meridian

ASSET MANAGEMENT (C.I.) LIMITED

Investment Memorandum

Despite the serious economic and financial background, investors can take some comfort from the strong performance of international equities which has been reflected in almost every market. High quality international bonds have also strengthened. Our review details our rationale behind these market movements which, in the case of equities, may, at first sight, seem counter intuitive but which we think are rational.

The tables below detail relevant movements in markets:

International Equities 30.11.11 - 29.02.12

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	+4.9	+8.7	+10.4	+11.1
Finland	+7.3	+5.0	+6.6	+7.3
France	+10.3	+7.9	+9.6	+10.3
Germany	+12.6	+10.2	+11.9	+12.6
Hong Kong, China	+19.2	+17.6	+19.5	+20.2
Italy	+7.3	+5.0	+6.6	+7.3
Japan	+15.2	+8.8	+10.5	+11.2
Netherlands	+9.7	+7.4	+9.0	+9.7
Spain	+1.5	-0.7	+0.8	+1.5
Switzerland	+8.8	+8.3	+9.9	+10.6
UK	+7.4	+7.4	+9.1	+9.8
USA	+10.3	+8.6	+10.3	+11.0
Europe ex UK	+10.0	+8.5	+10.2	+10.9
Asia Pacific ex Japan	+11.4	+13.2	+15.0	+15.7
Asia Pacific	+13.0	+11.3	+13.0	+13.7
Latin America	+10.8	+15.1	+17.0	+17.7
All World All Emerging	+12.6	+15.4	+17.2	+18.0
The World	+10.1	+9.1	+10.8	+11.5

Source FTSE World Indices

FT Government Securities Index All Stocks (total return): +0.8%

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

Currency	30.11.11	29.02.12
Sterling	2.33	2.14
US Dollar	2.06	1.98
Yen	1.07	0.97
Germany (Euro)	2.28	1.82

Sterling's performance during the quarter ending 29.02.12 (%)

Currency	Quarter Ending 29.02.12
US Dollar	+1.4
Canadian Dollar	-1.8
Yen	+5.9
Euro	+2.1
Swiss Franc	+0.4
Australian dollar	-3.5

Other currency movements during the quarter ending 29.02.12 (%)

Currency	Quarter Ending 29.02.12
US Dollar/Canadian Dollar	-2.9
US Dollar/Yen	+4.4
US Dollar/Euro	+1.0
Swiss Franc/Euro	+1.7
Euro/Yen	+3.7

Significant Commodities (US dollar terms) 30.11.11 - 29.02.12 (%)

Currency	Quarter Ending 29.02.12
Oil	+11.0
Gold	+4.0

Markets

International equity markets have performed strongly during the last quarter. In local currency terms, the total return on the FTSE World Index was 10.0%, in sterling terms 9.1%, in US dollar terms 10.8% and in euro terms 11.5%. Looking at the various local currency returns first, we note a particularly strong performance from Japan which returned 15.2%. There was a slightly above average performance from the USA where the FTSE USA Index returned 10.3% and also from emerging markets where the FTSE All World All Emerging Markets Index returned 12.6%, from Asia Pacific ex Japan where the FTSE Asia Pacific ex Japan Index returned 11.4% and from Latin America where the FTSE Latin American Index returned 10.8%. There were below average performances from Australia where the FTSE Australia Index returned a still very respectable 4.9% and from the UK where the total return on the FTSE UK Index was an even more respectable 7.4%.

As can be seen from the close bunching of performances from the various currency adjusted returns on the FTSE World Index, currency movements apart from the yen, some Latin American currencies, and, to a lesser extent, the Australian dollar, did not greatly affect the performances in other currency terms. The weakness in the yen was sufficiently pronounced to reduce the sterling adjusted FTSE Japanese Index's return to 8.8%, slightly below average. On the other hand, the strength of the Australian dollar raised the sterling adjusted return on the FTSE Australian Index to 8.7%, only slightly below average. Currency strength raised the sterling adjusted return on the FTSE Latin American Index to 15.1%. Although the emerging markets' currency strength was not quite as pronounced, it did raise the sterling adjusted return on the FTSE All World All Emerging markets Index to 15.4%.

In the international bond markets, the continued turmoil in the eurozone, plus some further quantitative easing, or variations thereof, was responsible for a further fall in gross redemption yields on the bonds of those countries reckoned to be the safest. Taking ten year government bond yields as a benchmark, the gross redemption yield on UK government bonds fell by 29 basis points to 2.14%, on US government bonds by 8 basis points to 1.98%, on Japanese government bonds by 10 basis points to 0.97% and on German government bonds by 46 basis points to 1.82%.

In the currency markets, sterling rose against the yen by 5.9% and the euro by 2.1% but fell against the two resource based currencies, the Australian dollar and Canadian dollar, by 3.5% and 1.8% respectively.

In the commodity markets, oil rose by 11.0% as measured by Brent crude, partly over tensions with Iran, and gold rose by 4.0%.

Economics

As the stock market movements show, the more positive sentiment in markets, which was apparent in the final quarter of 2011, has continued to prevail so far this year. This is in stark contrast to the third quarter of 2011 when sentiment was at rock bottom. The unsettling volatility which was apparent at times last year has disappeared, temporarily at least. Trends in stock markets can sometimes be self fulfilling. Investors, market analysts employed by financial institutions and the media, often reflecting what is happening in the markets, turn more bullish or bearish, as the case may be, even though nothing fundamental has changed to alter the picture. Sentiment and what Lord Keynes referred to as "animal spirits" can be very important in terms of causing the level of economic activity to change and the same can be applied to the stock market.

Because of the permanent state of economic crisis, which is the "new normal", as a result of the eurozone's chronic financial and economic troubles, it is becoming easier for investors to switch off and only really pay attention when the situation appears to become even worse. If the bad situation does not deteriorate even further, that seems to be good news and even better if the background becomes less bad. What really spooked markets in November was the concern about the eurozone banks, which were frozen out of the wholesale market and facing major refinancing issues in 2012. With substantial quantities of peripheral eurozone debt on their balance sheet, there were concerns about their safety.

Our clients will know that we have often said that the ECB was the only institution which could deal with the situation in the short term, although it could not solve a problem which we believe to be without a solution. The ECB is doing all sorts of things which it would never have envisaged having to do but, with a predicament as desperate as it was and still is, all sorts of reservations have to be put aside. If we look back over the last quarter, we can say that what has provided stock markets with their recent positive tone has been its Long Term Refinancing Operations (LTRO). This is the ECB's own form of quantitative easing and involved the provision of three year money for eurozone banks at enticing rates of interest against a wider than usual range of collateral. The original amount lent was €489.191 billion and there were 523 bidders. The operation has just been repeated, with €529.53 billion lent to 800 institutions. Both these figures are gross. In combination with two reductions in the ECB interest rate, this has given a strong boost to sentiment and removed fears that eurozone banks will be unable to finance themselves in 2012. Some politicians hoped that banks would take the opportunity to increase their profitability and buy government debt by "round tripping", using the cheap funds available to buy higher yielding eurozone government debt. Certainly the yields on Italian and Spanish government bonds have fallen significantly from their peak, these two countries, because of their size (number three and four in the eurozone) being of critical importance. At the same time, the ECB has scaled back the buying of troubled eurozone members bonds which it had been undertaking to keep bond yields below, and the total amount purchased remains at just over €219 billion.

So, the credit for the better sentiment in markets so far this year must go to the ECB not obviously for resolving the eurozone's problems, because it cannot do that, but for temporarily removing fears about the eurozone's banking system. At the same time, it has become even clearer, if it was not already, that the central banks in the USA, UK, eurozone and Japan will be keeping monetary policy very loose for as far ahead as one can see. The combination of very low short term interest rates, high quality government bonds standing on very low yields and some appealing dividend yields in absolute and, particularly, relative terms, have highlighted the attractions of equities even against such a difficult economic background. As this is written, details of the Greek bailout have been agreed in principle but many parties have to agree to the terms and it remains to be seen if that happens.

Whilst the removal of a serious short term threat to the world economy, namely a collapse of the eurozone's banking system, has been averted, and we were always confident that the ECB would do what was necessary, this is what we might call a "negative positive". By this, we mean that a further negative threat to the market has been avoided for the time being and, in the current environment, the market has taken this positively. We should, of course, never have reached the position where investors were worrying about the solvency of the eurozone's banks.

More encouragingly, although it is too early to say that the trend is sustainable, some areas of the world have produced better than expected economic numbers, notably the USA. It is not quite clear why this has happened but the point which we have often made is that the problems faced in the eurozone and UK are not typical of everywhere. Parts of the world economy are performing well and investors in those areas and in companies in other areas with exposure to the better performing economies can benefit. Company earnings have held up well and the dividend experience has been good as a result of the strength of the balance sheets of non financial companies. Because equities are generally quite modestly rated, earnings and dividend reports have often had a positive effect on share prices.

In its latest World Economic Outlook, the IMF estimates that world output will advance by 3.3% this year, down from 3.8% in 2011. The divergence between advanced economies and emerging and developing economies remains as stark as ever. The IMF is forecasting that advanced economies will grow by just 1.2% in 2012 against 1.6% in 2011, whereas its current projection is for emerging and developing economies to grow by 5.4% this year against 6.2% last year. Emerging and developing economies are so important to the world economy, nearly 50% of GDP, that their superior growth, even if not at the level of 2011, should be sufficient to keep the world economy growing. Within the advanced economies, the IMF predicts that the eurozone will contract by 0.5% this year. It expects the eurozone's no. 3 and no. 4 economies, Italy and Spain, to decline by 2.2% and 1.7% respectively this year. The USA is forecast to grow by 1.8% this year, Japan by 1.7%, the UK by 0.6% and Canada by 1.7%.

The drivers of growth are, as for some time, to be found elsewhere in emerging and developing economies. Although a modest slowdown in economic growth in 2012 in China and India, compared with 2011, is expected, growth will be at levels of which the major industrialised countries can only dream. The current IMF projection is for China to grow by 8.2% this year and India by 7.0%. The ASEAN-5 countries, Indonesia, Malaysia, Philippines, Thailand and Vietnam, are projected to grow by 5.2%. The financial strength of many of these countries in Asia and elsewhere, in countries like Brazil, means that they can carry out pro growth policies of various degrees compared with the austerity measures being inflicted on some members of the eurozone. These countries' requirements for the industrialised countries' exports will provide some support to world growth, albeit at not the same rate as in previous years as their rate of growth cools off.

These are, of course, only forecasts, but the leaders and laggards are evident. In the results from those companies based in advanced economies, it is noticeable that those with international spread refer to the good results from their developing and emerging markets business whilst their businesses in developed markets are often more sluggish. For this reason, either by acquisition or organic growth, many international companies are consciously raising their profile in these faster growing economies. The combination of companies based in well established developed markets having a sound but perhaps slow growing business and exposure to faster growing but perhaps more risky markets is quite an attractive investment proposition.

As the latest IMF projections indicate and, as everyone knows, the eurozone is going to have a poor year because of its debt woes. But going back to the paragraph above, we would reiterate that companies based in areas like the eurozone can still perform well. There are many world class companies based there which can overcome their sluggish domestic markets. There are also others which have a particular niche which renders them largely immune from the travails of their home market or the eurozone in general. Many can be considered safer than the eurozone country in which they are domiciled. International companies, we know, have been making contingency plans to deal with a possible fragmentation of the eurozone and associated bank problems and will be well used to the kind of environment where there is financial instability in some of their markets.

Whilst sentiment is more positive at the moment on the eurozone crisis, even if the deal on a second Greek bailout is approved, it does not solve the eurozone's sovereign debt crisis. The medicine being administered to Greece, Portugal and Ireland, the countries which have received bail outs, and to others like Spain and Italy about which investors have serious doubts, not to mention France which is undertaking its own austerity programme, will create its own spiral of economic decline. Apart from Ireland, a special case because it was its banking system which brought down the country, all these countries have overspent. Whilst there is no doubt that control of public spending is essential, tax increases are a much less effective way to improve public finances and it is a combination of the two policies which are being used in the eurozone. What is missing is the growth ingredient. As far as possible, these countries need to grow their way out of trouble. Some of the measures being imposed on the bailout countries are supply side reforms which, although they are long term in nature, are essential to raise a country's long term growth potential. Supply side reforms free up labour and product markets, thus leading to circumstances where faster growth can eventually take place. Labour market rigidities in the eurozone protect those in work at the expense of those out of work and the levels of youth unemployment in a number of the troubled eurozone countries are a major social and economic issue. Similarly, in the product market for goods and services there are examples of closed professions like law, pharmacies, lorry drivers and taxis where those involved are fighting hard against attempts to open up their services to outsiders. This means a lack of competition and higher prices than would obtain if the barriers to entry were lifted. More money in firms or individuals' pockets as a result of lower prices would be expected to stimulate growth.

Whilst supply side reforms are highly desirable and very necessary, they will not work overnight, and there is nothing in any of the policies which are being forced on countries in difficulty that give any prospect of growing out of the crisis in their public finances.

Whatever happens in the eurozone, it is not going to be pleasant. The most effective way for countries, in the sort of difficulties found in the southern eurozone countries, to make themselves more competitive is to devalue so that, at a stroke, exports become cheaper and imports dearer. That is obviously not possible in a currency union and these countries are therefore being exposed to brutal internal devaluations involving, inter alia, big pay cuts. No one institution or country emerges well from the eurozone's sovereign debt crisis. Those instrumental in founding the euro should be called to account for proceeding in the face of warnings that monetary union was fundamentally flawed. Once the currency was up and running, the financial disciplines embodied in the Stability and Growth Pact were ignored by Germany and France when the deficit disciplines did not suit. Southern eurozone countries tempted by interest rates lower than would have been obtained had they retained their own currency, went on a spending spree and allowed their competitive position to deteriorate so that they started running large current account deficits.

Now, perhaps most astonishingly of all, even though most independent observers recognise the fundamental flaws in the currency union, those involved in it, whether they be politicians, bureaucrats or central bankers, do not admit to any fundamental problems with the euro. They argue about the way in which they can try to keep it together whereas the question should be whether it is worth trying to keep it together. It is as if it has never entered their thoughts that the problem is without solution as it currently exists. The nearest that anyone connected with the project has come to movement on the issue has been an acknowledgement that Greece might leave the euro.

As clients will know, we have, for a long time argued that the euro will fragment. We have mainly concentrated on the economic reasons but, as the austerity measures bite hard, people will take to the streets, as we have seen particularly in Greece but also elsewhere. We believe that social unrest will force governments to renege on their deficit pledges. Already, we are seeing pressure in Portugal and Spain on the authorities to allow them to go more slowly with their austerity programme.

The way in which the euro project will unravel or the timescale in unpredictable but it may just be political rather than economic events which are the catalyst. One such political event may be the forthcoming French Presidential election. Like many politicians in the west, the main contender to Mr Sarkozy, Mr Hollande, has tried to milk anti banker and business sentiment but, more relevant to the euro in the short term, is his stated intention, if he wins in the second round in May, to try to reopen discussions on the new European treaty which was agreed last December. Because the treaty would have to be ratified by the French parliament, it is not an idle threat. Should he win the election and, according to the opinion polls, he is currently the favourite, this opens up the possibility of a showdown with Germany, which would be opposed to any softening of the terms of the treaty which will oblige signatories to pass legislation on debt and deficit levels. It is no wonder that Angela Merkel has said that she will campaign for Mr Sarkozy. If Mr Hollande wins and tries to renegotiate the treaty's terms, there will have to be a loser, and one would not expect it to be Germany. The fault line will then be well and truly exposed.

The latest economic forecast from the European Commission has just been published and it now forecasts economic contraction of 0.3% in the eurozone in 2012 and a flat outcome for the EU as a whole. Not surprisingly, with the exception of Ireland which has different characteristics, the most troubled countries in the eurozone face a bleak year. At this stage of the year and with so many uncertainties, it is anyone's guess what the final outcome for 2012 will be but, for Greece, the EC currently expects an economic contraction of 4.4%, for Portugal 3.3%, for Spain 1.0% and, for Italy, 1.3%. Belgium, which also has issues, is forecast to contract slightly, by 0.1%. Ireland was brought down by its banking system, having previously enjoyed healthy public finances, but it is much more like the UK economy than the southern eurozone economies in terms of flexibility. It has a low corporation tax rate, something it has so far successfully protected from attempts by countries like Germany and France to change. Of the remaining totally AAA rated countries left in the eurozone, the EC forecasts that Germany, after growth of 3.0% in 2011, will show just 0.6% growth, Finland 0.8%, Luxembourg 0.7% but that the Netherlands will contract by 0.9%. In the short term, none of the measures imposed on the bailout countries or measures taken to improve their public finances by countries such as France, which is in an in between position having lost its AAA rating from Standard & Poors, will promote growth and the one which will help, devaluation through dropping out of the eurozone, is taboo. If the eurozone did fragment, the cost would be enormous, but keeping it together with sticking plaster, even though it will ultimately fall apart, we believe, will prove even costlier.

Over the other side of the Atlantic, things are looking up. Whilst unemployment is a serious problem in the eurozone, and getting worse, the news from the USA is improving, albeit that the absolute level of unemployment is still high. In January, 243,000 employees were added to non-farm payrolls, which lowered the unemployment rate to 8.3% from 8.5%. It is possible to detect signs that the housing market, in its various forms, is stabilising, so that it will cease to be such a drag on the economy in future. With housing construction having been at such a low level, any improvement in demand will eventually have an impact on prices or returns and start the upward cycle of housing activity. Housing starts increased by 1.5% in January. We are a long way from this state at present, but the situation appears to have stopped getting worse. In the short term, the U.S. economy may benefit from a compromise agreement reached by a congressional committee which will extend payroll tax cuts and unemployment benefits until the end of the year. It needs to be passed by Congress. These two issues were due to expire on the 1st March and, if extended, will provide some relief to the US economy, albeit that the USA's very serious debt problem will have to be addressed. Whilst all attention has been on the eurozone, the U.S. debt situation has moved into the background, but it cannot be ignored forever. We see from the latest IMF projections for 2012, detailed earlier in this review, that it expects the U.S. economy to grow by 1.8% this year. With the momentum which the U.S. economy seems to have at the moment, it might be that this estimate is conservative, with optimists hoping that the figure may be nearer 3%. However, it is very early in the year, and the world economic background so uncertain that it is better to be cautious at this stage.

Elsewhere, there have been some interesting developments in Japan in the field of monetary policy, where the Bank of Japan surprised analysts by announcing a new programme of quantitative easing. Although the economy had contracted in the fourth quarter of 2011 by 0.6% and by 0.9% for the full year, the announcement was a surprise, prompting some observers to believe that the move had been made because of political pressure, something the Governor of the Bank of Japan has strongly denied. The Bank of Japan is increasing its asset purchasing programme to JPY65 trillion (US$829 billion) from JPY55 trillion. It is focusing its buying on short dated bonds with maturities up to two years to keep down yields and discourage foreign inflows which could drive up the value of the yen and make life more difficult for manufacturing industry. It also strengthened its policy on inflation and now vows to hit a goal of a 1% change in the consumer price index for the time being. Despite its enormous wealth (after China it has the world's second largest foreign exchange reserves), Japan has the largest level of outstanding public debt in relation to GDP at over 200% at the gross level. Japan's trade position has deteriorated in the face of last March's earthquake and tsunami which has reduced substantially the proportion of electricity generated from nuclear power stations and therefore necessitated much higher imports of fossil fuels. In January, Japan ran a trade deficit for the first time since 1980 and, although it has substantial income from its foreign investments, there is a possibility that, in due course, it could run a current account deficit. In 2011, its current account surplus was at its lowest level in fifteen years, down 44% on the previous year. Given its very large budget deficit, it could end up as a capital importer in these circumstances.

So, Japan does have problems looming as a result of its very large stock of outstanding debt and possible permanent deterioration in its current account position. However, it does have the advantage of vast foreign exchange reserves and, as in the USA, its problems are seen as some way behind those of the eurozone.

China, of course, has growth rates of which the west can only dream and, to be realistic, apart from making up the slack in the short term caused by the recession in some of the eurozone countries, the eurozone could not grow at the rate of China and other Asian economies. However, China also has problems to face. There is the delicate balance which policymakers always have to keep between ensuring sufficient growth to provide jobs for those coming from rural areas and keeping inflation under control. If either of those variables go out of control, the authorities would always be concerned about social unrest. In recent times, food prices have been a problem as there have been significant double figure year on year percentage increases (14.8% at their peak last July) which have now eased back but are still high at 10.5%. For this reason, many areas of China have raised minimum wages sharply to maintain purchasing power. The consequence of this is that China is no longer as cheap a country in which to manufacture as in the past. This had led to production by some companies being switched to cheaper producers like Vietnam or to "reshoring" where multinationals bring manufacturing back to their home country. For its part, China, in order to maintain the growth in economic activity is trying to move up the value added chain where relative labour costs are less important. As we have seen earlier on in this review, the IMF is currently projecting growth in China of 8.2% this year but it does warn that, in the event of a sharp recession in Europe, Chinese growth, as a result of trade linkages could decline by as much as 4%. If that happened, the IMF said, there would be broad based consumer and asset price inflation. If that should happen, the IMF's recommended policy response is a fiscal package of about 3% of GDP, covering tax reduction, subsidies for big ticket consumer items, improving social services and increasing the country's social housing plan. China has some leeway but, hopefully, it will not be needed. At the IMF's projected rate of growth for China and some other fast growing emerging and developing nations, important help will be given to the troubled industrialised economies to avoid a world recession.

Whilst we are talking about Asia, a word about Indonesia, one of the world's most populous nations which is attracting more attention and investment recommendations as its economy thrives. Full year growth for 2011 has been reported at 6.5% which is the country's strongest growth rate since 1996.

For the UK, there are just the faintest reasons for more optimism. Before we look forward we should look back to the fourth quarter of 2011 when it has been confirmed that the economy contracted by 0.2%. We all know the bad news about the UK economy, but what is there in the data which can given even modest grounds for optimism? The purchasing managers index for the services sector rose from 54 in December to 56 in January. Given that any reading over 50 indicates growth and that the services sector is dominant in the economy, accounting for about three quarters of it, the reading gives grounds for mild optimism. Such sections relating to companies' expectations, employment and new business were better. The purchasing managers index for manufacturing rose from 49.7 in December to 52.1 in January, again indicating that the economy was growing. For the first time in seven months, new orders were reported as growing. Against that, there was a decline in the purchasing managers index for the construction sector from 53.2 in December to 51.4 in January. Overall, however, the message from the various purchasing managers indices was positive. The ONS reported that manufacturing output rose by 1.0% in December following a 0.7% fall in November. Industrial production increased by 0.5%. As expected, inflation is starting to fall as January 2011's increase in VAT from 17.5% to 20.0% drops out of the figures. January's Consumer Price Index fell from 4.2% year on year to 3.6% whilst the Retail Price Index measurement fell from 4.8% to 3.9%.

There was also what many independent observers consider to be quite an optimistic forecast by the Governor of the Bank of England at the Bank's inflation briefing. Whilst the central projection for inflation is to be just below the 2% target by the end of 2012 and not much below that at the end of 2013, its central projection for GDP growth by the end of 2013 was 3% year on year. The importance of the decline in the rate of increase in price levels is that, at a time when earnings are squeezed, it takes some pressure off disposable incomes and hence a depressing influence on economic activity. There is also a feeling amongst some commentators that the Bank of England may be building into its forecast the perceived positive effect of the latest £50 billion of quantitative easing which takes the total figure to £325 billion, approximately 30% of outstanding gilts in issue. The latest Institute of Directors' survey was moderately optimistic, notwithstanding all the usual caveats. 50% of companies expect higher revenues than in 2011 compared with 27% expecting lower revenues. A balance of 40% to 32% expect higher rather than lower profits this year. This can change, of course, but, given the current economic circumstances, we do not think that this is a bad result at this stage of the year. There is also, at the moment, some good news on public finances, although monthly figures are notoriously variable. January's public sector net surplus was £7.8 billion, against £5.2 billion a year earlier, and it is quite possible that the forecast for the financial year just about to end, of £127 billion, will be beaten. With Moody's having put the UK's credit rating on negative watch for a possible downgrade, the UK cannot be seen to be significantly deviating from its structural deficit elimination target, even though it has slipped by two years. The idea that the UK can somehow spend more now to borrow less later on looks completely fanciful and it ignores the market. Almost certainly, investors would take very unkindly to any backsliding. Partly as a result of quantitative easing, the UK can borrow at extraordinarily low rates of interest but this is also a possibility because the UK's deficit cutting programme has credibility. If UK interest rates started rising, even though the UK's debt maturity profile is favourable, the effects on public finances later on would be bad.

Turning to other factors which could affect markets, Iran and the oil price, closely but not totally connected, are the obvious ones. The situation with Iran and its nuclear capacity is clearly very serious. Even though the world economy is subdued overall, largely because of the eurozone crisis, demand for oil is rising because of rapid growth in Asia. Were Iran to block the Strait of Hormuz or, worse still, Iran attack another country or be attacked, oil would obviously rise in price. It is an unpredictable situation. As it is, the rise in the oil price, if it continues, will provide some economic headwinds. These, then, are two further concerns for investors besides the eurozone.

However, investors cannot make their dispositions assuming that war is round the corner. We have to deal with the world as it probably will be. Our stance remains unchanged, namely that equities remain the asset class with most attractions. Our reasoning is this. Monetary policy is likely to remain accommodative, both from an orthodox point of view, i.e. very low interest rates, and from an unorthodox point of view, i.e. quantitative easing. Both these aspects of monetary policy are extreme but will serve as some offset to severe fiscal policies being implemented in some eurozone economies and the UK. Money printing on this scale, once money starts to circulate around the system, threatens inflation later on and it will have to be taken back at some stage. Whilst cheap and plentiful money has driven down bond yields, the latter are artificially low and. when they revert to more normal levels, some serious capital losses, realised or unrealised, will be seen. Meanwhile, the strength of many non financial companies' balance sheets means that dividend levels are unlikely to be threatened and, with the prospect of dividend growth, the relative attractions of equities against bonds are strong. Unless profits collapse, share ratings are reasonable. Besides direct exposure to the fast growing economies of the world, investors can take exposure through companies in industrialised countries which have a significant exposure to these markets. We think the economic situation in the eurozone remains very serious, and we expect to witness the partial, or total, fragmentation of the monetary union at some stage which will cause immense disruption. Companies may be better placed to deal with this than governments because they are used to managing their currency exposure and we know that they have been making plans. Notwithstanding low volatility so far this year, there are bound to be bouts of volatility as the news worsens but, having exposure to internationally diversified businesses, is, we think, the best way to play this very complex economic and financial situation.