



## Investment Review of 2008 and Outlook for 2009

You're Next Move Could be the most Important One You Make All Year!

**We believe that 2009 will offer many unique investments opportunities and, with a patient approach, has the potential to be a rewarding year for investors.**

Asset prices across the board are severely depressed, driven down by the wave of negative economic and corporate news that swept the financial markets last year. As conditions stabilise, and they will, we anticipate sentiment to improve later in 2009 thereafter followed by asset appreciation. We are not of the opinion that the end of the world is nigh! In summary;

- **Equity Markets;** will be turbulent but end 2009 higher. We are buyers of quality investments on weakness
- **Fixed Income Markets;** will rise in early 2009 but reverse with potential inflation later in the year. A switch out of Government Debt will be required.

- **Property Markets;** will fall further with limited upside on any turnaround.
- **Commodity Markets;** will ebb and flow but provide significant long term opportunity.
- **Alternative Assets;** will provide opportunity for excellent risk-adjusted returns.
- **Cash Deposit;** will no longer be king as interest rates near zero percent.

## What happened last year?

**2008 will certainly go down in history as one of the worst years for wealth destruction as massive losses were recorded across nearly every asset class.** The Sub-prime crisis that begun in the summer of 2007 transformed into a full blown economic crisis by the third quarter of 2008 and engulfed us all. The impact of the deterioration in the UK and global economies is so severe that governments around the world have been forced to act on an unprecedented scale to prevent the entire financial system from collapse. As well as witnessing the first “nationalisation” of a UK bank since the 1970’s we also witnessed the Bank of England reverse monetary policy and cut interest rates by an unprecedented percentage to leave them at their lowest levels for decades and finally even announcing a temporary cut in VAT as a stimulus to the UK economy. Unfortunately even this awe inspiring action was insufficient to restore confidence to beleaguered financial markets and sentiment remained stubbornly negative. Even the moderate rally seen in the last few weeks of the year offered little comfort.

**The UK stock market lost over a third in value** (as measured by the FTSE 100 index), with some of the previously considered solid company share prices falling over 85% (e.g. Royal Bank of Scotland). A loss of confidence continued in property markets as mortgage rates failed to follow interest rate declines and average bricks and mortar property fell 16%, - an unprecedented number. Access to credit as the Banks withdrew lending made corporate and private borrowing even more difficult. The senior management of the Banks has a lot to answer for in our opinion and have failed the economy. Unemployment begun to rise precipitously in the latter part of the year to its highest level in a decade as problems spread from financial markets to high street names (i.e. Woolworths, Wedgewood etc) and in recognition of the difficulties facing the UK economy the Pound fell against most major currencies, nearly reaching parity with the Euro and losing a quarter of its value against the Dollar. As Interest rates fell below the level of inflation even cash has become a relatively unattractive option, especially if you are unfortunate enough to have deposits in any one of the recently troubled banks. Chasing high interest rates from insecure sources became a dangerous pastime. The fixed income markets had mixed results; Corporate bonds fell dramatically as the number of bankruptcies increased whilst at the same time the UK sovereign debt market (or Gilt market) lived up to its safe-haven reputation and shone as interest rates fell. The Government will announce plans for massive issuance of new debt to fund heightened spending needs in 2009 potentially subduing demand. Having failed to predict the severity of the downturn in 2008, many market commentators are now speculating that the UK will claw its way out of recession by the middle of next year. We would rather take lessons from history combined with our own insight. In 1929 Albert Forsch, a partner at Lazard Brothers wrote “It seems to me that the cycle through which we are passing has not run its course, and aside from any slight change in sentiment I fail to detect any indications for betterment...The construction figures are certainly most discouraging. The automobile business if anything is worse, commodity prices have not changed their trend, and

unemployment shows no sign of improvement but seems to be on the increase.” As then, there is no quick fix.

**2009 will be equally as difficult a year for equity markets and most other investments but we expect volatility to subside somewhat and the year to end on a positive note.**

**Against this backdrop when investments seem to be falling in value every day and the press continually bombard us with bad news (unfortunately good news does not sell papers) how should investors position themselves?** As an investor it is almost impossible to remain detached and unemotional and the urge to close positions and retreat from the markets can become overwhelming, even for the most hardened professionals. However, in our opinion history and the present market position indicates to us that now, is certainly not the best time to capitulate. We believe now is the time to evaluate portfolios, make strategic changes where necessary, and look to profit from the many opportunities that will present themselves as undervalued areas of assets rebound.

How will TAM Asset Management seek to help you benefit from the opportunities that will occur in 2009? 2009 will be a year in which those that are able to identify the opportunities that present themselves in a timely and effective manner will prosper and those that can not will fail to meet their investment goals. Each and every asset class will face their own set of obstacles and choosing when to enter and exit these will be crucial. A buy and hold strategy in 2009 will not suffice. A move out of Gilts/Government Debt to Equities, for example, will need to be timed carefully.

TAM Asset Management will be seeking to exploit these opportunities on client's behalf. We expect investment returns to be subdued for the first part of 2009 but we have positive expectations for our portfolios and equities in the latter half of the year.

### **How do we see the various Asset Classes in 2009?**

**EQUITY MARKETS will remain volatile (although perhaps less so than as 2008).** First half performance of equities will be subdued but offers prospect for a “bear market rally”. We believe that the second half of 2009 will see gains and the market will finish higher by year end. 2008 proved to be the worst year for equity market performance for decades causing many to make comparison to the Wall Street crash of 1929. The UK equity market fell 31%, the US and European markets fared similarly

poorly. The sudden negative change in sentiment broke the relationship between company earnings and share price performance as companies with good prospects of delivering solid earnings saw their share price collapse. “The baby was thrown out with the bathwater.” Normal investment analysis was thrown out of the windows and panic ruled many investment decisions, with investors cashing in on their more liquid investments. This has left significant opportunity. Unfortunately this was not a conducive environment for medium to long term investors in 2008 but we anticipate 2009 will provide strong potential. We dealt, in 2008, with these particularly challenging circumstances in two distinct ways; firstly we maintained an underweight allocation to the equity sector throughout 2008, and secondly, we added an element of absolute return equity investment which was better able to defend from falls in share price.

Whilst this strategy did not insulate our portfolios completely from incurring losses in 2008 it mitigated losses and contributed greatly to performance against respective benchmarks.

With the worst now behind us we believe that there is a distinct possibility of a bear market rally and we anticipate 2009 beginning on a good note particularly as the “Obama effect” may lead to moderate enthusiasm in the first quarter. Unfortunately, this said, we do not subscribe to the quick fix school of investing and, against a challenging economic backdrop, fear the market will remain unpredictable and volatile. Companies related to the housing market or credit will continue to struggle and it will be hard for “good” companies to differentiate themselves from the pack, although this will be more likely in 2009.

There are a number of positive catalysts on the horizon which may help prevent further significant losses. We do not believe markets will collapse in 2009 - the inauguration of President-Elect Obama, the stimulus provided by lower interest rate, lower energy prices and improved sentiment will encourage investors to re-enter the markets considering the long term potential. We will therefore continue to adopt an opportunistic investment strategy with regard to equities until clear direction and strength returns.

We will look for under-valued opportunities that have fallen too far, too fast and make strategic investments and to build our equity allocation to a more full weighted position over the course of the year. By rotating out of more defensive positions to higher beta positions we trust will help improve returns as markets recover.

**FIXED INCOME markets are still attractive.** There were mixed fortunes in the fixed income markets last year. Corporate bonds suffered as sentiment soured and corporate profit warnings and

eventually bankruptcies increased. Company after company was downgraded causing investors to seek even great return for holding corporate debt, credit spreads increased and Corporate bond values fell. The mortgage-backed-sector continued to fall (as the primary instigator to many of our current difficulties) and high yield bond sector in general was hit very hard, particularly in those securities related to the financial sector. In the US even government sponsored agency debt was not immune with mortgage issuers Freddie Mac and Fannie Mae teetering near collapse before a government bailout.

Interestingly we are now seeing significant opportunity within the investment grade corporate bond markets where aggregate yields are significantly above their long term averages. At these levels we believe that prudent investors will be amply compensated for the additional risk they are assuming by investing in this sector. We will therefore adding focused investments in this sector during the first quarter of 2009.

The Sovereign bond market (“Gilts” in the UK, or “Treasures” in the US) have been the only real source of significant out-performance during 2008. As the focus for central banks round the world shifted from the fight against inflation to stimulating growth and preventing their respective economies from sliding into recession interest rates have been slashed. Interest rates in the US were cut aggressively, falling to zero (or 0.25%) releasing significant value in the US Treasury throughout the year. Whilst for US\$ portfolios we maintained our US treasury exposure during the year we began consolidating our gains in December and now hold an underweight exposure. In contrast the Bank of England and European Central Bank remained behind the curve only deciding to cut interest rates later in the year (although in the case of the BoE when they decided to cut they announced the biggest cuts ever in history!).

We increased our UK Gilt, and European Sovereign bond Exposure throughout the year in anticipation of further declines in interest rates. Even with UK rates at 2.00% and European Rates at 2.50% we still see room for further cuts and maintain our Sovereign Bond exposure into the first quarter. This Sovereign Debt rise also benefited from a rush to “safe-haven” securities during the year, a trend which may reverse should we see further stabilisation in the financial markets later in 2009. Increased issuance of bonds by Governments around the world to finance their costly stimulus packages may additionally add downward pressure to bond prices but we see gains for the first quarter. Government Debt to High Quality corporate debt will be the move to make as stability unfolds.

**PROPERTY MARKETS show no signs of recovery.** A decade of easy credit and soaring property prices certainly came to an abrupt halt last year as the unchecked issuance of mortgage backed bonds led

to a near systematic failure in the global financial system. The most acute problem has been the reluctance of Banks and other lending institutions to do business with each other or with the general public. The mortgage approval rate suddenly fell collapsed as lending criteria where increased meaning that many where denied access to new mortgages. Perversely even those that were offered borrowing had to face the prospect of higher interest rates at a time when base rates where aggressively falling. Unfortunately as Central Banks cut headline interest rates the Libor rate (the rate at which bank lend to each other) actually rose. A lack of credit, falling job security, increased house hold bills (as energy prices soared) and anticipation of further falls in property prices crushed property demand during 2008. Add the heightened instance of repossessions and it is easy to justify reports that house prices have fallen by on average 16% (even higher in certain areas) and show no signs of recovery. The commercial property space has suffered equally poorly as economic growth slows. Having recommended almost no holding to property in 2007 and zero holding in 2008 (other than for ultra long term holders) we maintain our negative recommendation on the property asset class into the first half of the year.

**ALTERNATIVE INVESTMENTS suffered a perfect storm in 2008.** Alternative investments as a whole (including define return products and hedge funds) posted one of their worst annual performance last year after falling victim to the liquidity crisis, investor redemptions and fraud revelations. Hedge funds in particular where one of the main users of leverage in the financial markets and suffered as credit lines where scaled back and they were forced to unwind very large positions into a very unreceptive markets. As losses mounted for the funds, investor confidence fell and redemption requests increased, adding further liquidity problems for most funds. The collapse of Lehman Brothers investment bank, one of the largest hedge fund prime brokers, caused serious short-term problems for many funds as their accounts and assets where frozen.

The revelation that the Bernard Madoff run Kingate fund was nothing more than an elaborate “ponzi” scheme costing investors a reported \$50 billion (the largest fraud ever!) soared investor sentiment further.

However, we now, as we did last year recommend an allocation to alternative investments for all our balanced portfolios. Through careful due-diligence and a policy of favoring fund-of-hedge funds (to add further diversification to our investments) we were able to navigate successfully through the unsystematic risks prevalent last year. Our portfolio of alternative investments performed well last year, with even the worst performers significantly out-performing the falls in the equity markets. Indeed a number of our funds anticipated the collapse of the credit markets and where able to position themselves to benefit from any declines; an option not available to the majority of traditional managers. We therefore believe that a continuous of our current selection and investment policy will provide a positive contribution to

investor returns in 2009.

**COMMODITY MARKETS will consolidate but provide superb long term opportunities.** Commodity markets after a rapid rise in early 2008 collapsed. Energy prices, one of the main drivers of global inflation in the preceding years accelerated to heady heights on speculation that demand would outstrip supply (interestingly there has never been any empirical evidence that this actually would happen!). Speculation that demand from China and other emerging countries would continue to increase pushed crude oil up to a historic high of \$147 during the year. Oils reversal in fortunes was equally spectacular falling over 70% from its highs (or 53% on the year) as speculators' now forecast falling demand from these same countries. With crude oil and natural gas trading below both long-term averages and below the comfort level for producer nations we anticipate some consolidation in prices followed by a period of appreciation. This will certainly be exuberated should OPEC continue to cut production, continued political unrest in the Baltic nation, military action in Palestine or any stabilization in the economic landscape. We have therefore recommend allocations to global energy markets during the first quarter of 2009 and into periods of weakness.

The metal markets posted mixed performance during 2008; industrial metals performed poorly in the face of an economic decline (particularly as falling industrial production figures were released) but the precious metal market, in particular gold, actually appreciated during the year. Gold's position as a reserve currency gathered strength as the US dollar declined and even managed to hold its ground as the Dollar strengthen against most other major currencies during the fourth quarter. Both its "safe-haven" appeal and the increased demand for physical gold combined with reduced gold sales from central banks helped support the price. The possibility of higher inflation later in the year certainly add to the allure of gold investment which certainly has more potential to advance than many other investments.

**CASH DEPOSIT is no longer King.** The return from cash on deposit becomes less rewarding the further interest rates have fallen. It will therefore be essential during 2009 to manage our cash position within portfolios; marrying the desire to maintain sufficient liquidity to allows us to invest swiftly when compelling opportunities present themselves against the desire to generate a positive return from any over-weight cash allocation. We see that in the first 3-6 months the use of UK Gilts will be a far more beneficial strategy than one of merely holding cash.

**This is where TAM Asset Management can help.**

TAM Asset Management through disciplined research and portfolio construction has sought to ensure that clients are as protected during these troubled times as possible. In 2008 TAM Clients benefitted



from a number of tactical asset allocations decisions made by our investment managers; a lower than normal allocation to equity markets, a higher than normal allocation to Fixed income markets and no allocation to property markets enabled our key portfolios to significantly out-perform both the equity markets as a whole and the multi-asset class APCIMS benchmarks favored by most investment professionals.

**With market volatility so high it is essential you have access to your portfolio whenever you want.** The ethos of our company is to work together with our clients to help them meet their investment objectives. To achieve this we believe that our clients must have online real time access to their accounts - a preserve once reserved for the mega rich. Our clients can gain an insight, through their adviser or direct, into how their accounts are invested with comment from our investment managers explaining the reasons behind every investment made on their behalf.

**Frequent Commentaries.** We believe that it is essential for building the relationship between our clients and ourselves to keep clients informed. Our team of investment managers believe in offering succinct views on the most compelling and topical areas of the investment market. Market Update, Investment idea and General notes are published throughout the year. However, unlike many, our notes are published when we have something important to convey not simple to waste paper!

**Sensible portfolios to meet realistic expectations.** By working with Advisers we seek to ensure that appropriate risk profiles are applied to investors – the goal is to meet client realistic expectations. We seek never to promise what we do not believe can be delivered.

**Protection that goes even further.** Unfortunately many investment managers focused solely on asset selection and ignored the risks associated with the companies with which they used to facilitate their investments. This became a key issue in 2008 when a number of banks and financial companies defaulting on their obligations. TAM Asset Management only uses for clients, the highest quality counterparty when managing your money. In our constant strive to provide clients, with a service of the highest quality and security, TAM Asset Management partnered with Pershing LLC to provide execution, clearing and custody services for all our clients.

Pershing LLC has been providing custody services since 1939 and is one of the most respected provider in the market. Being a subsidiary of the Bank of New York Mellon Corporation adds to the company's reputation. Pershing LLC is regulated by the Financial Services Authority (FSA) in the UK and is required



to comply with the FSA's Client Asset Rules which membership of The Financial Services Compensation Scheme (FSCS) and provision of a surety bond issued by Customer Asset Protection Limited (CAPCO) to protect clients from against financial loss. This security is amongst the highest available to investors and a full note is available if required.

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