

## INVESTMENT UPDATE

4th January 2012

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### WELCOME

Welcome to the first Investment Update of the new year. We hope you had a lovely break over the holiday period.

As we look forward to 2012, there is much to consider:-

- Using up your ISA allowance for this tax year and planning for the next. Don't forget about Junior ISAs for your children or grandchildren
- Pension contributions and fund limits are subject to the lower levels introduced last year. If you are building up your pension, we can help you maximise the funding opportunities
- Self-assessment returns – if you need any help, let us know
- Tax planning – we have the expertise and tools that can help you
- Next budget date – 21<sup>st</sup> March. We will study the announcements and inform you of any important changes

### PERFORMANCE UPDATE

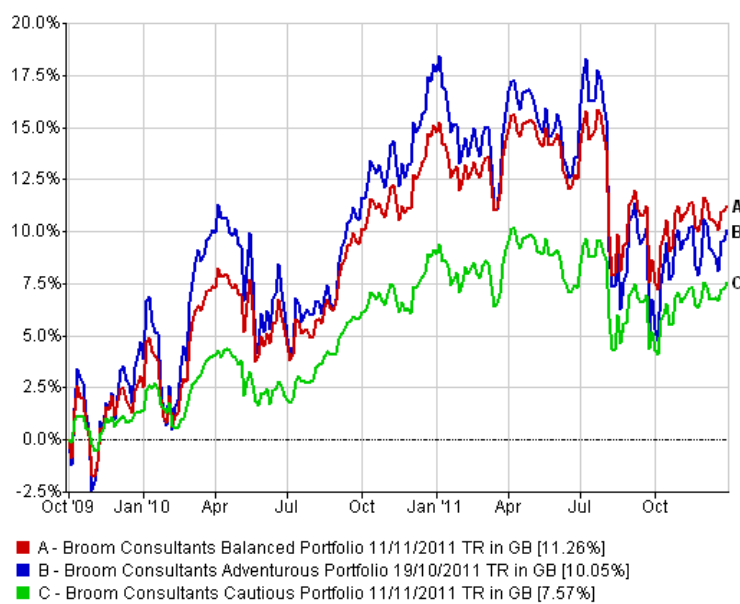
During December, global stock markets entered a “Santa” rally and increased by nearly 1%. The helped the Broom Consultants Cautious, Balanced and Adventurous Investment Strategies grow by 0.59%, 0.42% and 0.84% respectively.

Over the last year and since launch to the 31st December, our three investment strategies have performed as follows:

	1 Year	Since launch
<b>Cautious</b>	- 1.22%	+ 7.57%
<b>Balanced</b>	- 3.06%	+ 11.26%
<b>Adventurous</b>	- 6.52%	+ 10.05%

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	0.59%	-1.22%	7.57%
Benchmark - Cautious	1.27%	-1.64%	8.69%
Benchmark - Cash	0.15%	1.64%	3.22%
Broom Consultants - Balanced Portfolio	0.42%	-3.06%	11.26%
Benchmark	1.63%	-5.61%	8.76%
Broom Consultants - Adventurous Portfolio	0.84%	-6.52%	10.05%
Benchmark	1.56%	-8.42%	6.82%
<b>Average Outperformance</b>	<b>-0.68%</b>	<b>1.28%</b>	<b>2.45%</b>

## REVIEW OF 2011

### Stock Market Performance

The last year has been one of the most volatile stock market periods in history. For example, the US stock market (S&P 500) had 63 days where the stock market declined or advanced by more the 400 points (roughly 3.33%), which compares to a total of 52 in 2008 (another volatile year). This volatility has been caused by numerous factors including the Japanese natural and man made disasters, the Arab uprising, political inertia in America and Europe, banks going bust, countries going bust and rising commodity prices.

Fortunately for UK investors we have been somewhat sheltered as the UK stock markets and government bond markets have performed much better than other countries. The list below shows how much different stock markets have fallen over 2011:

- US stock market (S&P 500) - 0.003%
- UK stock market (FTSE 100) - 5.55%
- UK stock market (FTSE 250) -12.60%
- German stock market (DAX) -14.69%
- French stock market (CAC 40) -16.95%
- Japanese stock market (Nikkei 225) -17.34%
- Hong Kong stock market (Hang Seng) -19.97%
- Chinese stock market (Shanghai) -21.68%
- Indian stock market (Sensex) -24.64%

Whilst these figures look terrible there has been a clear trend that has emerged within the performance of individual companies, with the largest, global companies outperforming. This is why the largest 100 companies in the UK (FTSE100) have outperformed the middle 250 largest companies (FTSE250) in the UK by over 7%. This has led to some equity only investment managers being able to outperform, with the Invesco Perpetual High Income Fund gaining 8.99% over the year.

### The performance of other asset classes

Despite stock markets falling significantly, there have been other asset classes that have performed well, most notably:

- UK Inflation Linked Bonds +18.59%
- UK Government Bonds +14.61%
- Gold +13.26%
- Corporate Bonds + 4.10%

Again being based in the UK has helped shelter the average UK investor from substantial losses as European investors have certainly lost money over the last year by investing in European government bonds.

### Our Model Portfolio Performance

In summary they have all lost money over the last year, but have significantly outperformed the average fund manager. We therefore have mixed feelings about the performance, having minimised your losses compared to our peer group but still making a loss over the year. Against our peers the model portfolios are ranked as follows:

- Cautious Portfolio 89/205
- Balanced Portfolio 29/176
- Adventurous Portfolio 28/123

For example the balanced portfolio was the twenty-ninth best performing portfolio out of one hundred and seventy six similar risk funds in 2011.

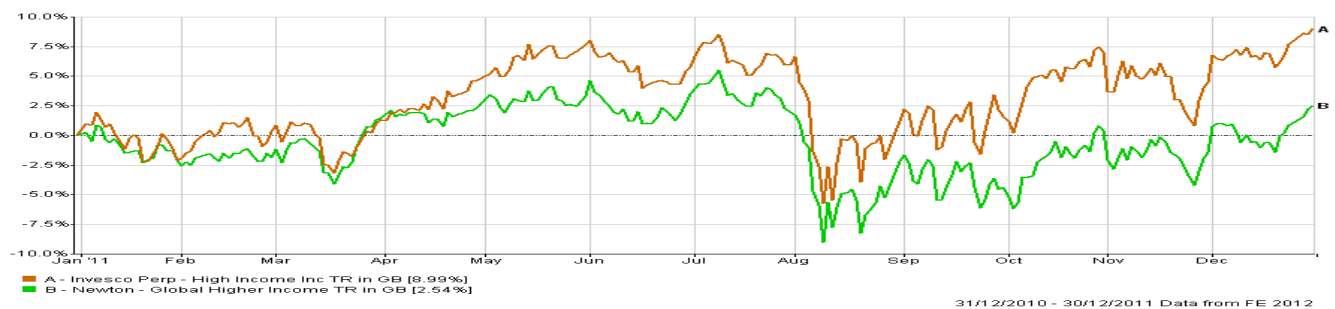
Investing money involves making tough decisions and not all those decisions will be correct. Even the best investors have made some bad decisions in 2011, with the most famous hedge fund manager, John Paulson, losing 48% in his flagship fund. So what went right and what went wrong for us in 2011?

### The Good Decisions

We finished 2011 with 20% of all of our model portfolios in inflation linked bonds. The initial investment was made in June and you can see how the M&G index linked fund has performed over the year:



We also weighted our equity exposure to funds, such as the Invesco Perpetual High Income and Newton Global Higher Income funds, that invest in the largest global companies and they have produced a positive return for us in 2011:



We started the year over weight in Asian equities but have reduced exposure over the year as positive trends have turned into negative trends. This has helped to minimise the losses and we have also exposed our lower risk portfolios to UK commercial property which has increased by 3.61% over the year.

## What Went Wrong?

The main negative contributor to the performance of the portfolios was the sharp and sudden drop in stock markets in early August, as we were unable to reduce exposure to equities quick enough. The chart below shows how the German stock market broke through its trend on the 1<sup>st</sup> August and 5 days later was down nearly 20%:



As part of the improvements to the Broom Consultants Wealth Management Service (to be communicated shortly) we hope to have in place the mechanism to reduce exposure to equities much quicker and thus in future if we see a similar sharp reversal then we should be able to help protect your portfolio by selling the equity holdings the moment that the trend breaks, hence avoiding most of the losses above. We therefore are much more confident going forward that not only will we continue to outperform but also produce future positive annual returns.

The other disappointment came in the decision that we made in investing in gold mining companies rather than gold. Gold was up 13.26% over the year but gold miners were down nearly 20%. If we had reversed that decision then every portfolio would have shown a positive annual return. Gold mining shares are up significantly in the first few days of trading this year and we will be reviewing our position in this asset class over the next few months. It may be that due to the volatility associated with gold miners we further reduce exposure to the Blackrock Gold & General Fund.

## STRATEGY FOR 2012

After such a terrible year for news flow in 2011, the New Year has started out with some of the most pessimistic forecasts. The headlines in the financial pages on the 3<sup>rd</sup> January read as follows:

- Economists see bleak year.
- Fresh Worries about Spanish deficit.
- UK "Double Dip" recession expected by most finance directors.
- UK Economists downbeat on year ahead.
- Manufacturing slumps in quarter 4 as recession looms
- World's biggest economies face \$7.6 trillion debt.

Our portfolios are all positioned very defensively with a high amount of cash. The rest of the money is invested in inflation linked government bonds, property funds, equity funds that invest in the world's largest companies and a smaller amount in gold mining shares. So let's take each asset class in turn and see what our current thoughts are about them:

### **Equities**

Our basic investment philosophy is to invest more money in asset classes that are on upward trends and reduce exposure to asset classes that are on downward trends. Some of the big multi-national companies are on upward trends at the moment, which is why we have exposure to funds that invest in the largest companies, such as the Invesco Perpetual High Income Fund. However, the majority of global stock market indices are on negative trends, especially those of the emerging countries.

If we look at China for example, we can see how far it has fallen and how the trend is progressively lower and negative:



We will only increase your exposure to emerging countries stock markets when these stock markets go above the red trend line. Due to how far they have fallen this may be some time. However, The US and UK stock markets are approaching their trend lines and this could mean that we increase your exposure to these stock markets in the short term. The UK and US stock markets are shown below:

### **UK**



## US



When investing we must remember that companies can perform well despite the economy doing badly and we could see the UK going into a double dip recession but the UK stock market rising in value. This could be due to an improving US or Chinese economy or the simple fact that Governments have printed so much money that it has to be invested somewhere. We therefore do not want to miss out on any rally if indeed we see one.

### ***Inflation Linked Bonds***

If we take a look at the longer term performance of index linked gilts you can see just how strong the trend is but also how far above the trend line this asset class is now:



What this means is that we need to be cautious as we could see a sharp pull back to the trend line, as most asset classes that are on strong trends either pull back sharply to the red trend line or pause for breath as the trend line catches up. We are therefore happy to keep our exposure to inflation linked bonds as we are riding a very strong trend but must monitor the performance carefully with a view to possibly reducing exposure at some time.

### ***Gold and Gold mining shares***

If we take a long term look at the price of gold we can see that it has now fallen below its trend line for the first time since 2008:



In 2008 it fell 25% from peak to trough so we have to be wary of investing in this asset class until the strong trend reappears. Gold miners have been moving sideways for the last eighteen months:



We believe that we are at a pivotal point for gold miners - if the price of gold goes above its trend line then gold mining shares will rally but if the price of gold mining shares drops a bit further below the low it experienced in June 2010 then we could see significant falls. Gold mining shares increased by 4% yesterday which shows how volatile they currently are. We are therefore viewing our investment in gold mining shares as our current riskiest investment which has to be monitored closely.

### **Property**

Our investment in the M&G Property Fund has increased by 3.60% over the last year, which compares favourably to bank deposit rates. However, in the current economic environment in which banks are only staying afloat with the assistance of Governments we do not want to have too much exposure to property. We therefore will keep the current exposure but will reduce it if we see commercial property values beginning to fall.

### **Government Bonds**

UK, US and German government bonds yield about 2% whereas Spanish bonds yield 5%, Italian 7%, Irish 8% and Portuguese 13%. Basically the markets are viewing the UK as a safe haven when compared to other countries. An investment in UK government bonds would have made you over 14% in 2011 and we did not have exposure to them as we wrongly feared the same problems that afflicted most of Europe would also hit the UK. We therefore have an asset class that is on a strong upward trend and yet we are not invested in it. We therefore may add exposure to government bonds but with forthcoming improvements to our service we can quickly reduce exposure if indeed the trend changes.

### **Summary**

We are currently very defensively positioned with the majority of money invested in cash, inflation linked bonds and funds that invest in the world's largest companies. We also have some exposure to gold miners which we consider a "risky" play. We will only turn more aggressive and increase your exposure to equities when we see the trends in global stock markets turn positive. This is likely to happen sooner in the stock markets of the developed countries, rather than the emerging countries.

## **WHAT RISK ARE YOU TAKING WITH YOUR MONEY?**

One of the most important factors that affect the returns on 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:

<b>Broom Consultant's Investment Portfolios</b>	<b>Volatility</b>	<b>Benchmark Funds</b>	<b>Volatility</b>
Cautious	4.79	Average Cautious	6.29
Balanced	6.33	Average Balanced	9.87
Adventurous	8.69	Average Adventurous	11.22

By comparison, the UK Stock Market FTSE 100 has a volatility of 13.11 over 1 year and 16.46 over 3 years and Emerging Market Equities has a volatility of 19.44 over 1 year and 20.19 over 3 years.

**As you can see all of our portfolios are currently experiencing a lower risk than their benchmarks.**

## SUMMARY

2011 was one of the most volatile years in stock market history. Whilst we are pleased with how we have outperformed against our peers we are disappointed not to show positive returns. We are working hard to spot the next positive investment trends so that we can invest more of your wealth in them during 2012 and hopefully make a good positive return for you this year.

During these uncertain times it is especially important to have your wealth actively managed within flexible investment strategies, which is the foundation of our investment philosophy.

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