

INVESTMENT UPDATE

3 August 2011

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CASH ACCOUNTS – can you do better?

Broom Consultants Wealth Management Service is designed to manage your Elevate investments. Through our active fund management approach we monitor the market aiming to react on your behalf to both positive and negative news.

However financial planning does not just incorporate your managed investments, it is important to also have emergency funds and deposit savings.

In addition to holding an emergency fund, some savings can be held in short term deposit accounts and NS&I products, similar to the National Savings Index Linked Savings Certificates we informed you about in May 2011. But for longer term deposit savings it is important that your money maintains its purchasing power.

Whilst interest rates for borrowers are at a historic low, this is bad news for savers who are trying to achieve returns. Broom Consultants Ltd are always looking for deposit accounts that can provide the peace of mind of capital security along with a reasonable rate of return.

Therefore, for this part of your financial planning we have the following examples of accounts currently available:

- **An Instant access deposit account currently paying 2.8% pa.**
- **A 3 year deposit account, guaranteeing a return of 4.25% at maturity, with the opportunity for this to increase to 12.25% if the FTSE 100 is higher at the end of the 3 years period.**
- **A 6 year deposit account which pays a regular income of 1.5% per quarter, up to 6% per annum providing that the FTSE 100 stays between 7500 and 4500 during the preceding quarter.**

If you would like any further information on deposit accounts or you would like to arrange a full review of your cash savings and emergency fund, please contact your adviser.

PERFORMANCE UPDATE

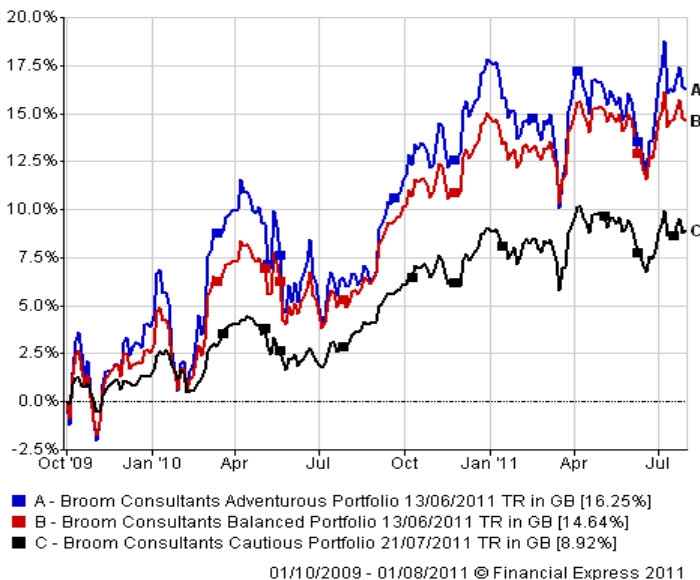
During July, the FTSE 100 fell by 2.13%, whilst gold rose 8%. The “Broom Consultants” Cautious and Balanced Investment Strategies rose by 0.36% and 0.30% respectively, whilst the Adventurous one lost 0.10%.

Over the last year, our three most popular strategies have performed as follows:

Cautious	+ 5.84%
Balanced	+ 9.22%
Adventurous	+ 9.60%

The graph below shows how the Broom Consultants Investment Strategies have fluctuated since launch and the table details the performance of our strategies compared to our benchmarks:

Since Launch



Various Time Periods

	1 Month	1 Year	Since Launch
Broom Consultants - Cautious Portfolio	0.36%	5.84%	8.92%
Benchmark - Cautious	-0.02%	7.17%	11.87%
Benchmark - Cash	0.12%	1.53%	2.64%
Broom Consultants - Balanced Portfolio	0.30%	9.22%	14.64%
Benchmark	-0.67%	10.11%	14.91%
Broom Consultants - Adventurous Portfolio	-0.10%	9.60%	16.25%
Benchmark	-0.94%	11.96%	15.54%
Average Outperformance	0.71%	-0.59%	0.70%

Writing this monthly Investment Update has been the most difficult to prepare, due to the amount of economic news hitting the headlines and the roller coaster ride of the prices of different asset classes.

Whilst it has been tempting to panic and move all our clients into cash in July, this has not been necessary to do as we did not see a serious deterioration in global stock markets in July. In fact the last two months have seen some good gains for our cautious and balanced risk clients and little change for our adventurous clients. Despite UK, US, European and Latin American Equities falling, we have seen a rise in Asian equity funds, gold mining shares and inflation linked government bonds. This has helped our returns as we are overweight in these three asset classes. **However, we have seen stock markets deteriorate in the last few days in August and we may be making some recommendations shortly, so please keep checking your emails.**

Despite markets going down over the last few days there are some funds held in our portfolios that have still managed to produce a positive return over the last month to August 2nd. The positive ones are as follows (the UK stock market has also been added for comparison):

- BlackRock - Gold & General A Acc TR in GB [4.28%]
- M&G - Index Linked Bond A Inc GBP TR in GB [3.67%]
- Stan Life Inv - Global Index Linked Bond Ret Acc TR in GB [2.48%]
- First State - Asia Pacific Leaders A GBP Acc TR in GB [1.59%]
- Newton - Asian Income TR in GB [1.25%]
- Stan Life Inv - Global Absolute Return Strategies Ret Acc TR in GB [0.90%]
- Insight - Absolute Insight Fp TR in GB [0.40%]
- M&G - Property Portfolio A Inc GBP TR in GB [0.29%]
- FTSE 100 TR in GB [-4.46%]

However, some of the funds have also lost significant amounts:

- Vanguard - FTSE UK Equity Income Index Acc TR in GB [-4.33%]
- Threadneedle - Latin American Ret GBP TR in GB [-6.52%]
- HSBC - European Index Ret Inc TR in GB [-10.44%]

As you can see there is such a huge disparity in performance over the last month with Europe suffering the most. Every client has just 2.5% invested in the HSBC European Index fund so losses from this fund have been minimised. Every client has between 7.5-10% invested in Blackrock's Gold fund which has helped immensely. During the troubled times we know that some of our investment will fall and our job is to try and balance these out with funds that are going up. We have so far done reasonably well in achieving this goal but are always looking to make changes especially in the underperforming funds.

FUND SWITCHES – Our commitment to you

Broom Consultants Ltd recommend fund switches when we feel it is prudent. It is important that these are acted upon as soon as we have received your acceptance. As part of our ongoing service we audit all accounts to ensure that there have been no delays in the buying and selling of funds. If any delays are identified we backdate the transaction to ensure that there has been no loss to your account.

Our recent audit was concluded on the 29th July 2011 and we are pleased to announce that all accounts are in the correct position based on the dates we instructed AXA Elevate to activate our switch recommendations. Full details of the audit process are available from your adviser.

THE US DEBT CEILING

Whilst much has been written in the press about the economic problems facing the world, we have tried in this update to summarise them and relate it to your wealth and our investment strategies. Whilst we expect stock markets to remain turbulent in the short term, they have not yet broken major support lines.

This month we had Greece saved (again) by European politicians and then the global economy was put at risk by "the American debt ceiling", only then at the last minute to be saved by the US politicians agreeing on raising the ceiling level. The newspapers have been full of commentary with some very emotive headlines but what we need to do is examine how all this is affecting your wealth.

Previously every time the US needed more money it raised its debt ceiling, almost automatically. However, this time the politicians decided to do some point scoring prior to next year's election. The Democrats want to reduce debt by raising taxes and cutting some spending, whilst the Republicans want to reduce the debt solely by cutting spending and are appealing to the electorate that a smaller Government would be better for America. The Republicans used the debt ceiling discussion to make their points. Although it was extremely unlikely that the ceiling would not be raised it went down to the wire. Perhaps if the election was not next year then it would have been raised without a fuss like it was in 2010. It also highlighted the lack of power the President has.

Raising the ceiling is the first part of the problem, with the second part being what the rating agencies think. They have the power to downgrade US debt, which basically means US government bonds go from being the most secure investment, to one that is slightly less secure. We await their response.

What we need to do is analyse how this will affect asset classes in the future so that we can position your wealth accordingly.

Firstly, let us look at the performance of the US stock market (S&P500) over the last year:



We can see that up until February it was growing extremely well but since that date it has moved sideways, ranging between 1250 and 1370. Last week the market fell on five consecutive days, but by looking at the chart this was not the disaster that the headlines are trying to make out. In fact, possibly the main reason that the market fell was not the debt ceiling crisis but the fact that growth in the US was slower than expected. This can be demonstrated by the fact that after the ceiling was raised markets barely rallied and are down as I type. The main reason why the stock market has not collapsed is the fact that the US economy and US stock market are opposites. US multinational companies have strong balance sheets, have made lots of cost cuts already and are benefitting from the strong growth in Asia (this is offsetting weak growth in the West). The same can be said for the largest UK and European firms e.g. BMW are selling lots of cars in China.

Therefore, when making investment decisions we must remember that we are investing in companies when we buy equities rather than economies. A weak US economy will affect the profits of companies but this can be offset by strong emerging economies. In fact it could be argued that the growth rates in India/China are now equally as important and if a large multi-national is growing in Asia then this can offset weaker growth in the US. For example, India is now Vodafone's most important market.

Therefore, we must examine which geographical location the profits of what we invest in are being generated. Previously, what happened to the American economy affected the whole global economy, but now America's importance is less. We could therefore make money from global companies, even if the American (and UK economy) is struggling. Economic data from the Far East is therefore vital. Your portfolio is overweight in large multi-national companies.

The second and possibly most important point to look at is the US as a safe haven. Basically a safe haven is where investors put their money in troubled times. In 2008 US Government Bonds rose substantially and so did UK bonds. However, the chart below shows the comparison of Government debts and how they have changed

over the years compared to their economy (the higher the figure then the more debt they have: 90% is the point at which it is thought problems occur):

Gross debt as percentage of GDP			
	2007	2010	2011 Forecast
Austria	62%	78%	82%
France	70%	92%	99%
Germany	65%	82%	85%
Greece	104%	123%	130%
Republic of Ireland	28%	81%	93%
Italy	112%	127%	130%
Japan	167%	197%	204%
Netherlands	52%	77%	82%
Portugal	71%	91%	97%
Spain	42%	68%	74%
United Kingdom	47%	83%	94%
United States	62%	92%	100%
Asia ¹	37%	40%	41%
Central Europe ²	23%	28%	29%
Latin America ³	41%	37%	35%

Sources: IMF, *World Economic Outlook* (emerging market economies); OECD, *Economic Outlook* (advanced economies)

¹China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand

²The Czech Republic, Hungary and Poland

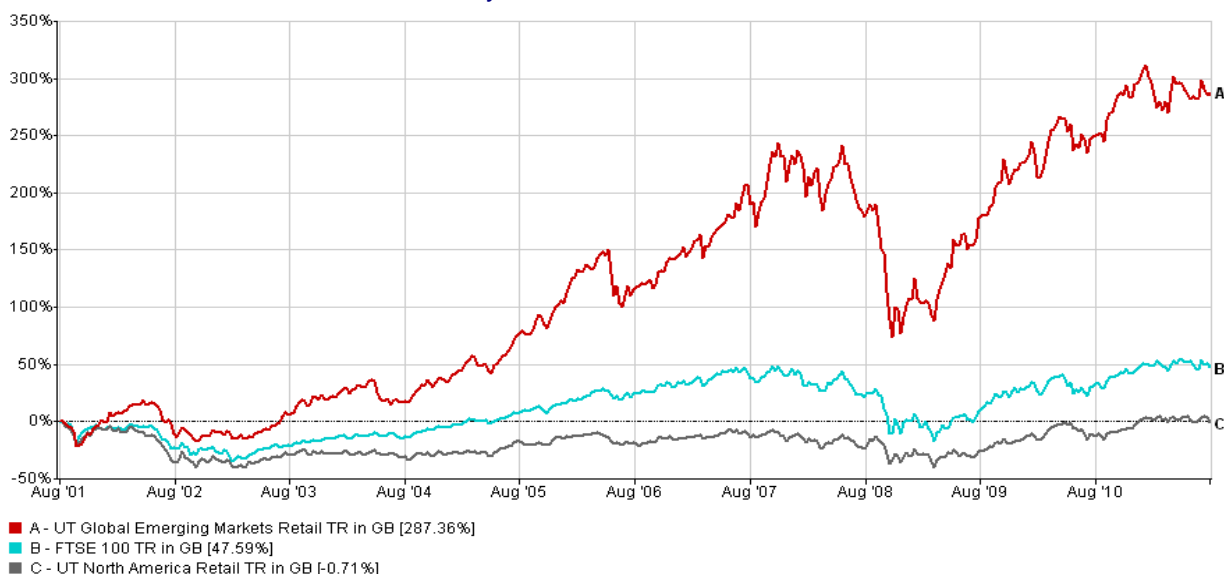
³Argentina, Brazil, Chile and Mexico

In 2008 when the banking crisis hit us, you can see that the debts of the Western Governments were not that high and moving money into these places during the troubled times made sense. However, during the next major global economic disaster where would you want to put your money - in the cash rich Asian and Latin American countries or in the indebted western countries? Whilst 2008 proved to be very profitable to invest in US government bonds, the next time it might not be. So we have to work out a strategy now of what will be the safe havens during the next crisis. We believe that it may just be the government bonds from the cash rich countries and this is one of the reasons why our cautious investors have initiated an investment in an emerging market government bond fund.

We also need to look at what this debt is doing to the US Dollar. Basic economics tells us that the more supply you have then the price should fall. The chart below shows the price of the US Dollar against a basket of other currencies:



You can see how it bounced in 2008 but has been in steady decline. We therefore have held the few to avoid investing in American equities as you might make money on the stock market but lose it on the currency. The chart below shows just this fact as it compares returns from the US (S&P500), UK (FTSE100) and emerging markets for a UK investor over the last ten years:



01/08/2001 - 01/08/2011 © Financial Express 2011

In summary, the American economy was once the most important economy in the world. It provided a safe haven in troubled times and when America sneezed everyone else caught a cold. The balance of power is slowly shifting to a more balanced future. Government bonds from cash rich countries could in the future be better “safe haven” investments.

THE EUROPEAN PERIPHERAL DEBT CRISIS

Just prior to the US raising its debt ceiling, Europe came up with another “bailout” for Greece. This was an attempt not only to support Greece but also in response to the “contagion effect” where yields on Spanish and Italian debts also started to rise. The fear for Europe is that whilst they can afford to bailout Greece, Ireland and Portugal, they cannot afford to bailout Spain and Italy. Fear spread in early July that Italy would be the next to require a bailout and then Spain. The rate at which the Italian Government could borrow rose from just under 5% to just under 6% and the Spanish Government from 5.5% to nearly 6.5%. Greece’s 10 year debt by comparison had risen to 18%.

The new bailout initially appeased the markets and certainly the interest rate on Greek and Irish debt fell and has remained lower since. The Greek yield has fallen to 13% and the Irish yield fell from 14% to 11.5%. The chart below shows Italian debt yield (the higher it is the worse it is) and as you can see it briefly fell after the bailout but has recently gone up again:



A similar chart can be seen for Spanish debt. Basically the bailout has not helped the risk of other European countries defaulting on their debt obligations and the latest bailout has just given a little bit more time for Europe before a final solution has to be found. The solution that is now being discussed is fiscal union. Fiscal Union described by Wikipedia is:

“Fiscal union is the integration of the [fiscal policy](#) of nations or states. Under fiscal union decisions about the collection and expenditure of taxes are taken by common institutions, shared by the participating governments. For example, in federal nations such as the United States, fiscal policy is determined to a large extent by the central government, which is empowered to raise taxes, borrow and spend. It is often proposed that the [European Union](#) adopt a form of fiscal union. Most member states of the EU participate in [economic and monetary union](#) (EMU), based on the [euro](#) currency, but most decisions about taxes and spending remain at the national level.”

Basically what it means is that for a union to survive it must collect more tax from the stronger regions and spend more of it on the weaker regions. The UK is a good example of this where London and the South East raises significantly higher taxes than the rest of the UK and this excess is then spent on areas that are not as prosperous. What that means for Europe is that as the German economy is one of the strongest it must use some of the taxes it collects to support the likes of Greece, Ireland and Portugal. The German economy is a strong exporting economy and if it wasn’t a member of the Euro would have almost certainly seen its currency appreciate substantially. This would have not helped its exporters i.e. BMW’s would be more expensive in China. The politicians now have to sell this idea to the German population (and the French) for the Euro to survive in its current format. This was known when the Euro was born but there was not the political backing to form a proper union.

We are therefore carefully monitoring the yields on European debt carefully and remain wary of exposing your portfolio too much to European equities and bonds.

MONETARY TIGHTENING - INDIA

Whilst Europe and the US have had problems of debt and slow growth, emerging economies such as India have had problems of dealing with high growth. When an economy experiences high growth or a boom, if inflation is not kept under control, then the boom can quickly turn into a bust. The way to combat inflation is to raise interest rates and last week India raised its interest rates by 0.5% (the market was expecting 0.25%). Interest rates have now been raised from a low of 4.75% in March 2010 to 8% today. Inflation is now a high 7% and this could mean rates are increased further. High interest rates are not generally good for the economy as it raises the cost of investment (i.e. bank borrowing) This tightening of monetary policy (raising interest rates) has been one of the reasons why the Indian stock market has performed poorly and lost 0.68% over the last year.

Under normal circumstances we would have sold out of India due to its poor recent performance. However, our adventurous risk clients still have a direct exposure to India of 5% of their portfolio, via the First State Indian fund. Why is this?

Well let's take a look at how this fund is performing against the Indian stock market:



29/07/2010 - 29/07/2011 © Financial Express 2011

Whilst the stock market has made a negative return over the last year, the First State fund has grown by 15.68%. This growth is solely down to the fact that the fund manager has excelled at his stock picks. For example, his second largest holding (a company called Marico) has grown by 42% over the last year.

First State has some excellent performing funds and every client has an investment in their Asian Pacific Leaders fund. This fund is the fourth best performing fund in its sector over the last year, having outperformed the average fund by over 5% in the last year.

Some fund managers can outperform and produce positive gains despite the market that they invest in making losses. Thus, when building your portfolio, it is vital for us not only to monitor the performance of the underlying assets but also of the fund managers.

WHAT RISK ARE YOU TAKING WITH YOUR MONEY?

One of the most important factors that affect the returns in your portfolio is the risk that you are taking. Our objective is to reduce the risk of your portfolio during the bad times and increase it during the good times so that we protect your wealth in the bad investment periods and you remain invested and benefit from the good investment periods. If this is achieved successfully then the overall risk to your portfolio will reduce and your losses will be minimised during the bad times.

But how do we measure the risk that you are taking?

The best measure is something called volatility. This is simply a measure of how much your portfolio moves on a daily/weekly basis. For example, if a portfolio grows by 10% in a month and then falls by 5% the next it is much more volatile than a portfolio that grows by 2.5% in each of the two months. Most investors would prefer to be in the second portfolio as the returns are the same but the risk is much less. The objective of managing a portfolio is therefore to maximise returns but minimise the volatility (risk).

So what are the risks of our portfolios?

We use the annual volatility as our preferred measure and the higher it is then the more risky the portfolio is. The table below shows the volatility of each of Broom Consultant's portfolios against the average fund:

Broom Consultant's Investment Portfolios	Volatility	Benchmark Funds	Volatility
Cautious	4.18	Average Cautious	4.07
Balanced	5.43	Average Balanced	7.99
Adventurous	7.02	Average Adventurous	9.01

By comparison, the UK Stock Market FTSE 100 has a volatility of 10.68 and Emerging Market Equities has a volatility of 13.98.

SUMMARY

Stock markets have experienced a very turbulent few months, and we remain in this sideways trading pattern. The debt problems in the West remain and we are relying on the politicians to fix them, which due to the short term nature of the election system can cause problems. In the East their problems stem from the problems associated with too much growth-inflation and rising interest rates. However, despite all of the bad news money can be made from investing. Your portfolio is weighted towards investing in larger multinational companies that generate a higher than average amount of their profits from the emerging markets, or in the stock markets of the emerging countries themselves. We believe that this strategy will best benefit from the shift of power from West to East.

We also prefer having an exposure to gold miners which are benefitting from the rising gold price. The gold price is benefitting in turn from the debt problems. We are also protecting our more cautious clients by investing in inflation linked government bonds and the bonds from cash rich countries. We understand that this is a tough time to make money and are monitoring the trends of each asset class to try and ensure that you have more wealth in those asset classes that are going up. Please keep checking your emails as in this period of uncertainty we are liable to make more recommended changes than usual.

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Please note that this document does not constitute a recommendation. It is intended only to provide you with a guide to how Broom Consultants manages client money. The past is not necessarily a guide to future performance. The value of any investments can go down as well as up and you may not get back the full amount invested. Taxation is subject to change and you may have to pay tax on any gains. The Broom Consultants portfolios are unlikely to exactly mirror our clients portfolios due to the timing of the initial investment and the speed of response to our fund switch recommendations. The figures above therefore assume a client invested on the launch day and have responded immediately to our recommendations. All figures and charts are provided by Financial Express.