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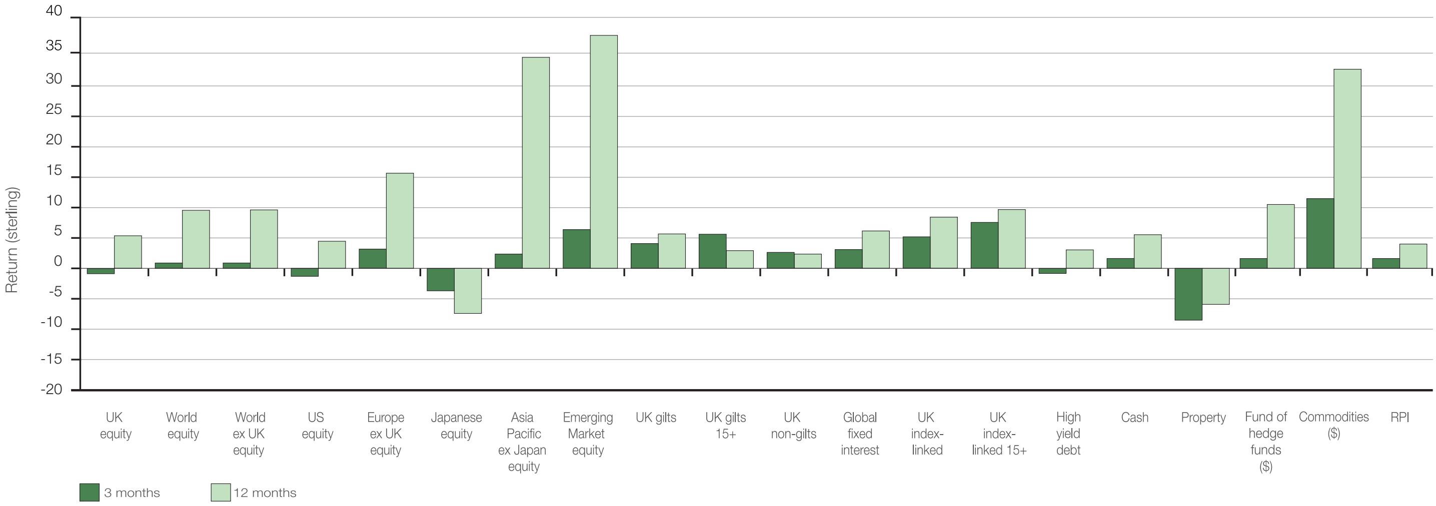
Investment market newsletter

December 2007

Review of investment markets for the 12 months to 31 December 2007

Total returns to 31 December 2007



2007 will largely be remembered for the 'credit crunch' which followed the US sub-prime mortgage crisis. It was a year of two distinct halves; the first six months were relatively quiet, with markets becoming much more volatile in the second half of the year. Over the first six months, concerns about inflation were foremost in the minds of investors. The Bank of England surprised many by raising interest rates earlier than expected in the first quarter to 5.25%, and once more during the second quarter. As a result, bonds (corporate and government issued) generally performed poorly over this period.

The second half of the year was broadly characterised by the effects of the credit crunch. The market responded with a 'flight to quality' where investors moved their assets from riskier investments (such as equities and high-yield bonds) to more stable investments (such as government bonds). The performance of equities issued by smaller companies generally suffered as investors tried to improve the liquidity (the ability to convert an asset to cash quickly) of their portfolios by favouring larger companies that are generally viewed as more stable. Bond markets initially experienced the effect of the desire for safer assets; the UK Government continued to issue bonds and investors favoured these, avoiding the bonds issued by companies, particularly those with low credit ratings. Bond markets produced positive returns during the volatile second half of the year as the Bank of England reduced interest rates in an effort to encourage positive performance in markets.

Despite increased volatility, equities generally recovered and produced strong returns over the 12-month period. Global returns were led by a robust performance from the petrochemical, mining and industrial sectors. Many regions performed better than in the previous year. The Asia-Pacific and emerging market regions in particular performed well, seemingly unaffected by the growing concerns of the more developed western markets.

Commercial property, after several years of strong positive returns, delivered a loss. During the final quarter, many investors became concerned that yields had fallen to levels that were too low. Uncertainty in property values led to some institutional property funds finding it difficult to provide liquidity for redemption requests (requests to take money out of the fund). As a result, some managers have started to impose either penalties or delays for redemption.

Despite all this activity, the year ended as it began, with concerns about inflation, consumer spending and energy prices continuing to create uncertainty in the markets. There are also continuing concerns that the pool of cheap credit which has helped to fuel growth in the past may have run out.