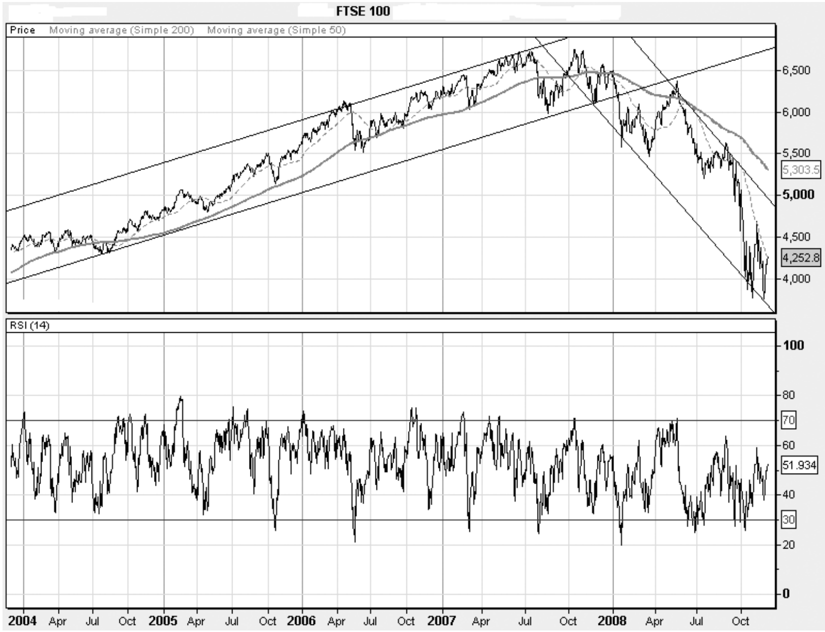
MARKET WATCH

by Mark Maloney Managing Director,
Gibraltar Asset Management Limited



Market Stats 27/11/2008

Major Indicies		
FTSE 100	4,223.10	
FTSE 250	6,036.64	
Eurostoxx 50	2,427.97	
S&P 500	887.68	
Nikkei 225	8,373.39	
Economic Indicators		
Inflation (CPI) % chg on year	5.20	
	current	*since*
Base Rate-UK	3.00%	06/11/2008
Base Rate-US	1.00%	29/10/2008
Base Rate-EU	3.25%	06/11/2008
Sterling Exchange Rates	*spot*	
US ($)	1.5434	
Euro (€)	1.1965	
Japan (¥)	147.2123	
Commodities	*spot*	
Oil Brent ($/Barrel)	55.19	
Gold ($/fine oz)	815.90	

Economic Outlook

The outlook for the UK economy is continuing to deteriorate with falling housing prices, higher unemployment and government borrowing rising to record levels. This is exerting downward pressure on the pound, which is expected to continue particularly against the euro. Further easing of fiscal and monetary policy is expected which although helping the economy will bring more misery to savers and pensioners alike.

Equity Technical Outlook

With the FTSE 100 over 35% off its recent high of 6732.40 reached in October 2007, equities remain firmly entrenched in a bear market. The main indicator of the movement's strength the RSI (Relative Strength Index) has just risen above the signal level of 50, which is a bullish sign. The index is massively below its bearish trend channel with no technical support until the 3,500 level. We expect the market to pull higher in the coming weeks with the fourth year of a US presidential election and the traditional "Santa Claus" rally providing seasonal support.

Investment Master Class

Preference Shares

With the world's major countries slipping into recession, many investors are taking their money off the table and placing their assets in cash. Unfortunately interest rates are falling as central governments scramble to protect their precariously balanced economies. Their bond yields have been driven down to unseen levels as the flight to safety has begun in earnest. This was recently witnessed by US Treasury bills which saw yields fall to –0.02% i.e. investors were actually paying the US government to hold their money for them. Not only that, cash held in the bank has proven to be not as safe as previously assumed with accounts being frozen at well known institutions such as Icesave amongst others. Even capital guaranteed structured products have been exposed with their "guarantee" only being as good as the guarantors' ability to remain in business.

This is leading investors to seek more adventurous ways of preserving the purchasing power of their capital and providing sufficient income. One interesting part of the stock market, which tends to attract little attraction but provides high levels of income is the market in preference shares, which typically yield more than 7%.

Preference shares are a special class of share, issued mostly by banks and insurance companies, which pay a fixed dividend net of tax. As the dividends are paid out of taxed corporate profits they are classified as "franked investment income". This is particularly beneficial for UK taxpayers as they pay a fixed interest rate net while bonds pay a fixed interest rate gross.

They are generally regarded as slightly lower risk than ordinary shares because they rank ahead of ordinary shareholders in the event of liquidation but they rank below corporate bonds. Preference shareholders are compensated for not receiving the growth element and rising dividends of ordinary shares nor the additional security of a corporate bond by the higher rates of interest on offer.

It may be rare for a big company to collapse, but it is possible that a troubled firm may not be able to pay a dividend to all shareholders (though only 3 out of the 100 existing issues are currently in arrears). Again, preference shareholders benefit because companies have to pay preference dividends in full before they can pay an ordinary dividend. Many preference shares are also cumulative, meaning if the company misses a payment, the dividend rolls up and has to be paid in full, including any arrears, before the company can resume paying dividends on its ordinary shares.

Most preference shares are irredeemable, which means there is no set maturity date. Thus, like undated gilts, the prices of preference shares tend to be more sensitive to movements in interest rates than shares with a fixed redemption date although some can be redeemed either at the market price at any time or at a pre-set price (usually par value) on a specific date (known as callable prefs). It is interesting to note that yields are mainly affected by the perceived standing of the company in terms of financial robustness rather than the fact whether they are cumulative or callable. For example, cumulative preference shares tend not to have noticeably lower yields than non-cumulative ones, despite the greater likelihood – although no absolute uncertainty – of the dividend payment being made in full. Likewise callable stocks can be less volatile than irredeemable prefs close to the date at which redemption may happen, yet do not tend to have lower yields.

There are pitfalls to be aware of when investing in preference shares. A takeover might result in unreasonable terms being offered for the preference capital, or in them being left alone, but this is something of a grey area. They could be repaid at par, but this is unlikely. Liquidity can be an issue with most market makers only making prices in sizes of £25,000 at the quoted price. The spreads can also be wide with bid offer spreads of 5% or more being the norm.

However we believe that the fixed interest paid by preference shares can make them ideal for income seekers. With further cuts in interest rates expected, good yields can be locked away now and they can always be sold at a later date and the cash invested elsewhere should a better rate of interest be found. Likewise the low market sizes sit well with the mindset of having a well-diversified portfolio.

One preference share that warrants particular attention is the General Accident 8 7/8%. This is a cumulative pref which pays a dividend twice a year on the 1st of January and 1st of July. The shares are pricing at 107.5p, which puts them on a yield of 8.2%. Having traded above 150p in the last three years, the shares are trading at a multi-year low, which could see investors pick up a nice capital gain as well as the above average yield in the years to come.