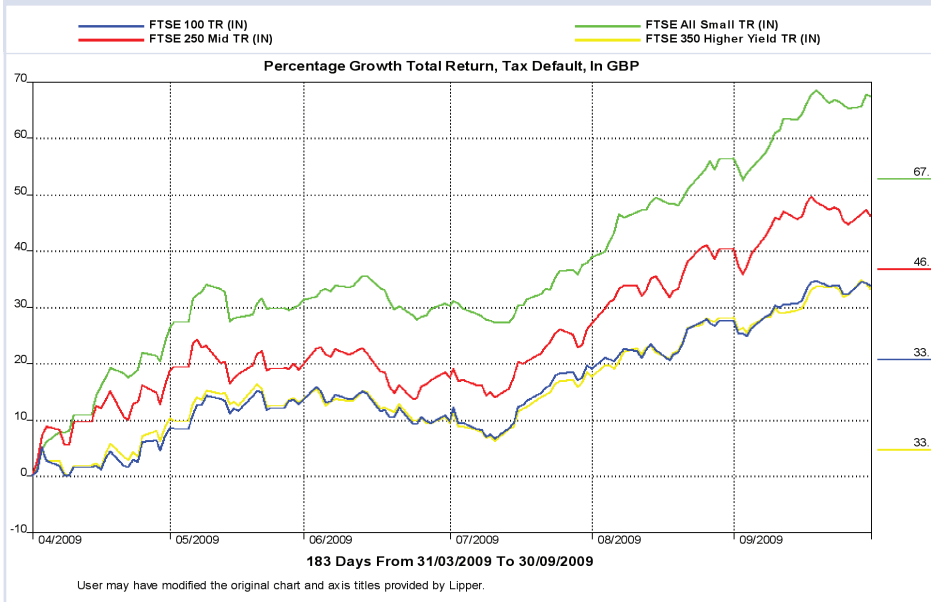


OCTOBER 2009

UK EQUITIES

The UK is probably emerging from a deep recession. Confidence is rising and financial conditions are improving but the risks remain to the downside, the economy is fragile and the prospects for a quick recovery are narrow. The problems associated with continued muted credit availability and high unemployment are key risks. Without wider credit availability, encouraging businesses to engage with productive investment, a recovery will not be sustained. Unfortunately, the UK Purchasing Managers' Index for manufacturing saw another decline in August with factory orders slowing – indicative of continued poor demand and further job losses. Households, too, are still denied credit. According to the Bank of England's latest credit condition survey the supply of unsecured credit, in particular, continues to be reduced by the commercial banking sector.

According to Moody's economy.com "Britain's financial industry faces a prolonged period of restructuring and regulatory reform, including restrictions on remuneration packages, which will mean slower income gains. Financial institutions will also need to set aside more capital, which will weigh on credit expansion and economic activity well into the next decade." This seems a sensible assessment, the effects of which will be a drag on corporate profitability.



US EQUITIES

It seems likely that the US economy emerged from recession in the third quarter of this year meaning that improvements may be seen in corporate profits later in the year. This is badly needed to encourage businesses to begin to expand and in turn create jobs. In September, the unemployment rate rose to 9.8% and the 'non-farm payrolls report' revealed a fall in the number of average hours worked which is usually

Continued over page

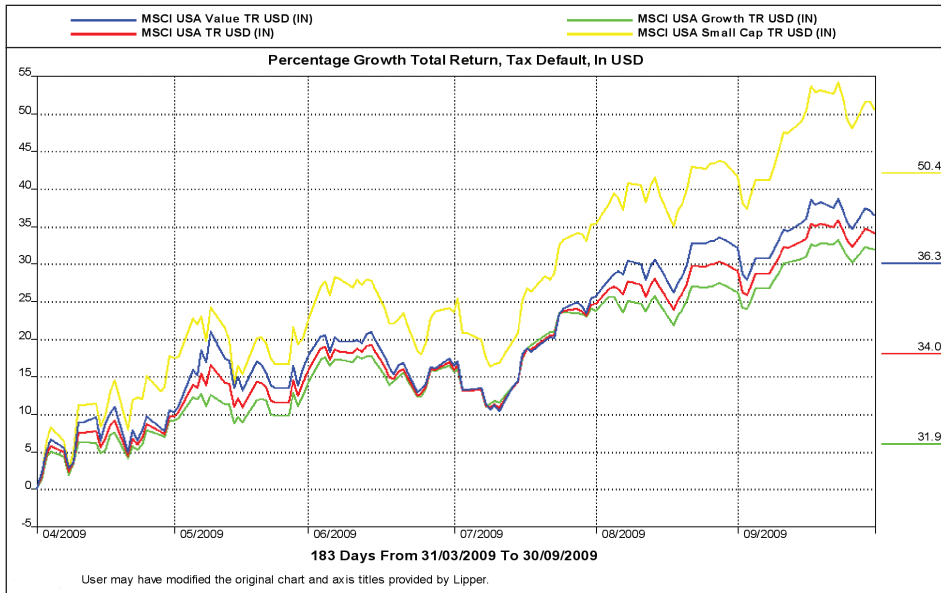
EUROPEAN EQUITIES

The results of Germany's elections are likely to prove a boost to the continued recovery in Europe's powerhouse economy, not necessarily because Angela Merkel's Christian Democrats will be partnered with a centre right pro-business party in the Free Democrats, but because the result was decisive. Previously the Christian Democrats were in a grand coalition with the Social Democrats with opposing political agendas. The election result may help to sustain improvements in business and consumer confidence; euro zone confidence surveys have been rising for six consecutive months. There is mounting evidence that the euro zone as a whole will follow Germany and France out of recession sooner rather than later. The latest survey of purchase managers is at levels most often associated with a growing economy and industrial orders have seen strong growth now for a second consecutive month.

JAPANESE EQUITIES

The newly elected Democratic Party of Japan (DPJ) is now faced with the task of improving Japan's economic prospects. They will strive to increase private sector spending and investment – something that has been in terminal decline since the early 1990s. Somehow the country's leadership must encourage savers to move from cash deposit to riskier, more productive investment. That is a difficult enough task as the asset price collapse that accompanied the 'lost decade' and a string of failed recoveries loom large in the Japanese psyche. To encourage spending in the face of sustained deflation is an even tougher task. August saw Japanese core inflation fall by 2.2% year-on-year which is the fastest rate of deflation on record.

a precursor for falling output. Continued job losses are likely to influence monetary policy in the coming year. A fragile recovery, which is likely to roll in fits and starts with setbacks along the way, will not lead to quick improvements in the employment situation. It is for this reason that the Federal Reserve may maintain interest rates at very low levels for much longer than many are anticipating.



SOUTH EAST ASIAN EQUITIES

Growth is predicted in the Asian economies for 2009 and 2010. The Asian Development Bank forecasted that developing Asia will grow by 3.9% in 2009 and by 6.4% in 2010. The forecast for China is 8.2% growth for 2009. This is driven by the massive increase in bank lending in China. The staggering amount being pushed into the economy through loans threatens more asset price bubbles and while deflation is the backdrop momentarily, inflation could provoke serious concerns. That might discourage the somewhat disappointing levels of foreign direct investment that are currently flowing into China. Without an increase in investment from overseas, China will be singularly reliant on government spending for growth.

UK FIXED INTEREST AND MONEY MARKETS

“The risk of a long-lasting economic depression is not over. There have been some positive signs recently, and the worst may be behind us - but we should not get too carried away. Retail sales have risen a little and there are some positive signals from the housing market. There was even some evidence of positive GDP growth in France and Germany. Nonetheless, in the United Kingdom, money supply growth remains weak, banks are still not lending and mortgages are hard to come by. The latest surveys for construction and manufacturing still show contraction. Negative equity is on the rise, as are mortgage defaults. Unemployment is climbing fast and a million jobless young people under the age of 25 are in danger of becoming a lost generation.” Those are the words of David Blanchflower, published in September in his opening article as economics columnist for the New Statesman. His view seems to be correct.

There are those that dismiss the employment numbers as a lagging indicator, as somehow less important, less influential on the potential economic environment. It may well be that future economic growth will be sustained at much weaker levels than in the recent past precisely because of the rise in unemployment. The labour market is particularly weak among the young. The focus is on this demographic because they have the highest propensity to consume (and consumption accounts for two thirds of UK GDP) and it is they that must support the retiring post war baby-boomers.

The impact of rising unemployment on monetary policy will be considerable. The Bank of England's quantitative easing programme has been remarkably successful in calming the credit markets. The repo/LIBOR spread stands at 15 basis points – only 4 basis points higher than the norm and some way below its 228 basis point peak at the height of the crisis. However, there is little evidence to suggest that credit is increasingly available to businesses. Bank lending to business must be jolted back to life; lost bank lending must be replaced. Short-term interest rates will remain low and longer-term interest rates – the real risk to the economic recovery – must also remain low. It seems likely then, that the quantitative easing programme may well be expanded beyond the currently planned £175 billion.

With monetary policy focusing on low, longer-term interest rates, the corporate bond market will remain buoyant. There should be some capital appreciation as the credit risk premium continues to contract reflecting improved conditions in credit markets and in response to increasing risk appetite among investors.

Would you prefer to receive the Monthly Investment Commentary by email in future?

Please email James Simpson (commentary@cartlidge-morland.co.uk) to request this service.

Cartlidge Morland is authorised and regulated by the Financial Services Authority

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. Cartlidge Morland's current views and suggestions in this document are based on research which is obtained from a variety of sources. Whilst these sources are believed to be reliable, the information obtained cannot be guaranteed to be accurate and may be condensed or incomplete. Past performance is not a guide to the future. The value of investments and income arising may go down as well as up.

Reproduction of this commentary is not allowed in whole or in part without prior written agreement from Cartlidge Morland.