



## CARTLIDGE MORLAND

### INVESTMENT UPDATE

3 March 2008

Since the beginning of 2008, we have seen markets fall dramatically with the FTSE All Share and the S&P 500 capital return indices down around 9% in sterling terms (source Lipper Hindsight 01/01/2008 to 03/03/2008). The noticeable characteristic of equity markets has been the level of volatility, which an indicator of uncertainty. The credit crunch now appears to be taking its toll on the rest of the economy, not just the financial sector and growth is slowing. The uncertainty surrounds just how much growth will be affected and for how long.

#### **Lack of Confidence**

Banks are restricting credit as evidenced by the cuts in credit limits on credit cards and larger deposits required for home purchase. This restriction has a knock-on effect on what consumers spend and ultimately the wider economy. With property prices falling, homeowners feel less wealthy and consumer confidence is adversely affected. This lack of confidence and uncertainty about the future will only add to volatility.

#### **The US Economy**

Speaking on behalf of the Federal Reserve in the latest semi-annual report to Congress, Ben Bernanke would not be drawn on the probability of recession in the US. When asked to strike a parallel with the last recession in 2001, he was keen to point out that each period of financial and economic stress brought unique circumstances. He did warn that the housing crisis has brought more problems than the end of dot.com mania. The governors of the Federal Reserve are, in our judgement, concerned that if they fail in their bid to stimulate growth,

the ensuing recession will be more severe than that in 2001. The capital markets, in particular the equity markets, are not prepared for that eventuality. Further aggressive action from the Fed should occur when the rate setting committee convenes on 18 March 2008. Inflation fears have been put on hold as the key to recovery lies in stabilising the housing market. Without the high rate of mortgage equity withdrawal that has been a feature of recent economic growth, consumers are finding it increasingly difficult to honour not just mortgage loans but other forms of credit too. The banks are 'spooked' and there is little prospect of the credit crunch unwinding in the immediate future. Make no mistake; the state of the US economy will have a significant influence on conditions around the world. If a US slowdown is pronounced, equity markets in the New York, London and Shanghai will move downwards.

#### **Diversification for the Longer Term**

We expect volatility to continue in 2008, at least in the short term, due to the many uncertainties in the market. However, there are still good investment opportunities as well managed companies who will still be producing a good level of profits and attractive dividends. This is where good 'stockpicking' managers come into their own. Investors need to ride out the volatility and resist the temptation to sell at low market points. Market timing is a notoriously difficult exercise with good days easily missed. We believe that investing for the longer term with a well diversified portfolio containing funds run by experienced and successful managers is the most prudent approach in these market conditions.

### COMMERCIAL PROPERTY

We recently met John Cartwright, CEO of Prudential Property Investment Managers (PruPIM), who has thirty-four years' experience in the commercial property sector. He has been managing property funds for twenty years. With such long experience we felt that his views on the current state of the commercial property market would be enlightening.

The commercial property market suffered a severe correction in 2007 – the fastest ever experienced in the market. The market was already slowing at the beginning of the year but the impact of the credit crunch in the summer of 2007 took its toll, as the cost of borrowing increased, with commercial property becoming a less attractive investment.

### **Recent Actions**

Commercial property funds experienced net outflows, so their pricing moved to a 'bid' basis, whereby investors realising units are penalised to protect the remaining investors against future costs in selling properties. This pricing technicality further accentuates negative returns as performance is measured on the change in the fund price.

PruPIM property funds had to move to this pricing and properties were sold for liquidity purposes. As John has been through other property cycles he was experienced in knowing which properties to sell and which to retain. In the event, he feels that their property portfolios are now higher quality.

John commented that this market correction is different from the last significant slowdown in the early 1990's as there is not an oversupply of property. In the 1990's buildings were constructed without pre-letting so the vacancy rates were much higher than they are now. The macro-economic background is also very different, with lower inflation, interest rates and unemployment.

### **The Immediate Future**

The supply of new property coming on to the market is muted in most property areas apart from town centre retail where PruPIM sees higher risk with oversupply. The construction of many of the proposed landmark City buildings that have recently been granted planning permission has been postponed, so the supply in some ways is self-correcting. However, there are concerns about vacancy rates rising in the City as financial institutions look as if they are likely to cut workforces. PruPIM have cut exposure here.

John is confident of the commercial property market recovering reasonably quickly. There

are now many more international investors looking to invest in this asset class as property portfolios are diversified on a global basis, so demand should continue. In addition, income from rents is a key component of returns and rents are currently growing at around 2.5% per annum. The last option for companies is to renege on their rental agreements, so income stream and rental growth look attractive.

PruPIM are expecting the returns for 2008 to be fairly flat and there is the risk of further downside. However, they expect 2009/10 to see better returns with performance coming from good stock selection and managing their assets effectively.

### **Cartlidge Morland Recommends**

If you have held commercial property funds for a long time you will have made good returns despite the current slowdown. For those who have invested recently, returns have been negative. Commercial property is held within a portfolio as it lacks correlation with the equity and bond markets and has the ability to lower volatility in the medium/longer term. We recommend that you continue to hold your funds as we expect performance to improve and returns to revert closer to their historic longer-term norm of around 6-7% per annum.



**CARTLIDGE MORLAND**

**83-85 Mansell Street London E1 8AN**  
**T: 020 7709 5560 F: 020 7709 5561**  
**E: [enquiries@cartlidge-morland.co.uk](mailto:enquiries@cartlidge-morland.co.uk)**  
**W: [cartlidge-morland.com](http://cartlidge-morland.com)**

Cartlidge Morland is a firm of Independent Financial Advisers that is authorised and regulated by the Financial Services Authority.