

Monthly Investment Strategy Update - April 2010

It looks like recovery is becoming more profit-driven and self-sustaining.

The global economy continues to revive and **there are some signs that the recovery is becoming more profit-driven and less dependent on stimulus measures.** Activity data for the major economies has been comfortably above consensus over the past few weeks. The global PMI is at its highest level since late 2007, while world trade has recovered around 60% of the ground lost during the recession. Nevertheless, the distribution of major forecasters' growth expectations remains skewed to the downside. In other words, they continue to view the glass as half empty rather than half full. Consequently, risk assets are likely to respond particularly positively to any further good economic news.

Improving profits are showing signs of feeding into business investment and employment.

Improving profits are beginning to favourably influence business investment and employment. Investment made a larger-than-expected contribution to US growth last quarter. With CEO confidence close to an all-time high, it is likely to be strong again this quarter. Investment in information technology is picking up particularly robustly. This reflects the desire of US companies to maintain strong growth in labour productivity, as well as pent-up demand, following the massive cutbacks that US companies made in inventories, staff and investment during 2008/2009.

US job growth may soon turn positive.

The US labour market has turned a corner and is showing increasing signs of stabilisation, with the prospect that **employment growth could shortly turn positive.** Temporary employment, traditionally an excellent leading indicator of overall payrolls, has now risen for six consecutive months.

Equities and corporate bonds are more appealing than cash and government debt as recovery takes hold.

With the economy **in recovery, equities and corporate bonds are likely to prove better investments than government bonds and cash.** However, returns from corporate bonds and equities will not match those seen over the past twelve months. Equity markets, which looked cheap a year ago, now appear fairly valued, while corporate bond spreads have returned to their historic average. Gains from here will be harder won and driven by earnings growth rather than re-rating to higher valuations.

Emerging Asian inflation contrasts sharply with the developed world.

In a number of emerging markets, including China and India, inflation is rising sharply and monetary policy is being tightened. This is not the case in the major developed economies, where the combination of large output gaps and the need to prioritise fiscal consolidation will result in official interest rates rising very slowly.

Flat emerging equity markets reflect policy tightening and currency concerns.

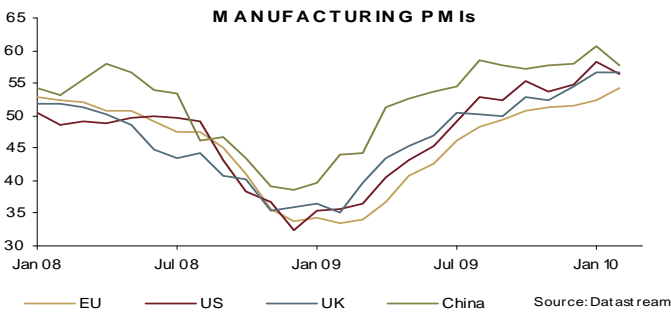
Emerging equity markets are flat so far this year in local currency terms and **emerging Asia has declined by 1%. This reflects concerns that policy tightening and currency appreciation may stifle growth** and hence profits. In contrast, developed markets have gained almost 4% in local currency terms. However, in dollar terms there is little difference between their relative performances.

Security selection will be a more important driver as markets become less homogenous.

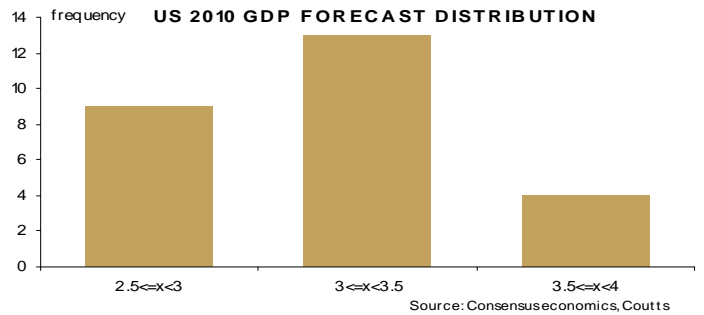
Nevertheless, **the performance of equity markets is becoming less homogenous.** Consequently, security selection will be a more important driver of returns than it was last year. For example, within Europe considerable pressure on domestic economies from financial and fiscal crises, combined with euro weakness, has resulted in less homogeneous performance across stocks, sectors and countries. In this environment, export champions are now outperforming domestically focused companies.

Macro-Economic Scenario in Pictures

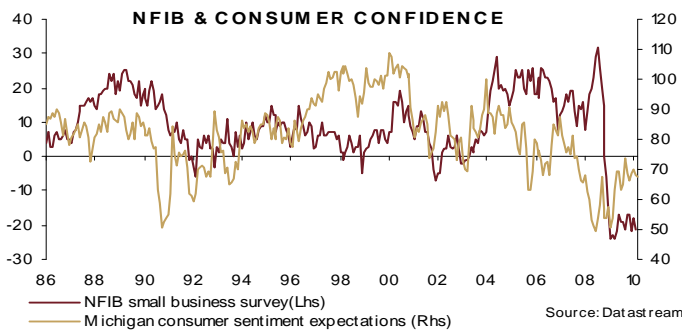
The global economy is expanding again, led by Asia and the US



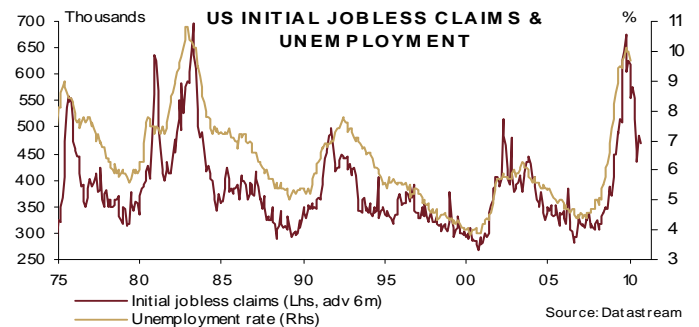
Further good news on the US economy would be a surprise to the markets



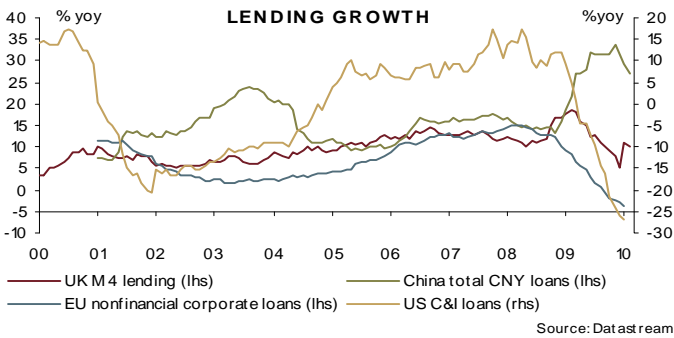
Consumer and small-business confidence remains relatively weak



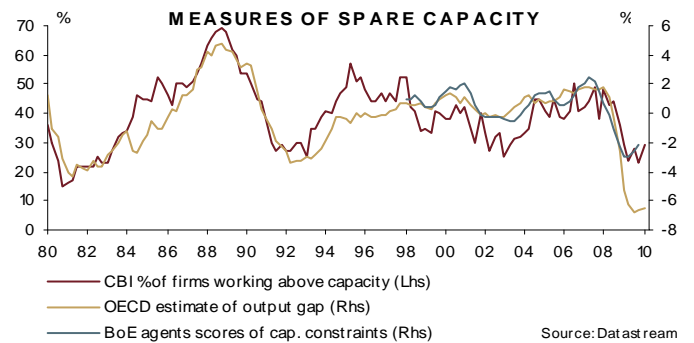
The US labour market has turned a corner, which should help consumer confidence



Headwinds from de-leveraging will hold back the global recovery



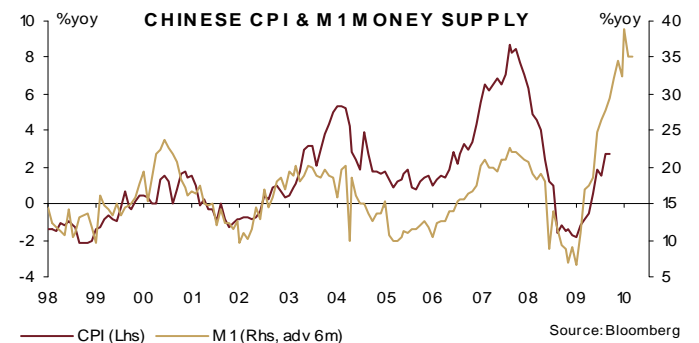
Output gaps suggest deflationary pressure, although other measures indicate it may be less pronounced



Rising government deficits pose structural inflation risks

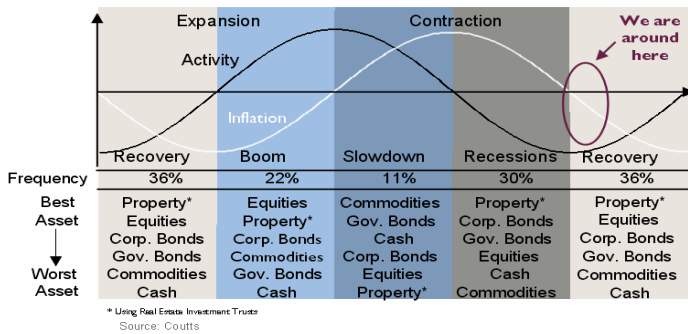


Inflation and interest rates are already rising in emerging markets



Investment Strategy in Pictures

Relative and absolute asset class performance is linked to the cycle, which currently favours equities and credit vs governments



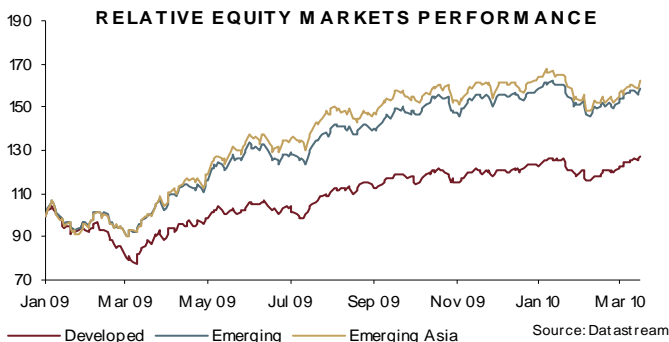
Recovery stage of the cycle points to lower equity returns in the year ahead than over the past 12 months

ECONOMIC CYCLE & EQUITY VALUATION

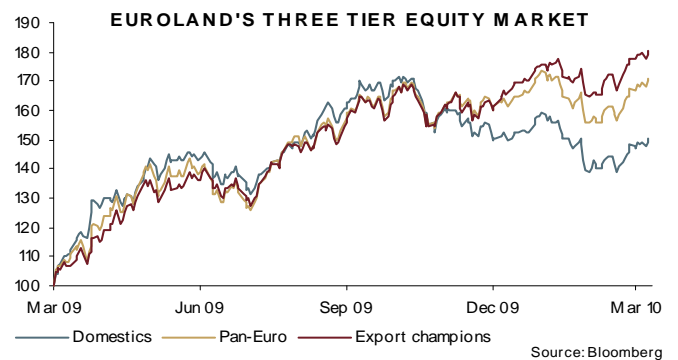
Cycle phase	Duration (in months)	% Δ Real PE	% Δ Real Earnings	% Δ Real Price
Early Recession	15	2	-10	-7
Late Recession	9	39	-5	24
Recovery	20	-8	16	5
Expansion	20	5	24	29
Slowdown	9	3	-10	-8

Source: MSCI, Coutts

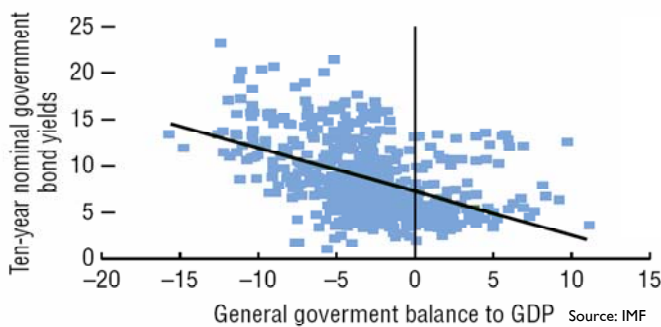
Emerging-market equities, particularly in Asia, have underperformed this year, but we still like them



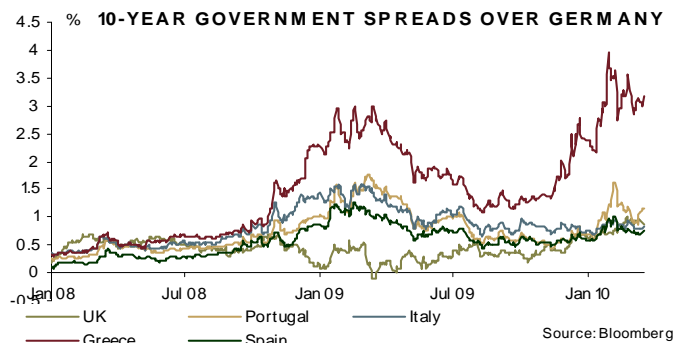
Equity-market performance is becoming less homogenous, as exemplified by Europe



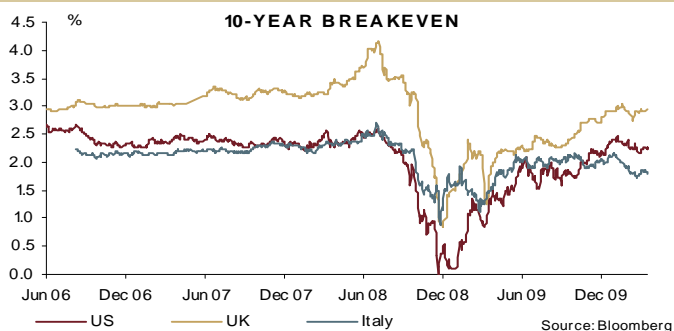
Large deficits and higher debt ratios are likely to eventually result in higher government bond yields



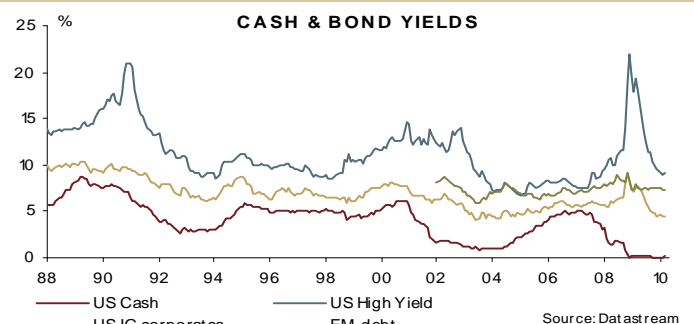
Bond markets are now in control of fiscal policy, as bond yields for high-debt nations are forced higher



Index-linked bonds and gold can be used to protect against outlier inflation risk, but are now looking expensive



Low cash rates are driving a hunt for yield, boosting demand for high-yield and corporate debt





Investment Strategy Recommendations

Tactical Recommendations	Short-Term 3 Months	Long-Term 12-18 Months	Relative Performance (26/03/10)					
			Curr.	-1M	-3M	-6M	YTD 2009	
ASSET CLASS								
Equities vs Bonds	Positive	Positive	Loc.	6.4	3.1	9.2	3.3	24.8
Corporate vs Government Bonds	Positive	Positive	USD	1.5	1.9	3.4	1.4	8.7
High Yield vs Government Bonds	Positive	Positive	USD	5.0	6.5	12.7	5.6	56.8
REGIONAL EQUITY								
US Equity vs Rest of the World	Negative	Negative	Loc.	-1.2	-0.2	4.6	1.1	0.9
UK Equity vs Rest of the World	Positive	Positive	Loc.	0.6	2.7	4.0	2.1	2.1
Europe Equity vs Rest of the World	Neutral	Positive	Loc.	1.5	-1.4	-3.4	-2.1	2.8
Japan Equity vs Rest of the World	Negative	Neutral	Loc.	2.3	2.7	-4.6	2.3	-18.9
Far East (ex JP) vs Rest of the World	Neutral	Positive	Loc.	-0.2	0.0	-3.2	-2.1	19.8
Emerging vs Developed Equity	Neutral	Positive	USD	0.8	-0.1	2.2	-1.9	48.5
STYLE								
World Small vs Large Equity	Positive	Neutral	USD	1.6	4.2	3.6	4.4	14.1
ALTERNATIVE ASSETS								
UK Real Estate vs Cash (as Feb'10)	Positive	Positive	GBP	1.8	7.1	14.9	4.4	0.0
Oil vs Cash	Negative	Positive	USD	1.7	1.3	14.7	-0.8	27.5
Gold vs Cash	Positive	Negative	USD	-1.3	-0.2	11.0	0.6	21.4

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