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Prices

Prices taken on the morning of 10.7.09.

The Pause That Refreshes

Many investors have been surprised by the tenacity and longevity of the current rally which has seen the FTSE Index appreciate by some 27% to its recent peak of 4513.

By restricting their observations solely to the stock market, investors may have obscured their view of other vital developments that may explain why the rally has proved to be so persistent. In commodity markets copper, a bellwether industrial item, has risen by 70% from its recent low, whilst oil, the most economically sensitive raw material, has more than doubled. It follows that currencies of raw material producing emerging economies have outperformed their counterparts. The Baltic Dry Index which has quintupled since its low point in November 2008 indicates an increase in shipping activity. In addition, global bond yield curves have steepened indicating that investors anticipate that the reflationary measures undertaken will ultimately work causing inflation and interest rates to rise. Taking this panoramic view suggests that it is more sensible to conclude that recent statistics are not isolated incidents but part of a wide ranging economic improvement that is lending support to the stock market.

It has been recognised for a considerable time that the property market is a key pillar in the financial system, particularly in the Anglo Saxon economies. Hence the recovery in house prices reported by both the Halifax (plus 2.6%) and the Nationwide (plus 1.2%) for the month of May 2009 in the UK has raised the question of whether the UK housing market could be about to turn. A positive assessment would greatly enhance individuals' collateral with lenders and strengthen the standing of bank balance sheets. Whilst house prices currently stand at 3.4 times disposable incomes versus the accepted average of 3.0, it could be argued that house prices remain 10% overvalued, yet this ratio has been rising. In the 1960s it was only 2.0. In support of housing stability, it should be noted that rents have risen sharply, mortgage rates where available are historically low and unemployment, whilst rising, is not racing upwards at the same pace as it did in the early 1990s. The UK housing market could be ushering in a phase of stability where buyers will regard homes as a place to live in rather than an asset to trade.

Undoubtedly the impressive recovery from March 2009 will come to an end if it has not already done so. Markets do not move in a straight line, but the pullbacks should be modest and in line with the accepted technical reaction of 10%. **Sustained by a wide range of economic indicators the stock market will make further progress interspersed by occasional pauses, yet these will be ones to refresh, and not abort, the longer-term recovery.**

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Charles Stanley Services for Charities

We look after a wide range of Charities, charitable trusts and foundations and firmly believe that each charity is individual with its own specific requirements, concerns, outlook and timescale. Each charity portfolio is tailored to the trustees' requirements and can be designed to reflect any ethical or social concerns. Our practice is not to push charities into in-house funds or products or models. In our view a focused and tailored portfolio provides a better solution.

In addition, we are aware of the importance of income to charities and are strong believers in long-term investment which can provide a rising income so charities can continue with their good work. Naturally we always discuss carefully with the trustees the level of risk which is acceptable. As part of our services to charities we provide regular reviews, comments, valuations and back-up paperwork which can be prepared at times and dates that fit in with requirements. Our charging system is simple and transparent.

We are able to access the Ethical Screening's Online Companies Database. This provides the ability to screen companies for all types of client and is available via Ethical Screenings website. On completing this process, reports and spreadsheets can be produced outlining the companies both approved and excluded, along with the reasons for any exclusion. Reviewing the reasons for exclusion with a client helps to ensure the results meet with expectations. In addition, the analysts at Ethical Screening can discuss any report with the client if necessary.

We expect to post the fifth edition of our Charitynews newsletter in the near future. Please let us know if you wish to receive a copy.

For further information, please contact Nicholas Pearson (ext 6647) or Nic Muston (ext 6610).

Capital Gains Tax

In his Budget speech on 22 April 2009, the Chancellor of the Exchequer, Alistair Darling, left the rate of capital gains tax (CGT) unchanged for 2009/10 at 18%. The previous year he greatly simplified CGT for individuals, trusts and personal representatives by abolishing the complicated indexation and taper relief provisions and introducing this flat rate of 18%. Companies CGT rules remain unchanged with a 1982 and a 1998 pool and indexation still accruing. Ironically Alistair Darling announced this April the introduction of a new top rate income tax of 50% from 6 April 2010. This makes the current CGT rate of 18% look relatively attractive, but there must be a risk that it will be raised in a future Budget.

In the tax year 2009/10, individuals are entitled to an annual exemption of £10,100 (v £9,600). Husband and wife are each entitled to this annual exemption as are civil partners and children. Personal representatives are entitled to the annual exemption in the year of death and in the two subsequent years. Most trusts receive an annual exemption of £5,050. Current year losses must be set against gains for that tax year before using the annual exemption. In the case of losses brought forward from a previous tax year, they do not need to set against gains that are covered by the annual exemption. It is important to show in the annual tax return the amount of any losses you have brought forward and also the total carried forward. Where securities, which have not been sold, are of negligible value, then this will be recognised by HMRC – please check on hmrc.gov.uk/cgt/negvalist.htm If you have made gains which are covered by the annual exemption, it makes sense to postpone a negligible value claim until a year when there are chargeable gains.

The identification rules for when shares are sold are first with acquisitions on the same day; then with acquisitions made with in the following 30 days; and finally with acquisitions treated as coming out of a pool.

The above is based on our understanding of the rules which are subject to change and the benefits of which will depend on your individual circumstances. All clients are strongly recommended to consult with their professional tax advisers.

Larger Companies

COBHAM (COB.L) – Accumulate

The supplier of products and services for sophisticated military and civil systems reported that trading in the first quarter of 2009 had been in line with management expectations. It has seen good growth in its military and government business but, as expected, the Mission Equipment business remains subdued. Trading has benefited from acquisitions completed in 2008 and favourable foreign exchange translation – the US accounted for 55% of revenue in 2008. Cobham has completed the acquisition for $36.25m cash of Argotek, a US national security company. Net debt decreased to £596m (v £641m at the end of 2008). Chief executive Allan Cook will retire at the end of 2009 which has created some moderate uncertainty. **Cobham continues to benefit from ongoing investment in niche technologies and a focus on high growth markets. Accumulate.**

BASIC DATA	
Price	170p
52 week range	
High	241p
Low	152p
Market Capitalisation	£1.9bn
Estimated P/E 2009	9.7
Estimated Net Yield 2008	3.2%
RIC Code	COB.L

MAN GROUP (EMG.L) – Reduce

The investment management company which provides alternative investment products announced pre-tax profit down by 40% to $1,243m for the year ended 31 March 2009. The total dividend for the year was maintained at 44 cents per share. Private investor sales for the year were $11.3bn with net inflows of $2.2bn. Institutional sales were $3.6bn with net outflows of $4.3bn. Net management fee income fell by 23% to $885m and net performance fee income by 62% to $358m. Funds under management were $46.8bn at 31 March 2009. **Although we still believe that Man should benefit from being one of the leaders in the alternative management business arena as competitors flounder, it is clear that the operating environment is still very difficult. Reduce.**

BASIC DATA	
Price	268p
52 week range	
High	639p
Low	150p
Market Capitalisation	£4.6bn
Estimated P/E 2010	11.4
Estimated Net Yield 2010	9.2%
RIC Code	EMG.L

SCOTTISH & SOUTHERN ENERGY (SSE.L) – Buy

The large UK energy company produced operating profit 11.4% higher at £1,541.4m for the year ended 31 March 2009, with all businesses except gas storage and property and corporate services contributing. The total dividend for the year was raised by 9.1% to 66.0p. The company is committed to sustained real dividend growth. Generation & Supply increased operating profit to £832m, 54% of the total. Energy Networks pushed operating profit up by 7.3% to £584.2m. Net debt at the year-end was up 32% to £4.822bn, but less than £150m of medium to long-term borrowings will mature in 2010. The generation portfolio now comprises 42% gas/oil, 37% coal/biomass and 21% renewables. **The balanced range of regulated and non-regulated businesses remains attractive providing a platform to deliver sustained real dividend growth. Buy.**

BASIC DATA	
Price	1140p
52 week range	
High	1549p
Low	1024p
Market Capitalisation	£10.5bn
Estimated P/E 2010	10.4
Estimated Net Yield 2010	6.2%
RIC Code	SSE.L

VODAFONE (VOD.L) – Accumulate

In the year ended 31 March 2009, the international telecoms group increased adjusted pre-tax profit by 17.3% to £10,468m on revenues 15.6% higher at £41,017m. The full year dividend advanced by 3.5% to 7.77p. For the current financial year, Vodafone is expecting operating profits to be in the range £11.0bn to £11.8bn (v £11.8bn). Vodafone, Verizon Wireless, China Mobile and SoftBank are working to create a joint platform for developers to create mobile widgets and applications and access the partners' combined 1.1bn customer base. The strategy continues to be to keep earnings stable in Europe and use the region as a source of cash flow, while increasing penetration in emerging markets. The challenge from software companies, handset manufacturers and content providers will be ongoing, but the mobile phone companies appear well placed. **The value of the shares lies mainly in Europe and the around 45% holding in Verizon Wireless. Accumulate.**

BASIC DATA	
Price	114p
52 week range	
High	161p
Low	96p
Market Capitalisation	£60bn
Estimated P/E 2010	7.9
Estimated Net Yield 2010	7.0%
RIC Code	VOD.L

Rio Tinto (RIO.L) The international mining group has cancelled its proposed transaction with Chinalco of China. It is instead making a 21 for 40 rights issue at 1400p per Rio Tinto share and A$28.29 per Rio Tinto Limited share (the Australian company). The rights issue will raise a combined $15.2bn and cover the mandatory prepayment of Alcan related debt of $7.15bn due in October 2009 and $8.1bn due in October 2010. Rio will not pay an interim dividend for 2009 but the final could be around 72p or more. Rio and BHP Billiton have agreed subject to regulatory and shareholder approvals to establish a joint venture encompassing both companies' West Australian iron ore interests. BHP will pay Rio $5.8bn. In the first quarter of 2009 pre-tax profit fell by 41.6% to $2,433m. At 2952p the shares are on a prospective P/E of 13.3 and yield 2.9%. Market capitalisation is £29.5bn (Rio Tinto). While some metal prices may weaken in the short-term, Rio has excellent opportunities to develop mines in emerging countries. **We still consider Rio to be good value and recommend Accumulate; shareholders should take up their rights.**

SABMiller (SAB.L) The world's second largest brewer by volume and leading emergent market brewer announced resilient results for the year ended 31 March 2009. Pre-tax profit fell by 6% to $3,405m because of a higher interest charge, while revenues increased by 6% to $25,302m. The full year dividend was held at 58 cents per share. Net debt fell by $338m to $8,722m making gearing 52%. Near term refinancing requirements are limited. The shares at 1295p are on an estimated P/E of 14.2 and yield 2.9%. Market capitalisation is £20.3bn. **The group has a very strong portfolio of beer brands and remains a unique vehicle for gaining exposure to long-term growth in emerging beer markets. Accumulate.**

Wolseley (WOS.L) The building supplies company issued a bleak interim management statement for the nine months ended April 2009. Pre-tax profit before exceptionals and amortisation was down 88% at £72m on revenues 15% down at £12.2bn on a constant currency basis. Net debt at the end of April 2009 was £1.5bn (2008: £2.9bn) due to reduced working capital and £1bn raised in the rights issue and placing. On a share price of 1103p, the estimated P/E is 12.5 and there is no yield. Market capitalisation is £3.1bn. **There remains uncertainty about parts of the portfolio in the Central Eastern European region and the rating is high. Reduce.**

Collectives Corner

Fund in Focus - Cazenove UK Smaller Companies

The UK stockmarket, in line with those around the world, has rallied hard and fast since 9 March 2009. A notable feature of this rally has been a marked rotation out of defensive stocks such as telecoms and utilities into more cyclical areas of the market such as retail and property as investor sentiment has shifted in favour of those sectors likely to benefit most from a recovery in economic activity. Driven by the same shift in risk appetite the shares of mid and smaller cap companies have outperformed their larger counterparts.

We recently met with Paul Marriage, a member of the Pan-European equity team and manager of the Cazenove UK Smaller Companies fund. Marriage joined Cazenove in 2005 from Insight where he was head of UK Small Cap investments. The investment process has demonstrated a value tilt over time and Marriage will typically be into stocks early and sell earlier than his peers. The fund will be made up of around 80% in core names and 20% in shorter-term opportunities. He never has and is unlikely to own any names in the Mining and Oil & Gas sectors given that he finds it impossible to value them.

The fund suffered a sharp decline in performance during the final quarter of 2008. Marriage had sold down many of the smaller, more illiquid holdings given the inherent risks at the back end of Q3 but, as small caps rallied hard into the year-end, the fund subsequently underperformed. Recent results have been more promising and the fund has recaptured its lost ground. The fund is highly concentrated and will own between 40-50 stocks.

At present, the fund is only £20m in size and hence Marriage has the opportunity to invest farther down the market cap scale than many of the larger, more established small cap funds (at present there is around a 40% exposure to the Aim market). He believes managing £100m of assets using the current strategy would not be an issue. As a pure play on UK based, UK quoted small caps, we believe the fund looks an interesting proposition and one we will continue to monitor closely.

Sedols: Acc - 0721936; Inc - 0721981

For further information please contact your broker or the Collectives Desk on collectivesdesk@charles-stanley.co.uk

Other Companies

HAMWORTHY (HMY.L)(*AIM) – Accumulate (formerly Buy at 206p in April 2009)

Slowing order intake (-22%) in the second half failed to detract from a very worthy set of full year results in which revenues rose 9.1% to £252.8m, operating profits rose 42.3% to £23m (margin up from 7% to 9.1%) and the dividend was raised 10%. The group (marine hydraulic systems) ended the year with an order book of £260.4m and cash balances of £55.5m.

Increasing after-sales service revenues, operational improvements, continued long-term growth in global demand for LNG and environmental structures (e.g. the imperative that ballast water be treated before discharge) help to underpin Hamworthy's confidence in the future despite seeing a downturn in new ship orders. **Accumulate**.

BASIC DATA	
Price	265p
52 week range	
High	595p
Low	152p
Market Capitalisation	£120m
Estimated P/E 2010	8.7
Estimated Net Yield 2010	3.5%
RIC Code	HMY.L

MAY GURNEY (MAYG.L)(*AIM) – Accumulate

Reporting its results in two new divisions, Public Services (highway, waste and facilities services) and Regulated Services (utility, rail and waterway services) served only to highlight the robust nature of May Gurney's business model. Revenues rose 8% to £470.3m, earnings rose 16% to £20.5m and the dividend was increased by 10%. The group ended the year with an order book up 25% at £1.25bn and cash balances of £18.5m. May Gurney believes that it remains increasingly well placed to help clients achieve change, re-structure services and efficiency savings through the outsourcing of various functions. With public finances stretched who can say the company won't continue its 10 year growth record. **Accumulate**.

BASIC DATA	
Price	177p
52 week range	
High	282p
Low	116p
Market Capitalisation	£124m
Estimated P/E 2010	8.0
Estimated Net Yield 2010	3.2%
RIC Code	MAYG.L

SEPURA (SEPU.L) – Accumulate (formerly BUY at 94p in June 2008)

In 1928 William Pye sold Pye Radio Limited to C. Stanley (no, not that C Stanley!), the company eventually becoming Sepura, a company now selling TETRA (TErrestrial Trunked RAdio) handsets to public safety users in 94 countries. Recent results continue to demonstrate the difficulty of being able to forecast shipments to coincide with financial periods, but having won five of the six tenders announced in Germany to become market leader in the world's forecast largest market, Sepura claim a global market share of 26%. Full year results saw turnover rise 9% to £74.1m, pre-tax profit fell 12% to £13m (principally as a result of investment in routes to market and an increase in R&D) and declared a dividend for the year of 1.27p. Cash balances at the year end were £5.5m but have subsequently been boosted by the unwinding of a year-end working capital position. The company suggests that the current year's results will be flat, as some public safety bodies struggle to fund the adoption and rolling out of their TETRA networks, but hope that two contracts in particular will 'fall' into forecasts as the year progresses to boost the eventual outcome. **Accumulate.**

BASIC DATA	
Price	42p
52 week range	
High	101p
Low	29p
Market Capitalisation	£58m
Estimated P/E 2010	5.5
Estimated Net Yield 2010	nil%
RIC Code	SEPU.L

Please note the market in these shares can be tight.

In Brief

Connaught (CNT.L)/ Mears (MER.L) In our view both these companies are significantly undervalued given the defensive nature and strong growth potential within their markets. Both provide maintenance and support services to the social housing market – Connaught 80% and Mears 69% of revenue – providing excellent visibility and quality of earnings. Connaught also provides services to the compliance market (20% of revenue), while Mears continues to develop its exposure to the domiciliary care market (13% of revenue) each of which also share strong defensive features. Connaught at 362p is on a prospective P/E of 16.4 and yields 0.8%. Market capitalisation is £447m. Mears at 230p is on a prospective P/E of 10.8 and yields 2.4%. Market capitalisation is £170m. **Both companies have already announced that they have secured over 90% of current year estimated revenues from social housing and the shares are attractive. Buy.**

* Please see important regulatory disclosures on Page 8

Charts / Fixed Interest

Charts – Crossing the Rubicon

At any given point in time equity markets are testing levels that have been established in the past, and the direction at the time determines whether they act as support or resistance. Of course, not every previous bottom or top has equal significance and, occasionally, levels are created that bring a downtrend to an end or, as is the case here, stop prices dead in their tracks. The chart for the FTSE All Share shows that just such a point was created back in November: following the dramatic decline which began in early September, the index experienced a sharp rally taking it from a closing low of 1931 to an intermediate peak of 2318 – a gain of 20% in the space of just six trading sessions. That advance did not last, however, and the All Share fell back to 1890, only to rally again at the beginning of January – on that occasion the peak was 2319, almost identical to the previous top.

Now we have seen another major rally run out of steam as it approaches those previous highs, which means that there can be no doubt that resistance has been created. What is interesting, however, is that the market has not retreated – it has simply lost steam and now appears to be marking time – and this looks positive, since it means that it is still within striking distance of new ground. Consequently, a decisive break above 2320 or so would constitute a major bullish event for the UK market.

A similar situation has developed in US equity markets and for the S&P 500 the critical level has become its own January high. In this case it is the intra-day peak, at 943, that has become an obstacle to further upside although, at the time of writing, the index is within 1 point of this apparent resistance area and it is not inconceivable that it will be breached before too long. Should that happen investors will have taken a step across the Rubicon and, to paraphrase Julius Caesar, the die will have been cast in favour of the bulls.

Charts by courtesy of Metastock

Fixed interest

For government bond markets on both sides of the Atlantic, the enormous amounts of supply continues to be the significant factor and in the medium-term this is likely to keep bonds under pressure. The Bank of England has extended its Quantitative Easing programme to £125bn, but this is unlikely to give enough support to turn yields round. In the corporate bond market, spreads are still continuing to tighten – an index that we follow has moved from +448 in the middle of March to +333 at the time of writing. This significant move is in part a result of the improvement in bank paper, but buying is taking place across all sectors. So yet again we would continue to recommend purchases of good quality shorter dated corporates, availability permitting, and also shorter dated index-linked gilts. For investors wanting a spread of corporate bonds, we still recommend M & G Strategic Corporate Bond fund (price 53.9p, yield 5.2%) and Invesco Perpetual Corporate Bond fund (price 69.2p, gross yield 6.4%).

Selected Stocks

	Price	Gross Red Yd%	Yield to taxpayer 20%	Yield to taxpayer 40%	S & P Credit Rtg
Treasury 4.0% 2016	105.49	3.15	3.03	2.27	AAA
Treasury 4.25% 2027	98.71	4.35	3.44	2.59	AAA
Treasury 2.5% I-L 2013	244.56	1.33*	–	–	AAA
Treasury 2.5% I-L 2016	278.38	1.15*	–	–	AAA
Marks & Spencer 6.375% 2011	102.05	5.35	5.00	3.75	BBB–
National Grid 6.125% 2014†	103.36	5.25	4.74	3.56	BBB+
BATS 6.375% 2019	102.56	5.94	4.97	3.73	BBB+
Tesco 5.5% 2019	101.88	5.19	4.32	3.24	A–

* real return at 3% inflation   † minimum denomination 50,000

Certain bonds recommended may have to be held through a nominee account which could incur a holding charge.

S2P OR NOT S2P, THAT IS THE QUESTION

The Slings and Arrows of Protected Rights

Although many occupational pension schemes are contracted out of the State Second Pension (otherwise known as S2P and previously SERPS), it was not until 1988 that it became possible for holders of personal pension plans to elect to contract out via an 'appropriate personal pension', under which arrangement a part of their Class 1 National Insurance contributions was refunded each year and paid direct to his or her chosen pension provider. The personal pension plan holder is thus foregoing their entitlement to SERPS/S2P (but not the basic state pension which is unaffected by this decision) in the hope that the invested rebates will grow sufficiently to generate a pension at retirement higher than that provided under the Government scheme. Initially, financial incentives were offered for contracting out, but the impact of these diminished and the extent of the rebate has been adjusted several times in recent years. Much energy has been put into creating 'decision trees' which attempt to guide people as to the risks and benefits of contracting out but, in spite of this, many insurance companies – the primary providers of personal pension plans approved for contracting out purposes – have progressively withdrawn from this market, in some cases compulsorily contracting their policyholders back into S2P should they have failed to make alternative arrangements. There has, however, remained a sturdy body of people who wish to continue to contract out as they have a preference for holding their own retirement funds rather than relying upon a promise of possible future Government funded benefit. These people understand the risks and are prepared to accept them. To their disappointment this choice is to be taken away from them.

Following the Pensions Act 2007, the ability to contract out of S2P via a personal pension/stakeholder plan or defined contribution/money purchase occupational pension scheme will cease from April 2012. At this point all persons contracted out via these vehicles will be automatically contracted back in, but protected rights funds accumulated to date within personal pensions or occupational pensions will remain available for investment.

Many people hold protected rights funds in specially designated 'rebate only' personal pensions and until recently were substantially wedded to their pension provider's in-house fund range. The only alternative was to take a transfer from one insured personal pension to another, but this would frequently bring with it an equally restricted choice of investment funds. Happily from October 2008 it has been possible for providers of self invested personal pension plans (SIPPs), to accept protected rights funds thereby enabling investors to allocate their rebate monies in exactly the same way as their personal contributions. The Charles Stanley Alpha and EBS SIPPs are able to take accumulated protected rights on board (but not continuing rebates for the last few years that they are being paid) so that clients may breathe new life into their protected rights arrangements by investing in line with their overall retirement investment philosophy – there are no restrictions other than those applicable in law or specific to the plan. This facility has proved immensely popular since introduction last year, as clients like the personal control, flexibility, transparency and comparatively low cost of a SIPP when compared with many of the old style personal pension contracts.

Such an arrangement is not suitable for everyone and individual advice is required so that personal requirements and attitude to risk can be taken into account. For those who are currently contracted out via a personal pension – or those previously contracted out who have already opted back in – now could be a good time to review the options for accumulated protected rights funds.

For detailed advice and information regarding pensions and other forms of retirement funding please contact your broker or the Charles Stanley Financial Planning Department on 020 7149 6549.

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Charles Stanley

Regulatory Disclosures

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"Gearing" means a strategy, with a view to enhancing the return for, or the value of, an investment without increasing the amount invested by the holders of the investment, involving one or more of the following: (i) borrowing money;
(ii) investing in one or more instruments, such as (but not limited to) warrants or derivatives, for which a relatively small movement in the value or price of the underlying rights or assets to which the instrument relates, whether favourable or adverse, results in a larger movement in the value or price of the instrument; and (iii) structuring the rights of holders of an investment so that a relatively small movement in the price or value of the underlying rights or assets, whether favourable or adverse, results in a larger movement in the price or value of the investment. The strategy that the issuer of geared investments uses or proposes to use may result in (a) movements in the price of the investments being more volatile than the movements in the price of the underlying investments; (b) the investment being subject to sudden and large falls in value; and (c) you getting back nothing at all if there is a sufficiently large fall in value in the investment.

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Equity, bond and technical analysis use different research recommendations definitions. These are set out on the above website, as is a summary of the bases of valuation and methodologies used by us to evaluate or set price targets for the subjects of our research. Details of the proportions of all research recommendations published during the preceding calendar quarter can be found at www.charles-stanley.co.uk/Research.jsp

Company-specific regulatory disclosures

Shares in smaller companies tend to be traded less frequently and in smaller amounts than those of larger companies. This means that price volatility is greater, which makes the timing of sales and purchases more difficult. Prices quoted in newspapers are only an indication of the actual dealing price, so you should ask for a quote before placing an order. Investors should be aware that shares traded on the Alternative Investment Market (AIM) carry a higher degree of risk than main market companies. As AIM is less regulated, less information is available. Of the companies featured this month, Hamworthy and May Gurney are traded on AIM.

The author of the reports in this newsletter on Hamworthy, May Gurney and Sepura has a personal account position in these companies.

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