



The Street Lamp News

Autumn 2011

Markets have started the fourth quarter like they ended the last. The stream of negative news and the collective gloom it has cast over investors shows little sign of abating. The US S&P500 index closed recently at its lowest level in over a year early in the month led by speculation that American Airlines may be near bankruptcy as well as further weakness in bank stocks. At the time of writing, the S&P500's level puts the premier measure of US corporate health into bear market territory – down more than 20% from its April 29 peak. In the UK meanwhile, the FTSE100 moved decisively below the psychologically important 5000 level but has subsequently rebounded.

In Europe, the concerns over a Greek default and its potential for contagion were heightened by the news of a potential banking casualty. The fact considerable funds have been already spent on bolstering the Franco-Belgian lender Dexia is not being lost on investors trying to get a handle on the extent of Europe's banking problems. The euro responded by hitting a 10-year low against the yen.

Emerging markets have not been spared either as investors have simply taken all risk positions off the table with little regard for their better long-run fundamentals during the eye of a storm. In fact, emerging markets are now completing a year of underperformance versus developed markets, reversing the trend of a decade. Few, however, would bet on this being a trend that can continue for a sustained period. The medium to long-term outlook for emerging markets remains compelling, particularly in the light of the developed world's indebtedness, and their ability to find internal and intra-regional sources of growth will be closely monitored by investors, going forward. While all markets seem to fall in unison in times of heightened uncertainty, history shows these periods do not last. Indeed, once investors extend their time horizons beyond the current myopia afflicting markets, all the evidence points to the fact we are now in a two-speed world with fast-growth emerging markets having considerably more scope for growth than heavily-indebted developed markets. Patient investors with one eye on the longer-term may want to use the current indiscriminate sell-offs to reassess their portfolio exposure and increase positions in emerging markets at a time when it can be done cheaply - relative to recent history when emerging markets have typically commanded a significant premium for their better growth potential.

Of course, the trouble with the accepted wisdom that stock markets are typically “darkest before dawn” is working out how far you are away from dawn. In short, no-one really knows at this point how much darker it will get. Certainly, the full implications of the credit crisis will take several years to fully resolve. However, we have already seen some significant declines in markets, sentiment is universally negative and a sense of urgency even seems to be building among euro-zone policymakers. It is the type of bleak environment in which a bottom could take shape and a robust policy announcement could spark a relief rally.

Clearly, diversification of assets remains paramount. For equities specifically, many investors take the view that we need to see some kind of capitulation or final wave of selling before stocks can consolidate. Indeed, technical analysts who study market patterns would point to the fact that the current wave of selling represents the ‘final’ wave of a textbook 5-stage correction pattern. Others believe that the Greek default situation simply has to be resolved or a wider euro-zone solution announced before markets can move on.

Of course, picking the exact bottom of stock markets is a fool’s game. But having a wider sense of the opportunity that market volatility can present and the potential for markets to bottom when news is bleakest is something that all investors should think about before they act on their emotions. One thing that markets have demonstrated beyond doubt is that sentiment can turn very quickly in this risk-on, risk-off world.

In the UK the economic outlook is far from certain and with this uncertainty comes a greater difficulty in forecasting future Gross Domestic Product (GDP). The current consensus for GDP is for it to increase by 1.4% in 2010, 2.4% in 2011 and 2.7% in 2012. These views assume that the removal of Quantitative Easing will be offset by an increase in activity in the private sector. The newspapers, widely renowned for their negative views, argue this is overly optimistic and hence articles predicting that the UK will fall back into recession in 2012.

Net borrowing in the UK is likely to reach £160bn, 11.2% of GDP by the end of 2010. This will be the highest in the G7 group of countries. The Government has already shown its commitment to reducing this figure and the consensus is that this will fall in the future to £76bn.

As far as interest rates are concerned it is likely they will remain low for some time to come. The Bank of England’s target is to maintain inflation within set boundaries. Whilst the rate of inflation is above target at present and is likely to continue to be so for some time to come it is unlikely the Bank of England will raise interest which would have the effect of cutting back spending in the private sector, reducing GDP and delay the recovery.

In summary there are a number of uncertainties in the economy and the future direction cannot always be accurately predicted. From an investment point of view there are many companies in the UK continuing to be market leaders in their field and with good stock selection fund managers should continue to be able to outperform the general market.

Building a NEST egg

Despite protests about the costs of setting up the scheme the Government has decided to continue its plans to launch the National Employment Saving Scheme (NEST). All Employers will be obliged to either have their own scheme, which must meet certain NEST criteria, or enroll their employees into the main NEST Scheme. All eligible employees will be automatically enrolled by their employer unless they opt out. Employers will not be formally obliged to begin the phased enrolment of their staff in Nest until October 2012.

The Nest contributions from employers and employees will go into conventional pension investment funds, just as if they were being invested in an employer's pension scheme. The scheme is designed to keep charges to a minimum: 0.3% of the accumulated pot each year, plus 1.8% of that year's contributions.

With just a year to go before auto-enrolment starts, all employers have now got to get a grip on their forthcoming obligations.

Automatic enrolment, either into Nest or an existing company scheme, begins in October 2012 and will apply to workers who:

- are at least 22 years old but below their state pension age
- earn more than £7,475 a year

Minimum contributions will be paid on their earnings between £5,035 and £33,540.

Employers will start paying a minimum of 1% of qualifying earnings, rising to a minimum of 3% by 2017. And employers can now make their contributions every two weeks, not just weekly, monthly or every four weeks.

Employees will start paying a minimum of 1% of their qualifying earnings, rising to a minimum of 5% by 2017.

The process of employers joining Nest and automatically enrolling their staff to it - or to their own pension scheme - will start with big and medium-sized employers between 1 October 2012 and July 2014.

Small and micro employers will have to join in the process between August 2014 and February 2016.

To look up your staging date in this table, the employer will need to know their PAYE scheme reference number(s) and the size of their PAYE scheme. The staging date will be based on the number of people in the PAYE scheme on 1 April 2012. If you or your employer would like to discuss this in more detail please contact us.

Market Review

During the six months ending 30th September 2011 capital changes in the main markets have been as follows:-

Indices			Percentage Change %	Adjusted Change % *
	31/03/2011	30/09/2011		
United Kingdom				
FTSE 100 Index	5908.76	5128.48	-13.21	
FTSE All Share Index	3067.73	2654.38	-13.47	
FTSE Mid 250 Index (exc. Inv trusts)	12190.40	10257.50	-15.86	
FTSE Small Cap. Index (exc. Inv trusts)	2628.60	2263.05	-13.91	
FTA Brit. Gov. Securities Index				
Fixed Interest - All Stocks	153.14	166.46	+ 8.70	
Index Linked - All Stocks	380.87	418.30	+ 9.83	
North America				
Standard & Poors Composite	1325.83	1131.42	-14.66	-12.19
Japan				
Topix Index	869.38	761.17	-12.45	- 3.13
France				
CAC 40 Index	3989.18	2981.06	-25.25	-27.28
Germany				
DAX Index	7041.31	5502.02	-21.86	-23.98
Switzerland				
Swiss Industrial Index	6357.55	5531.74	-12.99	- 9.82
World				
FT World Index	364.11	306.74	-15.76	-15.76

*This column adjusts the capital changes to reflect the movement of Sterling against the relevant local currency.

Composite Index 0.82%

This Index is calculated on the basis that a client's Portfolio is invested as detailed below with net income re-invested at the payment date:-

Building Society Deposits	30.00%
UK Government Index Linked Stocks	10.00%
UK Equities	40.00%
Overseas Equities	20.00%

Bulls & Bears

UK Equities

The market can be underpinned by improved valuations and the benefits of sterling's depreciation, but faces headwinds from weak consumer income growth and fiscal tightening, plus any global slowdown.

US Equities

Good cost control and continued export demand have supported strong earnings growth, although consumer debt and the housing market overhang limit many domestic stocks

European Equities

Valuations have become more supportive compared with other markets, while many exporters are benefiting from strong emerging market demand offsetting the weakness of some domestic economies.

Japanese Equities

Valuations have improved but the success of the government in helping the economic reconstruction after the series of natural disasters remains limited.

Emerging Markets

Selection is increasingly required. While some countries benefit from strong commodities demand and upgrades to sovereign debt ratings, others face growing inflationary pressures and valuation concerns.

Asia Pacific Equities

Strong economic growth is still translating into inflationary pressures, bolstered by food and commodity price shocks, which, in turn, requires continued monetary tightening.

Property

Although occupier demand has shown signs of slowing, yields remain attractive and we continue to expect reasonable returns versus cash on a 3-year holding period

UK Gilts

Although the muted economic recovery and fiscal tightening provide support for the gilts market, valuations have arguably reached expensive levels. Meanwhile, headline inflation risks will be present at least into 2012.

Investment Grade Bond

Positive corporate cash flows should enable a renewed decline in the now extreme yield spreads, although the volatility of the underlying government bond markets will periodically affect total returns.

Non Investment Grade Bonds

The market is still benefiting from an attractive carry, healthy balance sheets and low levels of default, although concerns about future economic growth have affected valuations.

Overview

We remain positive on the ability of companies to generate profits, despite the muted economic backdrop seen in many developed economies, as emerging economies continue to expand strongly. However, the rise in raw material costs is squeezing margins for some companies, while currency appreciation is becoming more of a problem for others.

Central banks in OECD countries are debating the pace and extent of interest rate changes. However, policymakers are becoming much more mindful of the ongoing sovereign debt crisis. This suggests that more central banks will be forced to accept some form of quantitative easing into 2012. Meanwhile, other central banks, especially those in Asia, are still forced to keep policy tight in the face of any inflationary pressures.

Post Office Index Linked Savings

Following the closure of National Savings Index Linked it became difficult to invest in a low risk investment with returns linked to inflation. The Post Office has recently launched a new product which will fulfill the needs of investors looking to protect their capital from inflation.

You can invest from £500 to £1million in either a 3 year or 5 year and 1 day investment term. Inflation will be calculated with reference to the Retail Prices Index each January. The 3 year plan will pay inflation plus 0.25% each year, paid at maturity. The 5 year and 1 day plan will be inflation plus 1% each year, paid at maturity. If the annual rate of inflation is 0% or below in any year you will still benefit from the fixed return for that year.

There are no withdrawals allowed during the investment term and early closure is only allowed in exceptional circumstances, at which point an early breakage charge will be applied and you may not get back your original investment.

The plan is open until 20th January but the Post Office reserve the right to close the offer period early if it becomes oversubscribed. If you would like more details please do not hesitate to contact us.

Contracting Out of the State Pension Scheme

At the moment, some pension schemes are set up to provide a pension which replaces all, or part, of the additional State Pension (also called the State Second Pension). This includes some company, stakeholder and personal pension schemes. When you join one of these pension schemes, you are said to be 'contracted out' of the additional State Pension.

There are two ways of contracting out, based on how the benefits are to be calculated. Some company schemes, generally money purchase or defined contribution schemes, along with personal and stakeholder pensions, contract out on a defined contribution basis. Currently individuals who are members of a contracted out scheme pay lower National Insurance contributions and/or receive some National Insurance rebates into their pension scheme.

The Government is planning to end contracting out of the additional State Pension on a defined contribution basis from 6 April 2012. If you are in a personal, stakeholder or company pension scheme which contracts out on a defined contribution basis you will automatically be brought back into the additional State Pension scheme and, depending on your earnings, you may begin to build up entitlement to the additional State Pension from this time. In most cases you will earn entitlement to the additional State Pension. There may be some cases in which you won't, for example if you stop working or earn less than the Lower Earnings Limit.

At present the Protected Rights proportion of your Pension Pot has to provide a spouse's pension if you are married. From April 2012 this will no longer be the case. If you would like to discuss this in more detail please contact us.

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The value of investments and the income from them can go down as well as up and investors may not get their original investment back. Past performance is no guide to the future.

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