Investment Manager Commentary

End 1st Quarter 2009

Most of the first quarter proved to be a grim replication of the equity market conditions that were so damaging in the final quarter of last year, although a “relief bounce”, which started in mid March alleviated losses. Nevertheless, the World Index fell 12.5%, S&P 500 11.7%, FTSE Europe 15.1% and the FTSE 100 11.5%.

Against this, selective emerging markets are showing a little progress, but then these suffered the biggest falls last year, and more accurately reflect the price of oil, up some 11% so far this year.

Interest rates in most major economies have been cut as low as they can go, which is the traditional response to a recession, but credit flows have not recovered. Banks remain unwilling, or unable to lend, whilst the indebted consumer has slammed the breaks on. House prices continue to fall, and unemployment will increase steeply from here; neither providing a positive backdrop for discretionary spending.

The result has been huge volatility in equity markets with economic activity plunging alarmingly on the one hand, balanced by positive reaction to the latest government stimuli on the other. Many of these are unproven, and certainly not trusted by electorates weary of spin, the latest example being the G-20 meeting in London.

Conventional policy has not worked, but this is hardly a standard recession. Efforts have therefore moved on to clean up bank balance sheets by means of government insurance in the UK and public/private co-investment funds in America. The sums involved are breathtaking.

We are still at the early stages of this “balance sheet” recession; consumers, companies, and some countries entered the downturn with far too much debt and this is now being unwound, where possible. The individual can cease all discretionary spending, and has done, witness car sales. Companies can seek to sell assets, or have rights issues, although these are likely to be capped by investor fatigue; only the stronger franchises will survive.

Countries do not have the same options. Lower levels of economic activity produce fewer revenues, and increased costs as unemployment rises. Whilst they can issue more debt, or simply print money, there are limits to what markets will credibly accept. This seemingly painless solution is being implemented in the UK, whilst a much more uncomfortable version, consisting of higher taxes, and lower spending, is happening in Eire.

Outlook

It seems inevitable that the most indebted countries will take the longest to recover, and not surprisingly, these are the same areas that “enjoyed” the biggest property bubble. India and China are at different stages of their development, and it seems likely that growth will continue, albeit at lower rates.

This will not be enough, of itself, to pull the rest of the World out of this downturn. Whilst there will be plenty more new initiatives, since politicians want to be re elected, we foresee a prolonged period with very little, if any, growth. Better corporate numbers, and comments, will occasionally brighten the horizon; destocking cannot continue for ever. But we are some way off seeing what the new, stabilized, lower level of economic activity is going to look like, or how we should attempt to put a price on it.

Many asset prices now reflect the debate of Recession verses Depression, hence the volatility. However, for us, it is more a question of duration; not whether it is getting worse or better relative to where we are today, but how long these conditions will endure.

Since we cannot foretell the future, we will continue to concentrate on preservation of capital in the knowledge that sustainable growth, and the opportunity to profit from it, will return. It just does not feel that this is going to happen in Q2, 2009.

David Oakes **6th April 2009**

IMPORTANT NOTES

This presentation has been prepared for private circulation and is not intended for clients categorised as retail customers under the rules of the Financial Services Authority. This is not a solicitation, or an offer to buy or sell any security. Recommendations do not necessarily imply their suitability for individual portfolios or situations in respect of which further advice should be sought. The price of securities and the income from them can go down as well as up and the amount originally invested may not be received back in full. The past performance of a security or market is not necessarily indicative of future trends. Opinions and recommendations are given in good faith but without legal responsibility and are subject to change without notice, however this does not exclude any duty or liability to a customer which Mercater Capital Management has under the Financial Services and Markets Act 2000. Mercater Capital Management and/or companies connected with it may within the last 12 months have provided investment advice or services in connection with any securities referred to or related securities and those companies or their officers and employees may have a position or engage in transactions in such securities. Mercater Capital Management is authorised and regulated by Financial Services Authority. FSA Register No: 2229392. Registered Office: Whitehead House, Pacific Road, Altrincham, Cheshire, WA14 5BJ. Tel: 0161 926 7150