

## INVESTMENT UPDATE

6 June 2011

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## PERFORMANCE UPDATE

During May, the FTSE 100 fell by 1.69%. The “Broom Consultants” Cautious, Balanced and Adventurous Investment Strategies experienced a rise of 0.05%, 0.18% and 0.18% respectively.

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

<b>Cautious</b>	<b>+ 7.72%</b>
<b>Balanced</b>	<b>+10.52%</b>
<b>Adventurous</b>	<b>+10.84%</b>

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*



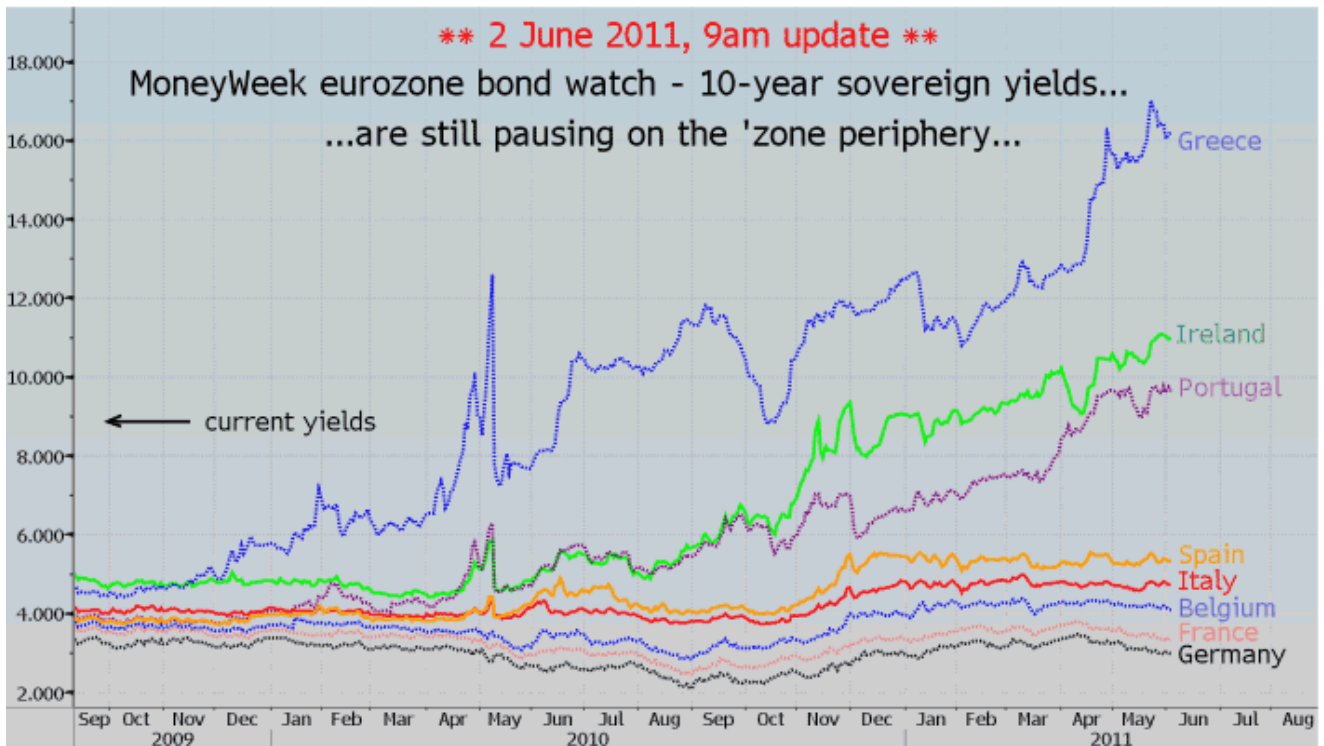
- A - Broom Consultants Adventurous Portfolio 08/04/2011 TR in GB [16.83%]
- B - Broom Consultants Balanced Portfolio 25/11/2010 TR in GB [15.51%]
- C - Broom Consultants Cautious Portfolio 06/05/2011 TR in GB [9.83%]

### *Various Time Periods*

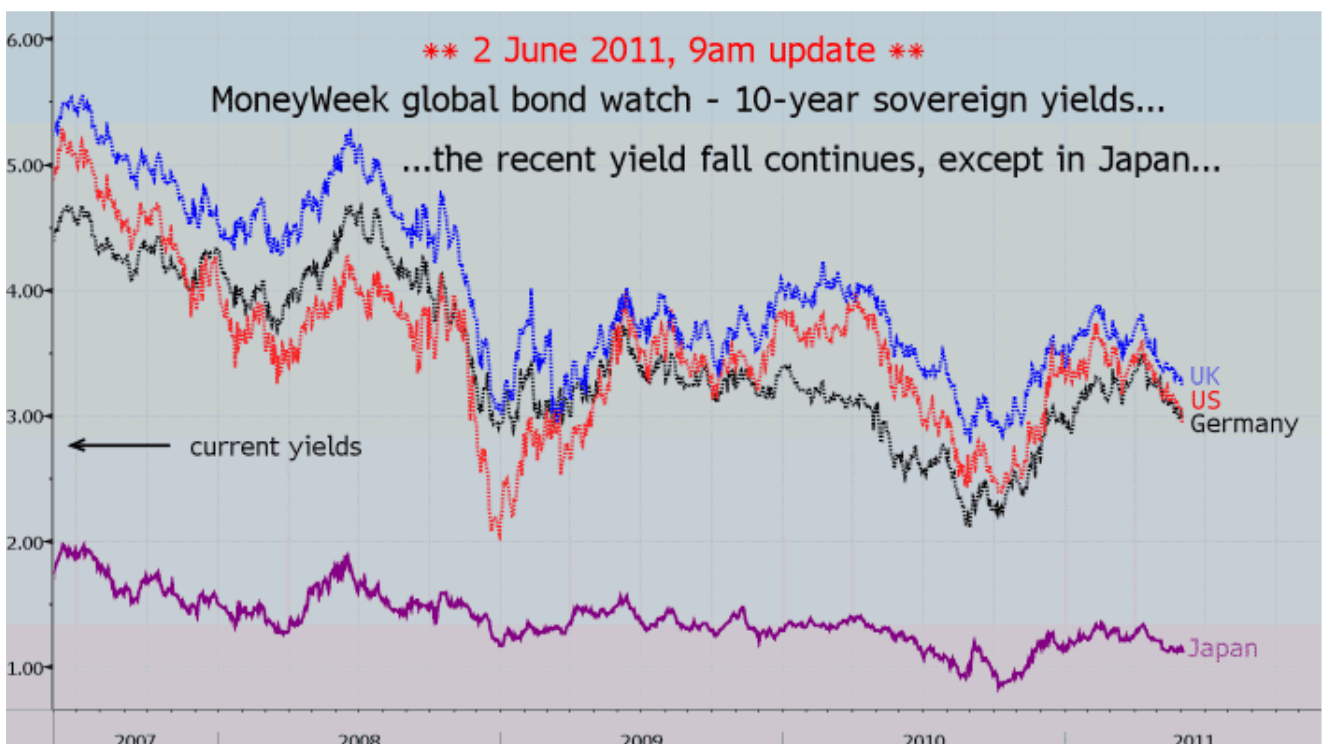
	<b>1 Month</b>	<b>1 Year</b>	<b>Since Launch</b>
Broom Consultants - Cautious Portfolio	0.05%	7.72%	9.83%
Benchmark - Cautious	0.25%	9.30%	12.62%
Benchmark - Cash	0.15%	1.51%	2.37%
Broom Consultants - Balanced Portfolio	0.18%	10.52%	15.51%
Benchmark	-0.14%	12.91%	16.49%
Broom Consultants - Adventurous Portfolio	0.18%	10.84%	16.83%
Benchmark	-0.41%	14.03%	17.44%
<b>Average Outperformance</b>	<b>0.25%</b>	<b>-1.08%</b>	<b>0.24%</b>

## MANIPULATED MARKETS

Understanding the global economy and how this impacts on investment markets is extremely difficult at the moment due to central banks around the world keeping interest rates artificially low and pumping money via Quantitative Easing into economies. This is creating abnormalities in certain markets. For example, one would expect that as a country becomes more indebted, its government bond market would fall in value and for its yield (the rate at which it can borrow) to increase. This is because there is a greater likelihood that the country is not able to repay its debts. Take a look at Greece, Ireland & Portugal for example where the yields have shot up again:



Then take a look at the US, Germany and UK where yields are again falling:



If we look at the US in particular, then it would appear from the above chart that they are in control of their debt and that they have balanced their books. However, we know this is the complete opposite. We also know that inflation is rising, which can be seen by the rising price of inflation linked government bonds. Rising inflation usually means that interest rates will rise to combat its effect (this is happening in Asia) and would normally mean that the yields on Government Bonds will also rise. However, interest rates have remained close to zero for a long time and economists continue to push back the date at which they will rise. Europe has increased their interest rates slightly but the UK and US have not.

So we have rising inflation but falling interest rates that the US, UK and German governments can borrow against. This breaks all economic theory and principles. So what do we think is happening?

The governments in the developed world are manipulating the bond markets by forcing banks (via capital adequacy requirements) and pension funds to hold more government bonds. The government is also printing money and buying back its own bonds. They are, therefore artificially creating demand for government bonds which is why we have such low yields despite rising inflation and spiralling debts.

Why are they doing this? A period of low interest rates and rising inflation is the easiest way to pay for the cost of debt and to reduce the real value of that debt. If we relate this to the average UK citizen who has a mortgage then what we are effectively saying is that we are happy to increase the price of your supermarket shop, hope that your salary rises in comparison and keep the interest rate on your mortgage as low as possible during this transition. By the end of the process your debt will have reduced as a percentage of your salary and you can easily pay back your mortgage.

Please remember this is our opinion and no government official has yet stated that this is their real objective. Whether it is a good plan or not is not for us to say, but it is important to understand what is probably happening so that we can position your wealth strategy in the best possible way.

#### **So how has this affected our investment strategy?**

**Well, we don't like holding Government debt as it is very difficult to predict trends in a manipulated market. We believe that inflation will remain higher than normal and investing in companies that produce higher than average dividends is one of the best ways to benefit from inflation. Your investments in the Newton Global Higher Income Fund and Invesco Perpetual High Income Fund are good examples of this and we may look to increase exposure to these types of funds shortly. We also do not favour cash, when inflation is higher than interest rates, even though your money is safe and going up in nominal terms, it is falling in real value. And finally gold is always a good investment during these uncertain times (however please read the section on gold miners).**

## THE INVESTMENT STEPPING PATTERN

The last six to nine months have been a very frustrating time for making money, as global equity markets have been trending sideways. Since the start of this year equity markets have made the following returns:

USA	+4.62%
Germany	+3.49%
Asia	+2.82%
Hong Kong	+1.01%
UK	-0.80%
China	-3.67%
Africa	-3.92%
Latin America	-4.09%
Japan	-7.69%
India	-9.69%

For the average UK investor, taking currency into account, the return this year from investing solely in a diversified spread of global equities would be between +/-1%. Has the strong upward trend that we have experienced in global equities since March 2009 come to an end? And should we find other asset classes to move our wealth into?

The best way to analyse what is happening today is to look at history and see if we can spot similar chart patterns. By doing so we can observe that stock markets generally go up in a stepped pattern. We can see this when we analyse similar Bull markets that occurred between 1991-1997 and 2003-2007 for the FTSE100 (UK stock market):

**1991-1997: 4 upward steps (green lines) and 3 sideways steps (red lines). Overall Increase 110%**



**2003-2007: 4 upward steps (green lines) and 3 sideways steps (red lines). Overall Increase 66%**



**2009-???-3 upward steps (green lines) and 3 sideways steps (red lines). Overall Increase 66%**

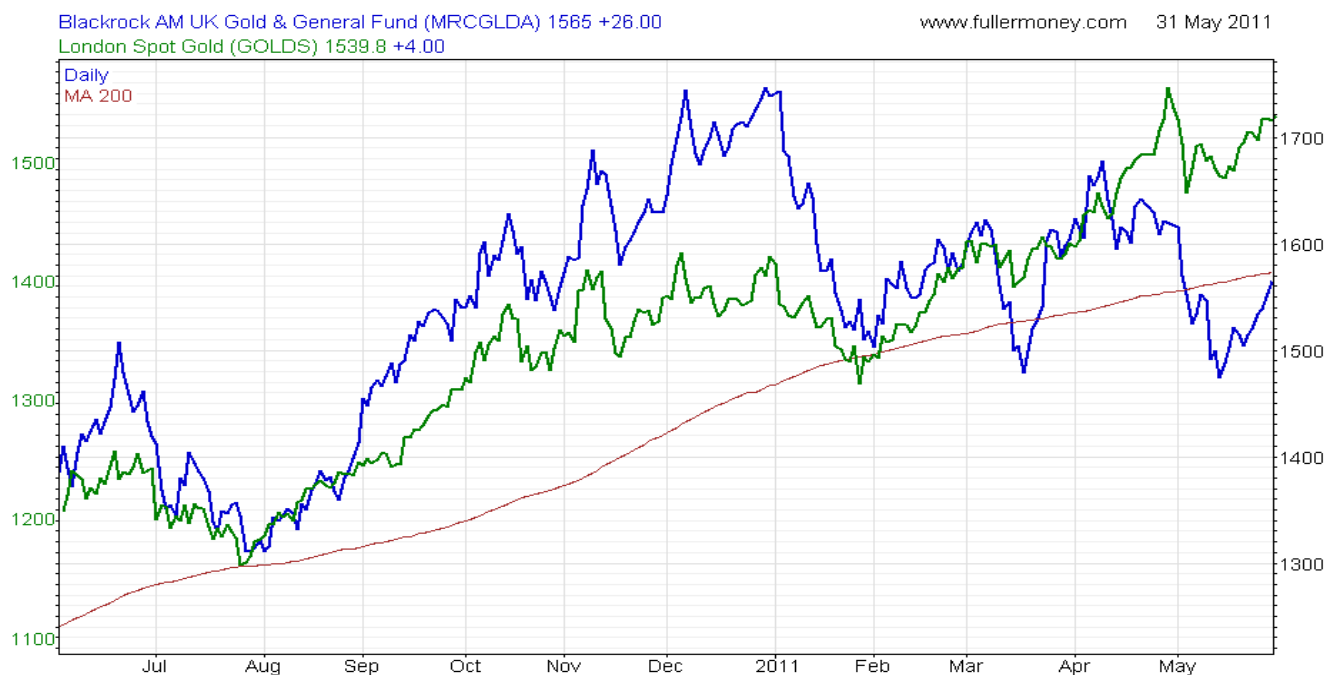


We can clearly see that stock markets tend to move up in a stepped pattern. They proceed on a clear upward trend and then have a period of consolidation. This "Stepping Pattern" is evident in many different global stock markets and other asset classes. We are clearly in a period of consolidation or the sideways part of a step. During this period the glass moves from half empty to half full quite quickly, creating more volatility and resulting in some investors taking fright and selling out of stock markets. So should we sell/reduce equity exposure?

**History tells us we are in a very normal and healthy consolidation period. Despite all of the poor economic and political news, coupled with some natural disasters, the stock markets have not fallen. We believe that it is highly likely we will see the next green step emerge during 2011 and are happy to keep your exposure to Equities for the time being. Obviously we are closely monitoring the situation and if we see this period of consolidation deteriorate then, we may recommend you to reduce your exposure. The risk is that the stepping process breaks down and when it does then equity markets can fall fast just like we experienced in 2000 and 2008. We do not feel that we have a similar situation as back then but obviously there is a risk that we could see markets fall again.**

## GOLD MINING SHARES BREAK DOWN?

Every one of our clients has an investment in gold mining shares via the Blackrock Gold & General Fund. Gold mining shares are usually very highly correlated to the gold price and a strong and rising gold price normally produces great returns for gold mining shares. The chart below shows how the Blackrock fund (blue line) has performed against the price of gold (green line) over the last year:



Gold miners were highly correlated to the price of gold until April of this year. Since then we have seen the price of mining shares fall substantially whereas the price of gold has performed strongly. This has affected the performance across all our investment strategies and is proving to be frustrating. If the price of gold mining shares had acted in accordance with the price of gold then your portfolio would be between 1.5 - 2% higher.

Possible explanations for the underperformance of gold mining shares are:

1. Oil is a major cost for gold miners and this has risen in 2011, which will affect profits of mining companies.
2. Historically May to September in odd numbered years has been a tough time for the price of gold and investors lightened their load in gold miners in anticipation.
3. Gold mining shares have been sold off irrationally like they were in 2008 as investors have booked in profits and reduced their overall risk.

**This leads us to the question of whether we sell, add or stay as we are. Well we slightly reduced the exposure for Cautious clients to gold mining shares last month as we felt that the price volatility of this asset class had increased and it would be sensible to reinvest the proceeds into less volatile funds. However, we remain of the opinion that the blue line will catch up to the green line over the next few months (like it has just started to do) but are concerned by this breakdown. We will closely monitor progress and for the time being not make any further changes, but with a view to reduce exposure if the breakdown in correlation continues.**

## 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:

<b>Broom Consultant's Investment Portfolios</b>	<b>Volatility</b>	<b>Benchmark Funds</b>	<b>Volatility</b>
Cautious	4.02	Average Cautious	4.47
Balanced	5.34	Average Balanced	7.77
Adventurous	7.15	Average Adventurous	9.71

By comparison, the UK Stock Market FTSE 100 has a volatility of 13.33 and Emerging Market Equities has a volatility of 14.31.

**As you can see, all of Broom Consultant's portfolios are currently experiencing a substantially lower risk than their benchmarks.**

## SUMMARY

Current Investment markets are being heavily influenced by political factors. Interest rates and Government Bond yields are being kept artificially low and having an understanding of this is essential in order to protect your wealth from potential future falls in asset classes. If confidence in UK government bonds were to fall, then many low risk UK investors stand to lose a lot of their wealth. Our Cautious clients should be protected from this eventuality.

Despite this being a tough period for investing money, a period of consolidation in equity markets is very normal and very healthy. We are closely monitoring the price action of the main equity markets and expect to see the next step up shortly. However, as always we will monitor the situation and if markets take a down turn we will be prepared to reduce your exposure to equities.

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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.**