



Lexington

Wealth Management Limited



Lexington Times -Summer edition no. 3

Market Update

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It's almost a year since the stock markets suffered a major setback arising from the failure of two US hedge funds and the credit crunch and over the last year things have got worse.

They will get better, but we don't have a crystal ball to tell us when. However we do have a rear view mirror so let's briefly look at what has happened over the last year.

July and August 2007 signalled the start of a very uncertain time for investment markets around the world. Markets fell for a few months before bottoming out around September then recovering to a new high by November.

On the 29th June 2007 the FTSE 100 stood at 6607 and it has fallen since to 5625 by the 30th June 2008 representing a fall of almost 15%.

The media are painting a grim picture of the economy and we are reading about the similarities of the 1970's. We are not saying that the current situation is, or will be, a repeat of the hyper inflation of the 1970's, we don't have a crystal ball, but if things do get that bleak investors should still hold their nerve and stick with their long term investment strategies.

Research has proved to us that market timing does not work. This is partly because there is no reliable economical indicator that allows us, or anyone else, to predict the future. There are some respected fund managers forecasting very tough times ahead, yet there are others, equally respected fund managers calling this as an ideal buying opportunity – nobody knows.

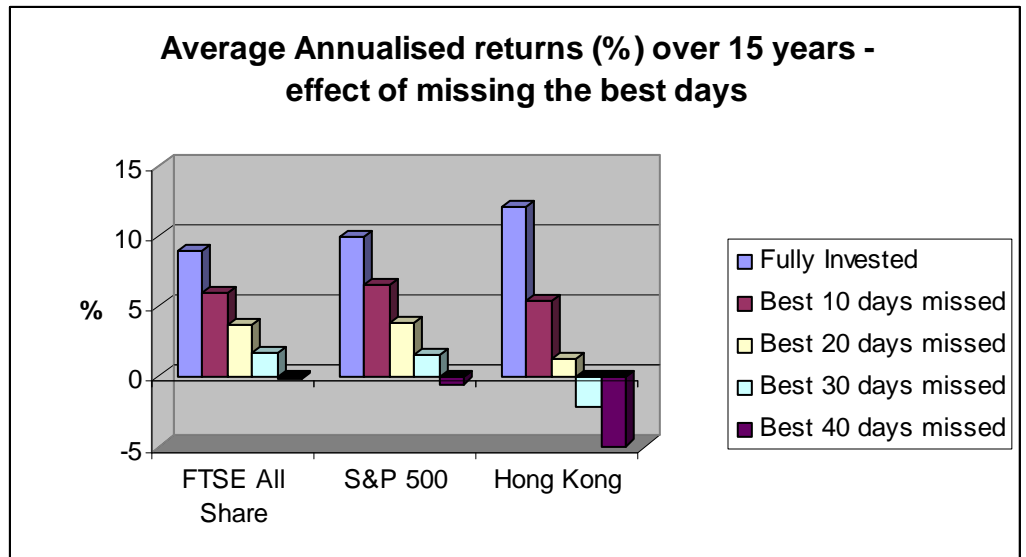
We do know from research that returns are highly concentrated in a very small number of days. Missing out on the good days can do as much harm to a portfolio's long term returns as avoiding the bad days. In fact over the last 15 years, missing just the best 10 days out of almost 5,500 days would have reduced the returns in both the UK and US markets by around a third and even more in other markets.

'July & August 2007 signalled the start of a very uncertain time for investment markets around the world.'

Market update

A stake of £1,000 invested in the UK stock market 15 years ago and left untouched would today be worth £3,261, assuming you reinvested the dividends. If you had missed the ten best days in the market since June 1993, then the stake would be worth a great deal less - £2,147. Strip out the best 40 days and that portfolio would have a value of only £885.

'Strip out the best 40 days and that portfolio would have a value of only £885'



	FTSE All Share (%)	S&P 500 (%)	Hong Kong (%)
Stayed Fully invested	8.89	9.88	12.02
Best 10 days missed	5.9	6.45	5.31
Best 20 days missed	3.62	3.8	1.25
Best 30 days missed	1.64	1.47	-2.1
Best 40 days missed	-0.17	-0.55	-4.94

'.. the only sensible strategy is to stay invested for the long term..'

Therefore the only sensible strategy is to stay invested for the long term and take a disciplined approach to rebalancing your portfolio. You must be in the market to benefit from the recovery which is often swift AND unexpected.

We must stress that we are not suggesting the current situation is a repeat of the 1970's but it may be helpful to use the 1973-75 bear market to illustrate a basic principle.

For illustrative purpose we will assume a very simple portfolio of 60% FTSE All Share and 40% 1 month T-Bills (Cash) and for the sake of simplicity we will assume a portfolio of £100,000.

Market update

Imagine you invest £100,000 on the 1st January 1973. £60,000 FTSE All Share and £40,000 Cash. You invest with some optimism and hope for a good return over the coming year.

It Transpires that 1973 is a terrible year for investment markets and your equity portfolio loses almost 29%, the good news your cash returns over 9%, at the annual review on 31st December 1973 your portfolio has fallen in value to £86,582, a loss of 13.4%.

As a result of the loss from equities, and gains from cash, your portfolio is now split roughly 50/50 between cash and equities which is a different risk and reward profile from the initial strategy.

There are a number of points to consider at this review:

- How do you feel about the loss?
- Are you still able to stick with the strategy given such a poor start?
- If you do decide to continue with the investment, how do you feel about the risk profile? Is it more or less risky that you feel comfortable with?
- If you agree that the original risk profile was appropriate and the current profile is not, do you have the conviction to sell £9,127 of cash and buy £9,127 of equities – which have just fallen 29% in a year?

Our advice is to rebalance at the review meeting and to sell high and buy low. Although we know this makes sense, very few people have the discipline to do this when it come to the crunch.

Let's assume you did rebalance and let's hope 1974 is a better year. What actually happened?

Unfortunately high inflation, industrial unrest, government enforced pay freezes, fuel surcharges, the three day week etc... all contributed to another dreadful year for investors. Cash still returned 11.85% (although is actually lost 6.1% in real terms after inflation) but equities lost a whopping 51%. Clearly this was a difficult review for clients and their advisers.

The original portfolio has fallen from £100,000 to just £63,870 in only 2 years. This is an annualised loss of 16.7%pa. Will you still stick with the strategy?

At the end of 1974 the portfolio now consists of 60% cash and 40% equities which is a totally different risk/reward profile from the original strategy.

' This is an annualised loss of 16.7%pa. Will you stick with the strategy?'

Market update

Left to their own devices, most investors will find this a very difficult pill to swallow. But as we have already seen, the best returns from the market can be very concentrated and missing only a few days can significantly reduce long term portfolio returns. Investors need to stay invested and stick with the risk/reward strategy. Discipline is key.

At the end of 1974 having lost nearly 40% of your investment will you continue?

Surely we must be due some good fortune?

Actually 1975 was the best year ever recorded for the UK stock market – it returned 151%. You would have finished the year £124,601. This is a total return on investment of 24.6% or 7.6%pa over 3 years, although this may not be the best return ever, it did include two very traumatic years.

Had you decided to remain invested but not rebalance each year, buying more cheaply, your portfolio would be worth £106,219 at the end of 1975. Therefore, simply applying a disciplined unemotional approach to rebalancing added £18,382 to your final value.

More importantly, if you had cashed in your portfolio, stuck everything in cash and run away to lick your wounds at the end of 1974 you would have finished 1975 with only £71,439.

While we cannot predict whether the current period will be similar to the 1970's the above example does make a serious point about the need to stick with a strategy and rebalance regularly even when markets are falling. I would be very surprised if we see a return of the 151% any time soon. Also there is no guarantee that after two bad years the market will have recovered and gone into profit. The same exercise starting in January 2000 would have taken 5 years to get to profit but the principle is still sound – choose a level of risk you can live with and stick with the program.

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National Savings now NS&I

National Savings Indexed Linked Certificates are looking attractive, current issues are:

3 year 18 th Issue	RPI + 1% (Tax Free) =5.6%
5 year 45 th Issue	RPI + 1% (Tax Free) 7% equivalent Basic Rate Tax payer 9.33 equivalent Higher Rate Tax payer
RPI currently = 4.6% June 2008.	

How much can I invest tax-free?

From as little as £100 up to £15,000 in each Issue of each term. Unlike ISAs, Index-Linked Savings Certificates aren't tied to the tax year. You can invest up to another £15,000 tax-free whenever a new Issue goes on sale – and NS&I normally release several new Issues a year.

National Savings and Investments are backed by HM Treasury, so any money you invest in Index-linked Savings Certificates is 100% secure.

Investor Perks

Many direct equity holdings, although currently performing disappointingly, offer the investor – Shareholder Perks. These are not widely known but below are some of the more common. If your shares are not listed, it may be a good idea to call the company registrar or Investor Relations department for details:

EuroDisney offer shareholders a 15% discount on ticket prices.

Banco Santander (who bought Abbey) offer a 10% off entrance to British Grand Prix

Laura Ashley, Marks & Spencer and Moss Bros all give money-off vouchers. Moss Bros gives shareholders 20% discount when you own just one share at 46p (although transaction costs would increase this figure to £15).

Regular pub goers could do worse than investing in 40 shares of Marston's. For a one off outlay of around £85 plus dealing fees, they will receive shareholder discount card giving 20% off food and accommodation at more than 500 brewers pubs throughout the country.

'Laura Ashley, Marks & Spencer and Moss Bros all give money-off vouchers.'

Investor Perks cont.

Fuller's brewery in Chiswick, west London, holding shares worth £100 will give you a discount card giving you 15% off beer wine in the brewery shop.

British Airways offers 10% off flights for those holding 200 shares.

However the biggest cash savings are with the building companies.

Bellway give you £6,250 off a £250,000 home, although you will need to hold 2,000 shares, costing £13,000 for 12 months to qualify.

£2,400 worth of Barratt shares will give you £500 off every £25,000 you spend and £5,500 of persimmon shares will reduce the cost of a house by 2% up to a maximum of £3,000 while Redrow offers 1% discount for shareholders with 2,500 shares currently worth £6,500. But they all have a 12 month holding period.

Around 60 companies offer share schemes, but this figure is reducing, so if you hold direct shares, it's worth asking about the shareholder perks.

Depositor Protection

It has come to light that although the government in light of the Northern Rock issue raised the protection for deposits held by a single FSA registered company (e.g. First Direct & HSBC is one registration) to £35,000 and there are plans that the Treasury will raise this level to £50,000 per Bank, some savers may not be aware that deposits in 12 foreign banks operating in the UK may not have the full £35,000 protection provided under Britain's deposit guarantee scheme.

The Banks include; Bank of Ireland, Anglo Irish Bank and Merrill Lynch International from Ireland, TD Waterhouse, ING Direct, Triodos and AkBank from the Netherlands, Bank of Cyprus and Marfin Popular Bank Public from Cyprus, Landsbanki Islands from Iceland(Icesave), Fortis from Belgium, and Bank J Safra from Gibraltar.

The deposits should be covered by the host countries scheme and any deficit covered by Britain's. The problem will arise when you need to speak with the overseas departments!

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Interest rates & Mortgage update

We believe the mortgage and finance market is entering a consolidation phase. Although rates available are higher than they have been in recent memory, those of us that have been financing property for longer can see that rates are still good overall value.

The major banks and building societies are gaining an increasing share of the market, driving down the level of choice available. Whilst LIBOR (London Inter Bank Offer Rate - the rate at which banks lend to each other) remains at a higher rate than BBR (Bank of England Base Rate) this can only mean that rates will remain at or around their current level until liquidity and confidence returns. Lenders may feel the need to reduce rates slightly to increase market share, but we strongly believe the current scenario will continue for the short term. Although lenders are offering slightly better rates for longer term fixed rates of 5 or more years, our current view is that the situation may not improve for at least 2-3 years and are advising our clients accordingly.

'A further trend is for lenders to be more conservative in their approach'

A further trend is for lenders to be more conservative in their approach. This usually manifests itself as lower amounts that can be borrowed but this time has also meant that higher deposits are required.

In the main, there are three major loan to value bandings. 75% or less, 75-90% and 95% plus. As you can imagine, the best rates and terms are reserved for the higher deposits, with rates increasing the higher up the bandings you progress. This is proving a particular challenge for our remortgage clients. With house prices softening, they can be unsure as to which banding they fall into. We are able to offer help on this issue using land registry information or surveyors. Whilst we appreciate it can be a difficult time when mortgage payments come up for renewal, we endeavour to find the best solution for our clients to reduce the impact of these changes.

We are pleased to note that more people than ever are seeking the advice of a professional adviser. We have positioned ourselves to be able to react quickly in a changing market and offer the best value and choice to all our current and future clients

Please note

Notes: Levels, bases of, and reliefs from taxation are subject to change. Past performance is not a guide to future performance and the value of investments can go down as well as up. Tax Planning is not regulated by the FSA. We have taken great care to ensure the accuracy of this newsletter. However, it is written in general terms and you are strongly recommended to seek specific advice before taking any action on the information it contains. No responsibility can be taken for any loss arising from action taken or refrained from on the basis of this publication.