+1.0	+4.3	+0.7
Switzerland	+3.0	-1.3	+1.9	-1.7
UK	+1.8	+1.8	+5.2	+1.5
USA	+4.6	+1.2	+4.6	+0.9
All World Europe ex UK	+4.5	+3.9	+7.3	+3.5
All World Asia Pacific ex Japan	+4.7	+1.9	+5.2	+1.5
All World Asia Pacific	+4.5	+1.4	+4.7	+1.0
All World Latin America	+11.6	+11.3	+14.9	+10.9
All World All Emerging Markets	+7.6	+4.5	+7.9	+4.1
All World	+4.4	+1.9	+5.3	+1.5

Source FTSE World Indices

FTSE UK Government Securities Index All Stocks (total return) : -0.7%

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

Currency	30.06.17	29.09.17
Sterling	1.33	1.41
US Dollar	2.28	2.32
Yen	0.09	0.05
Germany (Euro)	0.47	0.47

Sterling's performance during the quarter ending 29.09.17 (%)

Currency	Quarter Ending 29.09.17
US Dollar	+3.0
Canadian Dollar	-1.0
Yen	+3.2
Euro	-0.4
Swiss Franc	+4.1
Australian Dollar	+0.8

Other currency movements during the quarter ending 29.09.17 (%)

Currency	Quarter Ending 29.09.17
US Dollar / Canadian Dollar	-3.9
US Dollar / Yen	+0.2
US Dollar / Euro	-3.3
Swiss Franc / Euro	-4.3
Euro / Yen	+3.7

Significant Commodities (US dollar terms) 30.06.17 - 29.09.17 (%)

Currency	Quarter Ending 29.09.17
Oil	+18.9
Gold	+3.3

MARKETS

It has been a satisfactory quarter for international equity markets with a positive return in all the major currencies shown in the FTSE All World Index, although the strength of sterling has adversely affected returns for sterling based investors. In local currency terms, the total return on the FTSE All World Index for the quarter was +4.4%, in sterling terms +1.9%, in US dollar terms +5.3% and in euro terms +1.5%. Looking at individual performances in local currency terms, we see continued outperformance in the FTSE All World Latin America Index (+11.6%) and in the FTSE All World All Emerging Markets Index (+7.6%). Underperformers were the FTSE Australia Index (+1.0%) and the FTSE UK Index (+1.8%). In sterling terms, the FTSE All World Latin America Index (+11.3%), in particular, and the FTSE All World All Emerging Markets Index (+4.5%) outperformed. Because of the strength of the euro, the FTSE All World Europe ex UK Index (+3.9%) showed useful relative outperformance.

Using ten year government bonds as a benchmark, UK government bond gross redemption yields and those of US Treasury bonds drifted upwards by 8 and 4 basis points respectively to 1.41% and 2.32%. The German Bund yield was unchanged at 0.47% whilst that on the Japanese Government Bond fell by 4 basis points to 0.05%.

In the foreign exchange markets, sterling was weaker against the Canadian dollar and the euro by 1.0% and 0.4% respectively, but gained against the Swiss Franc (+4.1%), the yen (+3.2%), the US dollar (+3.0%) and the Australian dollar (+0.8%).

In the commodity markets, OPEC's efforts to stabilise the price by limiting production was successful, at least in the short term with the oil price, as measured by Brent crude, rising by 18.9%. Gold was firmer, up 3.3%.

ECONOMICS

We continue to live in extraordinary economic times. Extraordinary because of the rapid changes to the world economic order and extraordinary for the conditions that still prevail ten years on from the great financial crisis. It continues to be a difficult time for both pessimists and optimists with a true picture of the health of the world economy difficult to piece together; the size of the threats to stability is also unusually tricky to quantify. The world economy is growing, and the rate at which it is growing is also growing. This must be countered with the observation that growth levels are not as strong as they were pre-crisis and the immense stimulus packages that have been foisted upon the economy have not catalysed growth in the way that had been hoped. Financial systems are much stronger than they were previously but debt levels are very high and central banks are warning about the associated risks. Unemployment is low but inflationary pressures are largely absent despite basic economics telling us that low unemployment will mean rising inflation as the demand for labour outstrips supply, creating wage growth. Productivity growth is low yet companies are cash rich and, without efficiency improvements, growth levels will disappoint. These are extraordinary times.

The optic through which sense is made of this is investment markets, which, in some ways, are a meeting place for pessimists and optimists, who through every tradeable commodity offer a view on the direction of that asset's prospects and price, as buyers or sellers. If one outweighs the other, prices will move to compensate for the imbalance and re-establish a short term equilibrium. By this thin definition, current levels would suggest the optimists are prevailing in the market and the pessimists are winning in the media, though each rise in market levels need to be justified by changes to the fundamentals, rather than blind hope, for levels to remain justifiable. Investment management needs to be dispassionate and the views of the many pessimists need to be weighed against those of the optimists. Our view remains that there is a compelling argument to be largely fully invested at the present time and the monthly memorandum discusses our rationale in that statement whilst considering the omnipresent risks.

There is a conundrum in writing this memorandum in that, in many ways, little changes month by month but, at the same time, with the underlying subject being the world economy, there is limitless subject matter. The first of this month's themes is interest rates and debt levels, which are intertwined. Sensitivities run high on this subject as it was the mismanagement of debt which created the financial crisis - opaque packaged debt instruments which contaminated the banking sector once their faults were exposed and, equally, this theme is relevant because the route out of the vortex which we were dragged into was cheap money. Still, monetary policy has never been looser, to the point that negative interest rates are commonly applied and accepted, where only a couple of years ago, there were fears that accounting systems faced a Y2K moment dealing with the reverse maths. We now move to a third phase as it is now more likely that whichever central banker is appearing on the news this autumn will be either raising interest rates, cutting quantitative easing or talking about his or her intention to do so in the short to medium term. The tide is turning and there are strong arguments for well-signalled, gentle but consistent tightening of monetary policy. Successive interest rate cuts over the past decade have had a diminishing economic effect and rates are now so far away from historic levels that the act of raising interest rates, initially at least, cannot be considered tightening in the way it would have been pre-crisis, more so normalising.

Great sensitivity to changes in interest rates prevails at the present time and this is a consequence of how low rates have been for such a long time and how much debt has built up over this period of monetary accommodation. It is also because of the lack of historic reference to the current position and even, perhaps, because policymakers need to get it right as they sit in the shadow of 2007. In September, the chief economist of the Bank of International Settlements, the bank for central banks, warned of the risks, saying that policymakers face a delicate balancing act as they try to wean markets and businesses off extraordinarily cheap money.

The Bank of International Settlements goes on to say that the accumulation of debt at this particular time is a concern and must be monitored. The Bank highlights the highly exposed corporate sector and, ergo, the risk to bond markets. The additional yield provided on corporate bonds over government bonds (credit spread) has been reducing despite the balance sheets of those issuers deteriorating and net debt levels have increased amongst non-financial corporates in United States, United Kingdom and, to a lesser extent, Europe for a number of years. The share of investment grade companies has decreased by 10 percentage points in the United States, 20 in the euro area and 30 in the United Kingdom since 2000. The proportion of "zombie" firms has risen sharply. The Bank defines "zombie" firms as listed companies over 10 years old with a ratio of earnings (before interest and taxation) to expenses below one. In the United States roughly 17% of firms fits into this definition and the figure has risen from around 7% at the start of the century. The situation in Europe and the United Kingdom is less dramatic but has also risen, from under 4% to around 10%. The conclusions of these findings are, unambiguously, that these companies are vulnerable to economic slowdown or higher interest rates. Higher debt servicing costs and default risk could, ultimately, create a headwind for GDP growth. The risks to bond markets of a deteriorating credit market at a time of rising interest rates could conspire to create strong downward price pressures. Debt creation is neither good nor bad as it had aspects of both. A healthy lending market has the capacity to re-distribute capital to create investment and growth. It recycles cash to those who can creatively employ the money to generate more value than the cost of borrowing it. In difficult times or through poor judgement debt acts as an economic drag; it can be invested badly and the impact of default can mushroom in recessionary times. This is not to say that recessionary times loom but, rather, the price of these assets of debt - bonds, is driven not just by credit risk but also monetary policy. We find ourselves at a point where the confluence of rising inflation and tightening monetary policy could make for an uncomfortable time for some holders of debt.

When considering the possible effects of the reversal of quantitative easing and the tightening of monetary policy a good starting point is looking at what was intended by moving us to the current position. Monetary policy influences behaviour and money flows. By cutting interest rates, debt becomes more affordable and a company's cost/benefit analysis of its next project would become more appealing if the funding cost were lower, other things being equal. Further investment would lead to economic growth. Savers would be less inclined to save and, instead, consume, again boosting aggregate demand. Central banks buying sovereign debt drove up the price of the debt, reducing yields and moving investors into lower credit debt, property, equities or other investible assets. Re-directed cash crossed borders and affected real interest rates, and behaviour, globally. It would be reasonable to assume that there will be some amount of reversal of all of this as policy tightens. Nobody knows what effect this will have and the most prudent approach is, rather obviously, to start very slowly and constantly review the effects.

In October, the U.S. Federal Reserve starts the long expected withdrawal of quantitative easing and the protracted process of reducing its ownership of U.S. Treasuries will begin. It is at the same time clear and unclear what will happen. The supply of Treasuries in the market will grow and prices will fall, which will drive up the yield. There will be a transmission effect whereby slightly lower credit risks will trade at lower prices, to maintain the risk/reward incentive over Treasuries and this will continue down through the bond markets. What is not so easy to predict is by how much and when bond markets will move. A well signalled and cautious policy move should be met with rational and predictable market changes. Should there be a rush for the exits, then bond yields could spike as bonds are dumped and the situation could become dangerous as liquidity dries up and bond losses accrue. It is likely, should this occur, that many bondholders could be trapped with either a loss when they sell or being locked in to maturity at a relatively low gross redemption yield and reflecting on missed opportunity cost.

Beyond the bond market, an obvious risk area, cash liquidity will drain from the system as the money supply is tightening. This runs contrary to a healthily growing economy which would enjoy credit and money supply growth through the process of normal bank and non-bank lending, though, if managed optimally, the tightening would be done at such a speed that the normal expansion of the money supply would outstrip this new constraint. The $4.5 trillion question that Janet Yellen will be asking her Federal Reserve colleagues is what rate of reduction in the bank's balance sheet will markets tolerate - meaning bond, stock and cash markets, as all three could be affected. The wider, core economic question would concern the economic effect on inflation, employment, confidence and growth. Again, it is fairly safe to say that the process will be characterised by highly signalled, cautious steps with the option to pause or even reverse never ruled out. This will be an exercise in proportionality. On one hand, should the Bank of Japan (unlikely), the European Central Bank and the Bank of England all join the Federal Reserve in cutting their money supplies by reducing QE at the same time, the compounded impact is likely to be high. On the other hand, global stability sits above domestic targets on inflation and unemployment and the time constraint for central bankers getting this job done is only self-imposed.

Ignoring for a moment the geopolitical risks dotted around the globe, changing debt affordability risks becoming the most significant threat to economic stability in the coming years. Household accounting, corporate financing and national debt management are no different in that the borrower's position has been flattered in the past years by the ease with which and the cost at which money has been lent. A visit to the Bank of England's website shows that interest rates are lower now than at any point since the Bank first opened its doors, in 1694. For some years we, like many others, have warned of the risk to bond markets and have chosen to remain uninvested in the asset class, except where there is a special mandate and then the average duration has been kept very short. For some years the possibility of an increase in rates has been 'just around the corner' and, in fact, market interest rates have fallen. It now looks like the 30 year bond bull market is ending and the going may get a lot more difficult with the yield on 10 year Gilts, at the end of September, at a three month high, at 1.41% but still very low in historic terms and the yield on 10 year U.S. Treasuries was 2.32%, comfortably off its all-time low of 1.36% in July 2016.

Again, it must be said that the attractions of holding bonds, in our minds, is limited to very short dates, where the yields are minimal, and beyond that, they cannot be considered a lower risk investment at this time, something they are normally held out to be. This presents a distinct risk which contrasts with equities. In holding 'higher risk' investments such as equities, from the start the investor must understand that a sharp and prolonged fall in value is not impossible but that values based on all historical precedents will recover over the medium to long term. History demonstrates that sharp downwards adjustments do and will occur but that a recovery, which can even take years, will follow. If the starting point is that the investor is in lower risk assets and, exceptionally, those assets behave in a manner that is not consistent with the more cautious risk profile, then the investor may feel most aggrieved. The cautious investor would be far more sensitive to atypical performance.

If we accept that central banks, increasingly, will see that the time is right to start the lengthy process of reversing quantitative easing and raising interest rates, the question is how quickly this will happen. We must remind ourselves that we are in a period when the Republic of Austria can borrow money for 100 years at a rate of 2.1%, Netflix, the TV streaming business with a B+ credit rating, can borrow money for 10 years at 3.5% and the highest grade companies can still borrow money from investors and be paid to do so (the perverse implication of this is that borrowing money becomes an income stream!). Argentina, a country that has defaulted on its debt 8 times, can still access funding to be repaid in 2117 at 7%. None of this would have seemed possible even ten years ago and it is likely that, in years to come, it will be seen as an exceptional period. Another feature of current debt markets, which is highly unusual and of this time, is the fact that there is little term premium in the market. Term premium is a natural phenomenon where a borrower would expect to pay a lender a higher rate of interest for a debt to be repaid in 10 years than a similar debt in 1 year. The fortunes of the borrower are more susceptible to deterioration over a decade than over a single year and the lender will demand a greater level of compensation for committing money for ten years for fear that interest rates and/or inflation rise in the short term. QE has depressed market volatility and bond yields and, until now, there has been a consensus view in the debt markets that ultra-low interest and inflation rates are likely to be with us for some time. As conditions tighten, the yield curve will steepen as these expectations change and credit risk may become more stretched as those zombie companies, countries such as Italy and Portugal, to name two countries with high levels of debt, and asset classes such as mortgage backed securities cease to enjoy the free ride of excess demand. Borrowers may face a combination of a re-pricing of risk, higher expectations in terms of future interest and inflation rates and reduced demand as central banks manage down their positions. If stress fractures appear in the bond markets, it will be in longer dates, lower credit risks or narrow markets, or any combination thereof. It must be emphasised that this withdrawal of QE could not have been better sign posted. A consequence of the last decade is that central bankers, mindful of their need to contribute positively to predictable on-target inflation levels and unemployment levels accept an equal imperative which is not to scare the markets. This will be an exercise in making sure that expectations are managed with everyone knowing what happens next. Good signalling, along with respectable world economic growth and ample liquidity from the global savings glut, are adequate reasons to believe that markets can be insulated from abrupt downward movements.

Reference was made in the first paragraph to various conundrums which conspire to deny confidence, one of which was productivity and the sub-par growth trajectory of this measure. The term is easy to explain, the concept of why it is important that it improves is intuitive, measuring it in an accurate way is difficult and explaining why it has disappointed in the last decade has defied the expertise of economists. In short, productivity represents economic efficiency and so ongoing, incremental improvements are an economic good that translates into higher living standards. It gauges economic output in terms of economic input. Ideally more and more goods and services will be produced and consumed as a consequence of less capital input and fewer hours worked. The effort and man hours taken to harvest a field of wheat has decreased over the last 150 years. Along with enhancements in crop science the result is a cheaper product relative to the average wage. Productivity has risen. It is widely accepted that the technology boom that started in 1980s acted as a catalyst for the most recent phase of strong productivity growth with many roles in offices disappearing, the Big Bang in 1980s stock dealing, archiving, communications and data management all taking leaps into a new age. The modern office is staffed by fewer people and is capable of handling more clients, more accurately (hopefully!). Any particular innovation will deliver improvements to efficiency but only a finite amount. Whilst the introduction of the word processor transformed the workplace, its contribution no longer continues to keep adding to higher output in the same way. In this century we have not seen any groundbreaking technological innovation to carry forward productivity at the same rate, but this cannot explain the sudden reduction in productivity growth since 2008. The more-often cited explanation of the last decade's performance has been lower capital formation. Companies have, for a variety of reasons, invested less in ways of improving productivity and governments, for their part, have invested less in infrastructure. The most successful companies will continue to re-invest capital in their businesses and improve earnings which will translate into shareholder value. The value of doing this must be balanced against the attraction of share buy backs and short term performance gains. Investors may also benefit from more open articulation of returns on capital employed and more substantial commentary on future capital investment. The IMF, in a recent paper, referred to this post-crisis period of sluggish productivity growth as "productivity hysteresis" which it defines as persistent productivity losses from a seemingly temporary shock. Various factors, in various ways, such as balance sheet vulnerabilities, weak demand and elevated uncertainty, jointly trigger an adverse feedback loop of weak investment, weak productivity and bleak income prospects. These have joined longer, pre-crisis factors such as the waning I.T. effect and changing demographics.

There are signs that capital formation has improved of late and the OECD's chief economist, in the September update, commented that, with the immediate outlook brighter, there was now a "window of opportunity" for governments to prioritise capital expenditure and reforms in a bid to improve and ensure that cyclical upswings do not fizzle out in the years ahead by generating productivity growth and opportunities for higher living standards. Its parallel observation was that more private sector investment was needed for the expansion to endure, for wages to rise sustainably and for inequalities to be tackled. The OECD used this September review to revise upwards its GDP growth forecasts for the world economy to 3.7% (3.6%) for 2018. The 2017 figure is unchanged from June's projection at 3.5%.

Where productivity remains relevant is in considering that it is the largest determinant of improving living standards. This improvement comes via higher real wages which translate into improved spending power. Again, the current inter-relationship does not conform to established economic rules. In a number of advanced economies the unemployment levels have fallen below pre-2008 levels. A scarcity of workers would normally lead to wage inflation and also invite employers to invest in capital to replace more expensive labour and raise productivity. There is limited evidence of this and it may be that the headline unemployment figure no longer does its job(!). Rather, the gig economy, the underemployed, a trans-border workforce and temporary contracts all contribute to suppress wage growth. IMF analysis suggests that an uplift in productivity will yield a greater economic good than falling unemployment. Its modelling shows that in advanced economies a 1 percentage point improvement in trend productivity growth leads to a 0.7 percentage point increase in nominal wages. By contrast a 1 percentage point increase in the unemployment rate is associated with a decline in wage growth of between 0.3 and 0.4 percentage points. Interestingly inflation expectations, it estimates, have a smaller impact, accounting for just 0.2 percentage points of wage growth for every 1 percentage point increase in inflation. The conclusion here is that where productivity growth is struggling, wage growth will face headwinds even if unemployment is continuing to fall.

The pound has strengthened this quarter, and particularly sharply in September after, firstly, the Monetary Policy Committee pointed to sooner, higher future interest rates and then, the following day, one committee member, who has been regarded as one of the more dovish members, remarked that he may support raising interest rates in the near future. What is clear from the reaction to the September interest rate news is that we are in new territory, there is a range of views on how exchange rates reflect interest rates and that the future path will be unpredictable. This would be the first rate rise since July 2007 and a response primarily to the Bank of England's view that inflation could reach 3% in October, a full percentage point above the Bank's target. The August figure was 2.9% and the latest Committee minutes support the view that this level of inflation is not a spike but is becoming deeper rooted in the economy. Less economic slack, the lowest unemployment rate in more than four decades, indications of stronger consumption and some wage growth have been contributors to this feeling that the pressure is growing and it is important to remind ourselves, again, that current monetary policy is set for crisis conditions and in many ways, but not all, that moment has passed. Brexit presents a new set of challenges which are likely to manifest themselves as an unquantifiable impact on trade rather than a total collapse of the financial system. Let us remind ourselves that at the height of the financial crisis there was at least one Sunday meeting between the big banks and the then Governor of the Bank of England, Mervyn King, where they doubted whether they would be able to open their doors the next morning without support. It is easy to forget how serious the situation was and how rapid and extensive the response was. The sterling interest base was 5½% on 1st January 2008 and by March 2009 it was ½%, an historic low. Rescuing banks and bankers, popularly and uniformly stereotyped as greedy, self-interested fat cats, expended political capital but there was no alternative. The social fabric of a country quickly breaks down when people are prevented from accessing the money in their bank accounts. Even the strongest remainers would struggle to argue that the worst possible outcome of the Brexit negotiations would rival the impact of the financial crisis.

The first nine months of 2017 have been characterised by changes in the value of sterling against trading partners, after broader weakness in the second half of 2016. This has had a marked effect on portfolio performance for clients depending on the currency in which their portfolios are denominated. Over the first nine months of the year, the pound has strengthened against the US dollar but has lost value against the euro, which has been stronger than both. As a result, looking at the benchmark that we commonly use for international equity portfolios, the FTSE All-World index, the sterling total return is +8.3%, in dollar terms the return is significantly higher at +17.6%, but in euro terms the market is less impressive, gaining 4.9%. In many recent quarters sterling weakness has translated into enhanced returns in sterling terms. There will be those who would seek to hedge currency in the hope of optimising reporting currency gain but it remains our belief that hedging has more drawbacks than attractions when considering long term returns for three reasons. Firstly it requires the investor to take a view on the future direction of the reporting currency. The unpredictable movements of the pound over the last three years bear testament to how difficult that can be. Secondly, there is a cost to putting hedges in place, for example by buying derivatives, and, thirdly, over the longer term, many of the ups and downs of any currency pair disappear and the ultra-long term value of the pound has been to weaken, partly due to higher inflation, meaning that foreign earnings and share valuations will tend to increase in sterling terms over time. Currency hedging is very useful for locking in a rate for a specific event at a known date in the event, for example buying an expensive piece of machinery from abroad. Companies will hedge foreign currency exposure to gain price certainty rather than speculatively, where there is an income/expenditure mis-match; a good example would be around oil prices. This highlights another aspect of hedging portfolios where the underlying investments are international companies. It is impossible to know what the hedged position of each company is and all that can be known is that each is likely to have a large foreign exchange exposure that is constantly changing.

This month's memorandum coincides with the UK political conference season. This memorandum consciously avoids politics and, in particular, party politics but it is easy to re-iterate a statement that is often made in this monthly series and is made earlier in this month's memorandum. For various reasons the last 18 months have thrust the United Kingdom into a position of unusual uncertainty and the Conservatives currently find themselves in a weakened position, which presents an opportunity for the opposition parties. The country faces a challenging few years where political direction is particularly unclear and the consequences of which could be difficult to predict for UK companies and, above all, companies heavily exposed to the UK economy. The Labour Party is offering an alternative path to the country which may include forced nationalisation, changes to the tax regime and the revision of employment codes. One does not have to have a view on the desirability of Labour's policies as currently put forward, to accept that, if enacted, sterling is likely to fall, probably significantly, and the UK stock market likewise. The fact that the Shadow Chancellor says Labour is gaming a run on the pound emphasises this point. It remains Meridian's view that portfolios should invest internationally and exposure to any particular economy should be roughly proportionate to the size of that country's economy, although we emphasise that we do not hug any index or its relative weighting. There is a natural tendency, which should be resisted, to invest disproportionately in local names to which there may be a sense of affection, familiarity, perceived knowledge or loyalty. Meridian's policy remains to invest internationally in companies whose reach is global and to remain unhedged for reasons stated earlier. Where we hold stock that may be challenged by changing political winds we may disinvest and reinvest elsewhere. At present there is no intention to re-balance portfolios but the situation will continue to be monitored carefully in view of the very unsettled political situation in the UK. We continue to reiterate that the UK carries elevated risk.

As a summary of what has been written here, much as was said in the previous month's investment memorandum, it is important to frame the concerns and threats discussed within the bigger picture, which is far from being dominated by pessimism. The B.I.S. report from which some of this month's data are taken is titled 'Strong Outlook with Low Inflation Spurs Risk Taking' and seeks to strike a balance between the positive and the less positive. The driver behind the change of direction of monetary policy is the widening acceptance that growth in the world economy is improving slightly and is fairly satisfactory at around 3.5% p.a. Inflationary pressures are rising and in some ways a controlled amount of higher inflation is not unwelcome. There is a widening base to the economic expansion and a strong awareness of the frailties that exist within the economic ecosystem. The report comments that the global macro outlook was "upbeat" and "the purchasing managers' index (PMI), a leading indicator of economic activity, signalled continued economic expansion in advanced economies". The message remains that investors have enjoyed an exceptional period of growth in value which will not continue ad inifinitum and the possibility of negative quarters remains. In view of the fact that our clients' portfolios are fairly fully invested, we have, in some cases, been allowing liquidity to build up, awaiting an opportunity to add to equity positions (as stated, we remain negative on fixed interest securities) on any setback in the market. Despite ever-changing risks and a small number of amber lights flashing on the dashboard, one quite close to home, we remain comfortable with our levels of equity exposure and continue to be cautious optimists.