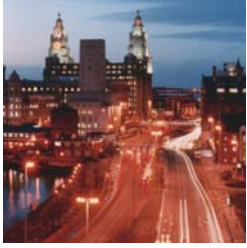




Market Review



JULY 2006

Goldilocks..... A Happy Ending?

In recent years, global business conditions have often been described as a "Goldilocks" economy. As in the nursery story, the porridge is neither "too hot" nor "too cold", the chair neither "too high" nor "too low", the bed neither "too hard" nor "too soft"- but "just right". As our April Review went to press, we suggested that the market's view of things was rather "too hot" and anticipated some "cooling". Since then, Three Bears have duly appeared on the scene, called "Rising Inflation", "Decelerating Growth" and "Slowing Corporate Earnings" and (for the moment) Goldilocks has run for her life. From a high-point in late April of 6137 the FTSE100 had fallen 11% to 5467 in mid-June. These "Three Bears" need some investigation.

RISING INFLATION-Clearly commodity prices (oil, gas, minerals) had risen spectacularly over recent years - driven by demand in emerging markets, and yet as markets fell in April and May, Gold itself (usually deemed inflation-proof) fell 26%, while bond yields (likely victims of inflation) rose only marginally. This is curious since US rates have now risen to 5.25%, Euro-rates have risen to 2.75% and UK rates may soon rise to 4.75%. Over the last year, oil has risen 26%, yet in the PREVIOUS 12 months it had risen 63%. The time to worry about inflation therefore was in mid 2005.

DECELERATING GROWTH-Despite widespread fears, China's GDP rose 10% (annualised) in the first quarter. European business confidence is at a five-year high (although ACTUAL growth has still to be delivered - and that in a year in which German VAT rates will rise from 16% to 19%) and in the US growth IS slowing (but that is *precisely* what the Fed. is seeking to achieve).

SLOWING CORPORATE EARNINGS-Recent history flatly contradicts this. At the FTSE low-point, the net dividend yield was 3.5% (the highest for three years), dividend-cover was 2.5 times (the highest for seven years) and the price/earnings ratio was 12 times (the lowest for more than a decade). Not only do earnings continue to grow in general terms, but there is no hint of any broad reversal in any of the analysts' forecasts.

So, what is fact and what is fiction? As markets got ahead of themselves, as the FEAR of rising interest rates took hold, many traders, hedge funds and speculators simply took their bets off the table. Demand for unit-funds and OEICs fell dramatically from the first quarter, while appetite for equities declined to the point where new issue prices (as with Standard Life) were reduced by 10% or so. That is the fact.

Another positive factor back in the first quarter was a steady stream of mergers and acquisitions. Some of these deals, such as BAA, Pilkington, and AB Ports are coming to fruition, and the cash from these sales will boost liquidity. After the lull, M&A is coming back onto the agenda, with a bid for EMI, and talk of bids for Morrisons, DX Services and others. At the same time the return of capital to shareholders continues (including £9bn from Vodafone, and £700m from 3i Group). The fiction is that liquidity has dried up.

All in all, we believe that the Three Bears are less fierce than they seem, and that Goldilocks can come back to the cottage in peace. The market could still reach 6500 but perhaps somewhat later than the year-end (as we originally thought)- which (in our book) WOULD be a Happy Ending.

Three Month Performance

	31/3/06	30/6/06	Change
FTSE 100	5964.6	5833.40	-2.2%
FT All-Share	3047.96	2967.58	-2.6%
US Dow Jones	11109	11150	+0.4%
Nasdaq Comp	2339.79	2172.09	-7.2%
FTSE Eurotop 300	1370.43	1313.62	-4.1%
Japan Nikkei	17060	15505	-9.1%
APCIMS Growth	3289.3	3165.85	-3.8%
APCIMS Balanced	2887.37	2787.80	-3.4%
APCIMS Income	2265.39	2203.91	-2.7%
£/\$	\$1.7558	\$1.8475	+5.2%
Euro/£	€1.434	€1.4443	+0.7%
Gold (per ounce)	\$583.2	\$612.60	+5.0%

IN THIS ISSUE:-

- Page 2 **Stock selections**
- Page 3 **Recommended Sales**
- Page 4 **Standard Life IPO
BRIC - new investment frontier?**

Stock Selections

(as at close of business 5th July 2006)

Associated British Foods

Price 793p Yield 2.4% PE 14.96
Mkt.Cap. £6424m High/Low 881p/700p

AB Foods is Europe's fifth-largest food producer, with brands like Twinings, Ovaltine, Mazola cooking oil and Silver Spoon sugar. It also owns discount fashion retailer Primark, which now accounts for nearly a quarter of group profit.

Profits growth has stagnated over the last couple of years, mainly as its sizeable British Sugar business struggled to improve returns in a market defined largely by EU quotas and price controls. Prospects are improving – the EU is set to open up its markets to LDC's (Least Developed Countries) from 2009. AB Foods has just made a £317m purchase of a 51% stake in Illovo, the largest sugar cane producer in Africa, and one of the world's lowest cost producers. It has also invested heavily in Primark, buying several former Littlewoods and Allders stores. Primark's operating profit grew by 30% last year.

The recent correction leaves the shares offering value.

HBOS

Price 949p Yield 3.8% PE 11.67
Mkt.Cap. £36003m High/Low 1062p/822p

HBOS was formed from the merger of Halifax and Bank of Scotland in 2001. With assets of £540bn and 22 million customers, it is the UK's largest mortgage and savings provider. It is also a major player in the provision of current accounts and credit cards in the UK.

HBOS recently stated that it is on track to deliver 7% earnings growth this year after a firm start to the year and a recovery in its share of mortgage lending. To say at the halfway stage, that they are comfortable with consensus forecasts for the full year, suggests the first half performance is at the very least in-line with expectations.

The share price has come back about 13% from the February high, leaving the shares at an undeserved discount to the European Bank sector.

Royal Dutch Shell

Price 1904p Yield 3.5% PE 8.66
Mkt.Cap. £122244m High/Low 2043p/1727p

The share price of oil major Royal Dutch has moved sideways for the last 12 months, despite further gains for the crude oil price, and another record profit for the company. This is at least partly due to disappointment that it had to cut its proven oil reserves in 2004, and then again in 2005, to fall in line with US SEC requirements. It was also operationally impacted by Hurricane Katrina and ongoing problems in Nigeria.

The unification last year of the Dutch and English parts of the business was a positive move because it put in place a unified board and clear reporting lines to the Chief Executive.

The group aims to get its Reserve Replacement Ratio to 100% for the 2004 – 2008 period. To that end, it has a massive capital expenditure program, but, at the same time, is still able to return £5bn in share buy-backs during 2006.

Carnival

Price 2241p Yield 2.1% PE 14.37
Mkt.Cap. £4763m High/Low 3397p/2027p

Carnival owns and operates 77 cruise ships under brand names which include Carnival, Princess, Cunard, P&O Princess Cruises, Swan Hellenic, and Ocean Village.

Carnival has had a turbulent year, struggling with higher fuel costs and slower business in the Caribbean, as well as a fire aboard one of its Princess cruise ships which led to cancellations and unexpected repair costs. The group reported a slight fall in second quarter profits to \$380m, from \$388m a year earlier. At the same time it announced a new \$1bn share buy-back and said it was seeing a rebound in Caribbean bookings, after a round of price cuts to lure in customers. Full year forecasts have been maintained.

Since the start of the year the share price has fallen over 40%. This is an overreaction in our opinion because the fundamentals of the business remain strong, and Carnival is the market leader.

Tomkins

Price 284p Yield 4.7% PE 11.92
Mkt.Cap. £2429m High/Low 344p/260p

International manufacturer Tomkins is involved in the making of, amongst other things, transmission belts, valve products, and air conditioning components.

We recommended taking some profits in our January review at 314p. Since then the share price has fallen as low as 260p, before bouncing. On 3rd May Tomkins reported first quarter profit of £77m compared to £68.7m a year earlier. This is an impressive performance given the background – weaker global automotive production, higher energy costs, and a falling dollar (about 70% of sales are in the US). Tomkins said the overall outlook for its markets was favourable.

Its shares trade on a discount to the sector which is unjustified, and the correction in the price has run its course.

Hanson

Price 659p Yield 3.1% PE 12.51
Mkt.Cap. £4715m High/Low 785p/527p

Hanson supplies building materials to the construction industry worldwide - it is the world's largest supplier of sand and gravel. The US is its biggest market, accounting for nearly half of group sales.

At the end of June Hanson said it expected first half operating profit to be up 10%, and it expected to make further progress in the second half. It is eyeing price increases to absorb higher energy costs, and expects its main profits growth driver, its 2 US divisions, to continue to perform strongly through the year-end. It completed or agreed 11 acquisitions in 2006 for a total of £515m.

With a strong asset base and market positions, continued investment in acquisitions, backed by a robust balance sheet, the shares do not look expensive here, 20% below the March peak. There is also the chance of bid interest.

We recommend reducing holdings of the following ...

Tate & Lyle

Price 625p Yield 3.1% PE N/A
Mkt.Cap. £3130m High/Low 641p/530p

At the end of May the group posted a higher than expected 16% rise in annual profit. Profits were driven by products such as its super sweetener Splenda sucralose which helped offset falling earnings in Europe due to the reforms of the EU sugar regime, in which support prices are being cut. There have been problems for the company including higher fuel costs, and replications of its patent-protected sucralose imported into the US. It has launched a vigorous legal defence in the US courts, believing its patents to be watertight.

We recommended Tate & Lyle as a buy in our October 'Market Review' at 458p but feel the price is now up with events and some top-slicing is justified.



Diageo

Price 912p Yield 3.2% PE 18.74
Mkt.Cap. £25687m High/Low 935p/774p

Diageo is the world's biggest alcoholic drinks group, operating in 180 countries, and its brands include Guinness, Smirnoff, Johnnie Walker and Baileys.

Diageo expects to beat its target for sales growth this year, but only match expectations for profit. It is having to spend more on marketing, partly to offset difficulties in Europe. Increased regulation, and a trend amongst younger drinkers away from Scotch whisky towards rum, are expected to lead to a net 1% fall in sales in the region.

Overall the performance of the business is solid but not spectacular. With the share price close to a record level, and at a premium to the sector and the market, it is time to reduce exposure.

EMI

Price 303p Yield 2.6% PE 19.26
Mkt.Cap. £2399m High/Low 308p/207p

EMI had a difficult 2005, mainly due to the delayed release of albums from Coldplay and Gorillaz. There is also some concern about its ability to capitalise on digital music sales. We recommended EMI in April last year at 243p, believing that it was poised for strong growth on a forward basis. This was beginning to be borne out by May's full year results, which showed a 12% increase in profit.

Encouraged by better prospects the management resurrected the long talked about tie-up with Warner Music, tabling a \$4.2bn takeover bid. There is logic in the deal. A combined EMI-Warner would be able to compete with the top two in the industry, Universal Music and Sony-BMG. Warner's response has been to counter-bid for EMI, offering 320p per share. EMI is now valued at about a 25% to 30% premium to the consensus measurement of fair value.



Standard Life prices IPO at 230p

(first day trading 242p)

Standard Life priced its initial public offer (IPO) at 230p a share, in the lower half of its indicated range. This price puts a value on Standard Life of about £4.7bn. making it eligible for inclusion in the FTSE 100 index.

It said there was significant oversubscription in the institutional and preferential offers. Investors who were involved in the preferential offer will receive shares at 218.5p, a 5% discount, and will also receive a bonus issue of one share for every 20 shares held continuously for a full year after flotation.

At 230p per share, Standard Life will be listing at roughly 0.93 times its embedded value (EV) – an industry measure that values how much a life insurer is worth to shareholders – which is a discount to its rivals. Among its closest peers, former mutual Friends Provident is trading at 1.2-1.4 times EV, while Legal & General, which shares its UK focus, trades at around 1.1-1.15 times.

Standard Life will pay its first dividend of 5.4p in May 2007. This is half of what the full dividend would have been had it been listed for the full year. This equates to a yield of 4.7% at a price of 230p. The life insurance sector historic yield is 3.5%.

The yield is attractive, and given the recent activity in the sector it is not inconceivable that there may be some bid interest in Standard Life. At, say, 1.25 times EV, Standard Life's share price would be 308p, suggesting its shares will offer value at 250p or lower.

BRIC - Extending investment frontiers

Brazil, Russia, India & China are the top four emerging growth economies - they stand out due to the substantial gap in terms of population between the fourth and fifth ranked countries. During the last five years these four countries have accounted for 25% of global economic growth. Each of the four is predicted to emerge as major world players by 2050.

Brazil is regarded as the "commodity warehouse", Russia the "energy store", India the "services centre" and China the "production plant". As a result not only does each country have its strength and weaknesses but the four complement each other.

These countries all benefit from having populations with average ages well below the global average and rapidly rising rates of consumption, whilst also tending to be low cost producers either of goods or services.

Emerging markets were hit hard during the May sell-off, including those of each of the BRIC countries – at one point the Indian Sensex index was down 30% from its 11th May peak. The legacy of the 'shake-out' is that a good deal of the speculative froth has been removed and there is now some value to be had in these markets, i.e. it is a good time to buy.

We would recommend the **Allianz RCM BRIC Stars Fund**. This unit trust aims to invest an equal proportion in each of the four countries, re-balancing once every 12 months, on the fund's anniversary.

**For more information on all of our services please go to our revised website at
www.blankstonesington.co.uk**

Blankstone Sington Limited is committed to producing high quality research that is informative and helpful to our clients. The size of our business means that analysts work closely with the Investment Department directors and therefore we cannot meet the standard required by the FSA Conduct of Business rule 7.16 for the production of impartial investment research.

This document is for private circulation and the information contained herein is believed to be correct, but cannot be guaranteed. Opinions constitute our judgement as of this date and are subject to change. The Company directors, employees and clients may have a position or engage in transactions in any of the securities mentioned. Past performance is not necessarily a guide to future performance. The value of investments and the income derived from them may fall as well as rise. This document is not intended as a personal offer or solicitation to buy or sell securities, and as such the investment and related investment services referred to may not be suitable for all investors. We therefore strongly recommend you consult your professional adviser before taking any action. If any of the above advice refers to the impact of taxation, it must be remembered that the levels and bases of taxation can change.

MAKING INVESTMENT SIMPLE



Blankstone Sington
stockbrokers • investment managers

91 Duke Street, Liverpool L1 5AA
Telephone: 0151-707 1707
Facsimile: 0151-707 1247

www.blankstonesington.co.uk

Blankstone Sington Limited
Registered Office as above
Registered in England No. 2378144