GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Newsletter - Spring 2009

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EQUITY MARKET OUTLOOK

At the start of the year we suggested that UK equities could have a good year - notwithstanding high volatility and terrible figures released during the first half.

The latter is still applicable but in the last few weeks the VIX has come down dramatically. This is a bullish sign as many investors have stayed on the sidelines while the volatility has made it extremely dangerous to attempt trading.

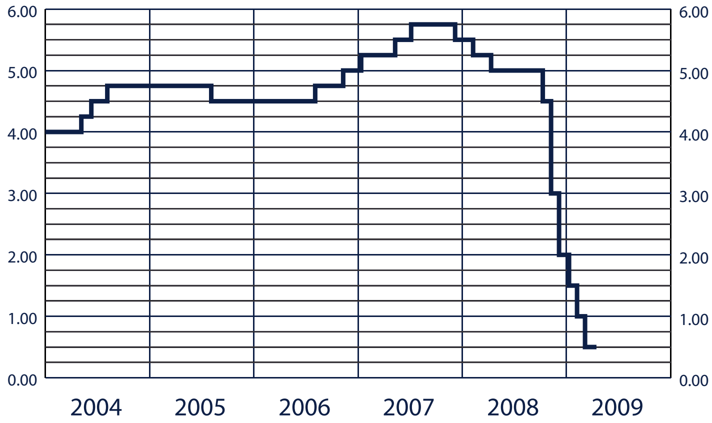
The market is currently trading below long term average Price/Earnings ratios, with the trailing PE ratio (based on historical earnings) currently below 10 partly as a consequence of shattered confidence and frayed nerves, but risk appetite is returning.

The ten year bond yield is 3.65% and returns on cash are minimal. Discounting further dividend cuts we still have the All-Share index yielding around 4% by year end.

Over the long term the Bond/Equity yield ratio has not remained below 1 for long as equities tend to grow their dividends and therefore we would argue that this is a medium term buy signal.

FTSE100 close prices over the last 5 years. *Data Source: ProQuote.*

AS A MATTER OF INTEREST...



Bank of England base rate. *Data Source: BoE*

As interest rates sit at their lowest point in the Bank of England's 315 year history, income on deposit account savings has been decimated with deposited cash now returning close to zero.

The general consensus, following the announcements on May 8th that the sterling rate is to remain at 0.5% and of a further cut in the Euro rate, is that interest rates won't be heading northwards any time soon. So the assertive move for nest-egg cash is alternative income-producing investment vehicles.

Bonds are a good income generator, while they can fluctuate in value, many have a good record of providing a steady income.

When buying bonds, rather than guesstimate which direction interest rates will go in terms of what maturity date to purchase, a '**Bond Ladder**' is a straightforward strategy that provides reliable income and the chance to capture higher interest rates.

A bond ladder is the name given to a portfolio of bonds with different maturities, so you won't be locked into one particular bond for a long duration.

This considered investment approach gives a better return on cash than the near-inert savings account. On the next page we take an in-depth look at the workings of a typical bond ladder.

Next issue: Proactive stock picks for the toughest of economic climates.

Gibraltar's Member Firm of the London Stock Exchange

Gibraltar Asset Management Limited
One Irish Place
PO Box 166
Gibraltar

Website: www.gam.gi

Telephone: (+350) 20075181

INCOME STRATEGIES WITH A BOND LADDER

A "bond ladder" removes the necessity to forecast where interest rates are headed and focuses instead on factors that are most common to the fixed income investor: safety, high current income, predictability of future income, and adaptability to changing conditions.

A bond ladder is the name given to a portfolio of bonds with different maturities. Suppose you had £100,000 to invest. Using the bond ladder approach, you could buy ten different bonds each with a face value of £10,000. Each bond, however, would have a different maturity. One bond might mature in one year, another in two years etc all the way out to ten years. Each bond represents a different rung on the ladder

With a laddered portfolio, under normal market conditions, you realise greater returns than from holding only short-term bonds, but with lower risk than holding only long-term bonds. Moreover, by spreading out the maturities of your portfolio, you mitigate the effects of interest rate changes.

The advantage is that you don't need to worry about movements in interest rates - especially if the ladder you construct has notes coming due every year. If rates do rise soon after you bought this year's bonds, you can take comfort in the fact that soon you will have money coming available to take advantage of the change. Similarly, if rates decline after you buy, you've managed to lock in the higher rates for most of your portfolio. The bottom line is, you won't get stuck one way or the other. Bonds close to maturity are reinvested back out at the long end (i.e. at the top of the ladder) which will result in a continuous rolling of the portfolio.

An example bond ladder constructed with £108,000 to give 10 rolling holdings maturing over the next decade.

Portfolio Running Yield: 5.54%, Portfolio Gross Redemption Yield: 4.09%

Interest Date	S&P	Nominal	Security	Coupon	Maturity	Price	Cost	Yield	GRY	Income
15-Dec	A-	10,000	Anglo American	5.125%	15/12/2010	104.30	£10,430.00	4.91%	2.32%	£512.50
07-Nov	BBB-	10,000	Marks & Spencer	6.375%	07/11/2011	104.70	£10,470.00	6.09%	4.32%	£637.50
29-May	BBB+	10,000	Compass Group	6.375%	29/05/2012	108.55	£10,855.00	5.87%	3.37%	£637.50
29-Jan	BBB-	10,000	BATS Intl.	5.750%	09/12/2013	107.10	£10,710.00	5.37%	4.01%	£575.00
08-Dec	BBB+	10,000	Pearson	7.000%	27/10/2014	112.00	£11,200.00	6.25%	4.46%	£700.00
04-Mar	AA-	10,000	Roche	5.500%	04/03/2015	106.50	£10,650.00	5.16%	4.21%	£550.00
14-Jun	A-	10,000	Rolls Royce	7.375%	14/06/2016	116.55	£11,655.00	6.33%	4.58%	£737.50
07-Jun	A-	10,000	National Grid	6.000%	07/06/2017	109.25	£10,925.00	5.49%	4.60%	£600.00
15-Oct	AAA	10,000	EIB	4.750%	15/10/2018	105.15	£10,515.00	5.52%	4.08%	£475.00
13-Dec	A-	10,000	Tesco	5.500%	13/12/2019	105.05	£10,505.00	5.24%	4.87%	£550.00
		100,000					£107,915.00	5.54%	4.09%	£5,975.00

Portfolio dated as at 11 May 2009

Why Use A Bond Ladder?

1. By staggering the maturity dates, you won't be locked into one particular bond for a long duration. By using a bond ladder, you smooth out the fluctuations in the market because you have a bond maturing every year (or thereabouts).
2. It provides the ability to adjust cash flows according to their financial situation. You can generate a regular income based upon the coupon payments from the laddered bonds by picking ones with different coupon dates. This is more important for retired individuals because they depend on the cash flows from investments as a source of income. If you are not dependent on the income, by having steadily maturing bonds, you will have access to relatively liquid money.
3. A laddered bond strategy provides the potential for high current income, diversification of bonds and maturities, predictability of future income, and the ability to automatically adapt to a changing interest rate environment. A laddered bond strategy does this without requiring investors to forecast future interest rates or make complicated reinvestment decisions.
4. The laddered strategy spreads out the fixed income capital over a range of maturities. Income generated by the laddered portfolio strategy will gradually change in line with the overall direction of interest rates. With a laddered portfolio, under normal market conditions, you realize greater returns than from holding only short-term bonds, but with lower risk than holding only long-term bonds. Moreover, by spreading out the maturities of your portfolio, you mitigate the effects of interest rate changes.