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Market Review






JULY 2008

MIDSUMMER MURDER?

In recent weeks global equity markets have retreated savagely in the face of the twin threats of rising inflation and likely stagnation as banking finance dries up. Despite the rally anticipated in our April edition (which in FTSE-100 terms developed into a 1000 point rise to around 6400), the focus now is on anticipated interest rate rises to counteract oil at $140 and a recent doubling of grain prices, AND on a consequent down-turn in construction and industrial activity in the developed world, leading to rising unemployment and repossessed homes. The FTSE at 5380, the Dow-Jones at 11250 and the FTSE Eurotop-300 at 1150 are all more than 20% below the best levels of last October, (usually the classic measure of the onset of a bear market), even worse is the 50% fall in Shanghai over the same period. Many investors are now overweight in cash in the face of continued weakness in commercial property, and the risk to conventional bonds posed by rising inflation. So how will the second half of 2008 shape up? Housing finance in the UK is still in poor condition with mortgage lending at levels some fifty to sixty per cent below last year's, and this in the face of major balance-sheet restructuring in the banking sector. Write-downs have been dramatic, rights issues and placings (some with sovereign wealth funds) have been significant, employment levels remain healthy and actual repossession rates remain subdued. In the US, the UK and in Europe the dramatic rise in food and fuel bills has already crowded out discretionary retail spending, so any interest rate rises would amount to overkill. OFFICIAL rates may have remained largely unchanged for many months, but ACTUAL rates are trading at significantly higher levels. In the UK, OFFICIAL rates may be 5%,but ACTUAL rates are 5.95% - actually higher than when OFFICIAL rates were at 5.75%, BEFORE monetary conditions were supposedly eased. Wage settlements in the UK should remain subdued since government finances cannot afford generosity in the public sector, whilst the private sector is facing other cost increases across the board. It now seems that the credit-crunch is moving from the banking sector to the wider economy, yet even now there may be some grounds for optimism. The rise in food and fuel costs (although savage) may turn out to be a "one-off" event. If you believe the global recession scenario, then commodity prices will fall as demand declines. If you believe in steady global growth, then equities are already fundamentally cheap and will soon begin to absorb the cash-piles. The US which was loudly proclaimed to be in recession earlier this year, has STILL not produced any evidence of such negative growth,($150 bn in tax refunds will have helped).

In the UK the danger is that we talk ourselves into the very down-turn that we fear, with banks failing to support commercial activity in a sensible manner. Understandably many investors seeking low-risk returns are taking up one-year deposits yielding 7% gross (5.6% net to a basic rate tax payer). Yet such has been the fall in the FTSE 100 that a portfolio of defensive 'blue chip' stocks can be constructed, yielding this much or more. At such levels equities look heavily oversold and should be acquired by the courageous.

Three Month Performance

	31/03/08	31/12/07	Change
FTSE 100	5572.6	5702.1	-2.3%
FT All Share	2855.69	2927.05	-2.4%
US Dow Jones	11350.01	12262.89	-7.4%
Nasdaq Comp	2292.98	2279.1	+0.6%
FTSE Eurotop 300	1201.36	1262.14	-4.8%
Japan Nikkei	13481.38	12525.54	+10.5%
APCIMS Growth	3109.64	3186.98	-2.4%
APCIMS Balanced	2726.73	2801.75	-2.7%
APCIMS Income	2128.11	2195.92	-3.1%
£/$	$1.9927	$1.9828	+0.5%
Euro/£	€1.2640	€1.2579	+0.5%
Gold (per ounce)	$926.07	$918.60	+0.8%
Brent Oil	$140.24	$105.98	+32.3%

IN THIS ISSUE:-

Stock Selections (prices as at 11.07.2008)

Given the current market uncertainty we highlight some more 'defensive' choices

BT Group

Sector – Fixed Line Telecommunications

Price 206p Yield 7.7% PE 9.6

Mkt.Cap. £15.81bn High/Low 336.75p/194.70p

BT's traditional revenue source – local and long distance telephone calls – is in gradual decline. This has been offset, however, by growth provided by its 'new wave' businesses (broadband network solutions and web hosting, network ADSL, ISDN and IP services, and broadband internet access). For the year ending 31 March 2008 new wave revenue represented some 40% of the group total (BT has about 35% of the UK's 12 million broadband subscribers).

After the turmoil of the 'dotcom' bubble, around the start of the decade, BT has settled into a more stable and consistent business. It is hugely cash generative with a strong balance sheet, and able to comfortably pay a dividend which gives its shares a yield of over 7%. The share price almost touched 340p in mid-2007, the best level since 2001. After a 40% correction, the shares offer value.

Unilever

Sector – Food Products

Price 1389p Yield 3.7% PE 13.1

Mkt.Cap. £17.95bn High/Low 1947p/1385p

Unilever manufactures branded and packaged consumer goods, including food, detergents, fragrances, home and personal care products. Its famous brands include Knorr, Hellmans, Comfort, Dove, and Cif.

Sales growth all but disappeared during the early part of the decade as food and personal goods retailers squeezed suppliers very hard. Supermarket groups in particular were experiencing deflation, and forced their suppliers to take much of the pain. Unilever responded by promoting its strongest brands, innovating with new products, and cutting costs. The strategy was successful and sales growth has gradually returned, accelerating recently helped by inflation. Announcing first quarter results this year, it said it expected underlying sales growth for the full year to exceed its 3%-5% target range.

RSA Insurance

Sector – Non-life Assurance

Price 122.3p Yield 5.7% PE 6.3

Mkt.Cap. £4.05bn High/Low 159.9p/116.2p

RSA is a multinational insurance group which writes all major classes of general and life assurance. It has operations in over 50 countries. The group's main brand in the UK is MORETH>N.

The group under-performed during the first half of the decade due to a costly and protracted exit form the US, and the extraordinary payouts associated with the UK floods of 2006. Now modest growth in the UK (38% of net written premiums) is being supplemented by strong growth in overseas sales. For the first quarter of 2008 RSA reported International (52% of group total) net written premiums rose 24% to £893m, and Emerging Markets (10%) rose 23% to £163m. Management said its financial position remained healthy and it was confident of achieving a strong result in 2008.

The shares trade on a low rating and are set to out-perform the market.

Firstgroup

Sector – Travel & Tourism

Price 544.5p Yield 3.1% PE 19.7

Mkt.Cap. £2.62bn High/Low 824.5p/487.5p

Firstgroup is Britain's largest bus operator running more than one in five of all local bus services. In addition it is also one of the largest UK rail operators, operating nearly one-sixth of the UK passenger rail network. It's US divisions account for about a quarter of group profit and include Laidlaw (yellow school bus and Greyhound coaches) which it bought for £1.9bn in October 2007.

In May the group announced record results across all divisions, and that it expected Laidlaw to generate $150m of savings from April 2009, up from $100m originally forecast. It is being forced to put prices up to combat the high oil price and it is only partially hedged going forward. The plus side of the energy equation is that passenger numbers for bus and train are growing strongly, as travellers switch from using cars to lower cost forms of transport.

Centrica

Sector – Gas, Water & Multi-utilities

Price 295.5p Yield 4.4% PE 8.4

Mkt.Cap. £10.96bn High/Low 397.5p/281.75p

Centrica was created from the demerger of the former state owned British Gas. Through various subsidiaries it provides gas and energy related products and services to residential and business customers throughout Great Britain.

British Gas supplies gas and/or electricity to nearly 16m customers, but It does not produce enough gas and electricity to meet this demand itself, so has to make up the balance by buying in the wholesale market. The problem for Centrica is that when oil and gas prices are rising rapidly, as they have been over the last 9 months, it is not able to pass on these increased costs to customers as swiftly as it needs to. This factor has led Centrica to warn that interim profit is going to be materially lower than it was last year. A 25% fall in the share price over the last 6 months has priced this in Oil and gas prices should ease as economic growth slows.

Lloyds TSB

Sector – Banks

Price 293p Yield 12.3% PE 5.0

Mkt.Cap. £16.66bn High/Low 585.25p/282.25p

Lloyds TSB is Britain's biggest provider of current account and personal loans through 2,500 branches. It also has an international operation with 500 offices in 24 countries.

Banks' share prices have fallen heavily during the last 12 months, as most have made huge write-offs relating to the credit crunch. Lloyds took a £280m charge from the global liquidity crisis at the end of 2007, but this was in sharp contrast to most of its global peers who have been more exposed to the crisis. Lloyds failure to expand more rapidly, and be more aggressive in its investment banking, now stand it in good stead. Despite this, its share price has suffered in line with its peers – the shares trade on 5 times last year's earnings and yield 12%. Lloyds is expected to at least maintain the dividend going forward.

Mining Stocks – has the 'bubble' burst ?

This is boom time for miners, but it is unlikely to get any better. Profits are at record levels thanks to a huge rise in metal prices, but there are signs that the run is coming to an end.

Background

Commodities have been in a strong bull run since 2002 with the prices of copper, lead and other base metals rising by between 100% and 300%. Gold has risen from $250 per ounce in 2001 to over $900 today. Other precious metal prices have done likewise. For commodity prices in general the first half of 2008 produced the best first half gain for 35 years (the CRB index of 19 commodities was up 29%). This is the typical price acceleration normally associated with the climax of a 'classic commodity bubble'.

The Mining sector index has risen 6x since 2003

What has driven prices higher?

A combination of factors including growing demand for metals from newly industrialising countries such as China, India and Brazil, investment and speculation, and a weak dollar.

China in particular has seen an explosion of demand for metals and minerals driven by rapid urbanisation, infrastructure build and economic growth of 10% per annum.

Investment in commodity indices through various types of funds has ballooned to $235bn by the end of the first quarter of 2008, compared to just $70bn at the start of 2006. This goes hand-in-hand with a big jump in trading volumes of commodities on all relevant exchanges.

Lastly, most metals are priced and traded globally in US dollars. Over the last 5 years the dollar has fallen by over 20% - an important catalyst for price inflation in metals.

End of the bull market ?

There are a number of factors which we believe signal the end of the bull market in mining stocks. Demand for metals is starting to level-off, or in some cases decline, as global economic growth slows and buyers are put off by high prices. At the same time supply of some metals is starting to rise as new mines inspired by the high prices, come on stream (the International Copper Study Group is forecasting a supply surplus this year and next, for example). The change in the supply demand balance is already affecting prices – zinc for instance is currently priced at approximately $1800 per tonne, compared to a peak of over $4500 at the end of 2006. Also, the rate of investment into commodity funds has slowed markedly – second-quarter net inflows into European exchange-traded products linked to commodities fell 58% to $800m form the previous quarter.

The $160bn hostile takeover bid by BHP Billiton for Rio Tinto is the sort of mega deal that often occurs during the final stages of a major bull market.

Our View

Investors should look to take profits on holdings of mining stocks such as Rio Tinto, BHP Billiton, Anglo American, Antofagasta, and Vedanta.

Rio's share price has risen sevenfold in 5 years

Anglo's price looks to be topping-out

'Bear' product on mining stocks

We are currently in discussion with the structured product divisions of several major banks, on creating a product which would allow investors to benefit from falling prices in the mining sector, but providing some level of capital protection. Please contact your account representative for further details

INHERITANCE TAX – TRANSFER OF NIL RATE BAND

In his 2007 Pre-Budget Report the Chancellor announced that it will be possible for the unused inheritance tax nil rate band on a person's death to be transferred to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007.

The amount of the nil rate band available for transfer will be based on the proportion of the nil rate band that was unused on the first death. For example if 40% of the nil rate band was unused on the first death then the amount transferable will be 40% of the nil rate band at the time of the second death.

In order to make a claim it is necessary to complete a claim form and to provide HM Revenue & Customs (HMRC) with information about the estate of the first spouse to die to prove that the relief is due, including

- **THE DEATH CERTIFICATE**
- **THE MARRIAGE CERTIFICATE**
- **A COPY OF THE GRANT OF PROBATE**
- **A COPY OF THE WILL, IF APPLICABLE**
- **ANY DEED OF VARIATION**

The first death can have occurred at any time so it may be difficult to find the information but HMRC have commented that it is generally possible to obtain duplicates of the documents required.

They have a certain amount of discretion although it is unlikely to be exercised where the first death occurred after the announcement of the relief. It would now be sensible, when administering an estate, to assemble all the information that will be required on the death of the surviving spouse and keep it with their Will.

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

www.blankstonesington.co.uk

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Registered Office as above
Registered in England No. 2378144
FSA No. 143694