

## Investment Outlook for 2009

Prepared By Landmark Financial Planning.



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### Introduction

Welcome to Landmark's Investment Forecast for 2009. What an extraordinary year 2008 proved to be. The global banking system grinding to a halt combined with the onset of a recession in Europe and the US culminated in unprecedented actions by Governments around the world. 2008 is likely to be a year that shook out many of the excesses of the financial system and in some way laid the groundwork for future global prosperity. In any event it is time to look forward as even in the most difficult times, new opportunities will arise.

Please remember, when reading our forecast, any short term period has to be put into the context of longer term trends which is our main focus.

As always, I remind you that we are not stock pickers (we leave stock picking to those with time and resources) but asset allocators trying to select the right asset class in the profitable cycle of the asset. This helps to improve returns and manage risk.

### How accurate was last years forecast ?

Before looking forward, we need to check the accuracy of our forecast. I know many of you will have neatly filed away last years forecast ! but for those less organised last years predictions are shown below.

	Forecast (2008)	<u>Measurement</u>	<u>Outcome</u>	
Cash	Neutral/Negative	B of E base rate	- 3.5%	√
Bonds	Neutral	iBoxx £ Gilt 5-15 years	+14.4%	x
UK Residential Property	Negative	Nationwide HP Survey	-13.9%	√
UK Commercial Property	Neutral	IPD Index	-21.3%	x
Equities	Positive	MSCI AC World Index	-43.5%	x
Commodities	Neutral/Positive	DJ – AIG Commodity Index	-38.1%	x
Oil Price	Negative	Oil Price Data	-49.6%	√
Gold	Negative	Gold Price Data	+3.9%	x
Inflation	Neutral	Consumer Price Index	+1.2%	√
Interest Rates	Neutral/Negative	B of E base rate	-3.5%	√

## **Our process (you may wish to skip this section if you are already familiar with it)**

I thought it would be useful to run through our investment process as it is fundamental to how we advise and manage your investments and financial planning.

### Stage 1

The starting points are your financial and lifestyle objectives. Your portfolio will need to provide income or capital at various times during your lifetime and the risk and reward tolerance has to be established to meet expectations.

### Stage 2 – Asset Allocation

An appropriate split of investments between the main investment asset classes provides risk management and diversification. Our risk rating formula allows us to design a portfolio to meet your risk tolerance.

### Stage 3 - Forecasting

Over the long term (10 years+) the expected returns from the main asset classes are more predictable as investments perform in a cyclical nature. Over the short term (1-3 years), the performance of asset classes will depend upon their position in regard to their investment cycle and current economic conditions. We feel it is important to position your portfolio in investments that we feel will perform over the next 12 months, and if the forecast is correct, underperformance may be avoided.

### Stage 4 – Fund Selection

We help you select the appropriate collective investments to meet your asset allocation. We leave stock picking to the major investment houses who manage these funds as they have the resources and research facilities to perform this difficult task. We hope to choose fund managers that can produce outperformance and due to the high number of funds available, can be replaced if underperforming.

### Stage 5 – Review

It is essential you review your portfolio at least annually to take account of any changes in objectives, risk tolerance and short term forecasting. Our main benchmark is to outperform cash returns otherwise the risk reward of capital invested is not worthwhile.

## **Forecast**

A brief word about how we derive our views. Financial forecasting is a difficult business and can be split into short term (1-3 years) and long term (5 years+). To be consistently accurate in the short term is very difficult and a higher level of accuracy is usually achieved in the long term.

If you read the financial columns of the daily newspapers you will see the diversion of opinion on how the main asset classes and particularly equities

will perform over the next 12 months. For every positive forecast there is a negative one, so who do you believe ?

We compile our forecast from information provided by a number of market strategists who we believe have a solid basis for their data and a good track record. We also listen closely to the views of some of the main investment houses who provide a reliable perspective on global markets. The filtering of this information combined with our own views and experience produces our forecast.

A brief word regarding the indices we use to measure our asset classes. With the exception of simple prices such as gold, oil etc, we use indices which measure a broad range of components for each asset class. In the case of equities, the MSCI All Country World Index is a measure of global equity markets split by capitalisation. Different sectors within the index will have performed better or worse than others. To review all individual sectors would be beyond the scope of this forecast.

## **Review of 2008**

If someone had explained at the start of the year the events that were to unfold during 2008, they would have been regarded as unbelievable.

The events of 2008 have been well documented and news coverage has provided a blow by blow report of all the serious issues. At the beginning of the year, global markets suffered significant falls as investors wrestled with the implications of the credit crisis. This was followed by short periods of recovery and decline. Into September and October we experienced what was effectively a stockmarket crash.

The banking crisis, collapse of US investment banks and economies slipping into recession has resulted in Government intervention in the US and Europe on an unprecedented scale. The swift reduction of interest rates and cash stimulus are attempts to bolster the banking system and to bring the main economies out of recession.

During these times, a great deal of introspection takes place and at Landmark we have asked the question why our forecasting did not provide a clearer picture of the banking crisis and collapse of commodity and equity markets. It is probably true to say that none of the major forecasters had predicted the sort of epic events that were to unfold in 2008 and this is unusual as there are always a few lone voices.

We think there are two main reasons why it became difficult to predict the events of 2008. In terms of the banking crisis, the depth and complexity of the structures created by retail and investment banks were such that it became virtually impossible for anyone to have a complete picture of the high levels of risk and lack of due diligence being undertaken. It became apparent that even at board level, senior managers knew nothing of the type of investments made and how their failure could affect the financial stability of the institutions they managed.

More importantly, when looking at equities, we did not believe markets were overvalued. Infact, we believe (and still do) they were undervalued. In the case of a crash, markets become severely oversold. This was the case for the residential UK property and commodity markets. In these sectors, high levels of demand lead to increasing prices and ultimately a bubble. In both cases, it is clear to see speculation has overvalued the asset class and prices had to fall. This has been borne out by the bursting of bubbles in both markets during 2008.

In the case of equities, there had been no significant increase in value and the high point of global markets was reached in October 2007. On normal fundamentals, equities were undervalued; however, valuations were devastated in October 2008. In our opinion, these valuations have been overstated and gives us greater potential for recovery moving into the New Year.

## **Investment Asset Forecast 2009 (UK)**

Many of the asset classes listed below subdivide into a number of categories and an analysis of each of these subdivisions is beyond the scope of this report. The forecast provided is general relative to the asset class.

### Cash – neutral/positive

As the economy slipped into recession, the Bank of England took decisive action by reducing interest rates from their height of 5.5% at the start of the year to the current rate of 2%. Reductions of 1.5% and 1% occurring in quarter 4 of 2008.

Earlier in the year, high interest rates were supported by the view that inflation could pick up again and the banks were offering rates well above the rate of inflation to attract funds which were needed to assist with the rebuilding of their balance sheets. This period was ideal for investors who were obtaining real returns for low risk.

In quarter 4 of 2008, the view on inflation changed as the Bank of England expected inflation to come under control. In addition, it was felt important to stimulate the economy by reducing rates. In 2009 we expect rates may fall again during the first quarter of the year but as 2009 progresses, inflationary pressures may return and the Bank of England may see the UK moving out of recession. The result will be an increase in rates.

Whilst our position is neutral at the moment, investors may see improving returns during quarters 3 and 4 of 2009.

## Bonds - Government Bonds – negative/Corporate Bonds – positive

The bond market has seen a number of interesting developments during 2008. Government bonds performed well producing real returns due to the significant reduction in interest rates which led to lower yields and therefore increased capital values. There was also a high demand as investors sought safe havens for their capital.

Corporate bonds however have maintained higher yields which has resulted in a larger spread between Government and corporate bonds. This has been due to the credit crisis which has meant the expected default rate on corporate bonds has been high therefore supporting higher yields.

Our view is Government bonds have seen the best of their performance and if interest rates rise in the second half of 2009, capital values will reduce. Therefore we are negative on Government bonds. In the case of corporate bonds we are positive as we expect the default risk to be revaluated in favour of the corporate bonds and this will result in reductions in yields which offer the opportunity for capital appreciation.

## Property

### UK Residential – Negative

We have been negative on UK residential investment property for a number of years. 2008 was the year in which the bubble burst. This was due to the credit crisis which limited the supply and choice of mortgages and the UK slipping into recession.

For the homeowner, a reduction in property price makes little difference as they are not sellers in the market; however the sharp reductions in valuations has meant for those who have used equity in their property to fund borrowing for purchases outside the home the available remaining equity is reduced. This may ultimately cause a reduction in consumer spending.

The worst hit is the buy to let sector and we have heard a number of high profile stories of investors with highly geared property portfolios who have now hit on hard times.

Our outlook for this sector remains negative as it is likely house prices will fall further during 2009. At some point over the next 2 years prices will bottom. It is typical of the UK housing market that once prices reach a floor, they remain subdued for a number of years allowing earnings to catch up. During this period there will be a number of opportunities for investors to pick up good value properties as the demand and supply issues for UK property are still relevant. In addition, as values decline, rental yields become more attractive.

### UK Commercial Property – negative

We reported in the 2008 forecast that the UK commercial property market bubble burst in 2007. 2008 has brought continued falls in valuations. This has been a result of developers being unable to obtain credit facilities and the onset of a recession which has affected tenancy positions.

In our view there is little scope for a significant bounceback in property valuations and a high probability of further reductions. Although we may start to come out of recession during 2009, our longer term forecast is for the UK and US to enter into a deeper recession by the end of 2010. A struggling economy directly affects commercial property in terms of development and ongoing tenancy. Based on this forecast, there seems little room for a period of recovery which brings us to our conclusion.

In the short term, one advantage of commercial property funds is the overall rental yield has increased on the back of falling valuation and many funds have a portfolio of blue chip tenants which up to date have been able to weather the storm of the economic downturn.

### Equities – positive

There is no doubt 2008 and specifically quarter 4 was a disastrous period for equities. From September markets fully valued the effects of the credit crisis and retreated to valuations not seen since 2000.

Looking ahead, we feel the reduction in global equity markets has been overstated. This is normal for equities which either over or under perform during their cycle. Therefore we believe that we shall see an increase in valuations during the first half of 2009. We do not believe these valuations will come back to the levels seen in October 2007 which could prove to be the high point for equities in the medium term.

The increase in equity values will come from a natural rebound as markets are undervalued. In addition, interest rates and Government bond yields have fallen which will mean investors will become unhappy with their low risk returns. Combined with the fall in commodity prices, investors will start to look for the best prospective returns on their capital and equities seem the most logical conclusion. Added to this, western Governments have committed to a large financial stimulus package. This may bolster consumer spending and allow the markets to anticipate Europe and the US coming out of recession. This will have a positive effect on equities.

### Commodities – positive

The commodity bubble burst during 2008. It became apparent that many of the increases in metals and farm commodities were stimulated by speculation. When it became apparent that economies were sliding into recession and the demand from developing nations was likely to reduce, commodity prices plummeted.

The most startling reduction related to the price of oil which at one point reached \$147 a barrel and at its low touched under \$32 a barrel. This perhaps confirms the level of speculation which took place as the supply issues relating to oil have not changed albeit the demand has been recalculated in line with recessionary influences.

Due to the significant falls in commodity prices, we see this as a positive sector. Many of the issues relating to the supply and demand of commodities moving forward have not changed and if our view on inflation during 2009 is correct, commodity prices could see improvement. As with equities, the reductions have often been overstated and this leaves room for recovery.

We believe the price of oil has scope for significant increase may be up to \$80-\$100 a barrel during 2009 and this leaves current prices at attractive levels.

The gold price held up well during 2008 making a small increase. Gold and silver are seen as a good hedge in times of recession and with the instability of the banking system, may prove to be positive during periods of high volatility in currency values.

### **Summary Forecast for 2009**

Cash	-	neutral/positive
Bonds	-	(Government) negative/(Corporate) positive
UK Residential Property	-	negative
UK Commercial Property	-	negative
Equities	-	positive
Commodities	-	positive
Oil price	-	positive
Gold	-	positive
Inflation	-	neutral
Interest Rates	-	neutral/positive

### Summary

From an investment point of view, 2008 will be a year we look back on without much affection. One positive has been many lessons have been relearned and forced investors (and advisers) to re-assess their risk tolerance and revert to fundamentals in their financial planning.

We believe 2009 will offer opportunities in various asset classes and specifically allow for a recovery of equity valuations which have been a concern for many investors.

We also believe 2009 could be a transitional year for many asset classes. As you may be aware, our short term forecasts sit below our medium to long term forecasts which take a view on demographic changes. As we have been saying for some time, the end of this decade could result in a more severe

recession in western economies as consumer spending (the basis for much of our prosperity) starts to decline. This will have a real affect on valuations in all asset classes but the hardest hit could be equities and it will be important for investors to reposition their portfolios appropriately.

It is likely we shall see continued geopolitical problems during 2009 and further interesting outcomes as the credit crisis finally unravels and we see the effect of the massive fiscal stimulus packages introduced by the US. As always it will be important for investors to take a rational view staying focused on the fundamentals which always underpin prudent investments.

We look forward to advising you during 2009.

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