

Monday 15th September 2008

MARKET UPDATE

You will no doubt be aware from the media that the US investment bank Lehman Brothers has filed for bankruptcy protection and as a consequence stock markets around the world have significantly fallen in value.

We want to take this opportunity to explain to you the background to these events to help you understand how these directly affect you.

Financial institutions around the world have been purchasing assets supported by high-risk mortgages in the US (sub-prime). As the US housing market has dropped in value, the value of assets owned by banks has dropped causing banks to write down the value of these assets.

As a consequence, banks have had to solve two problems:

1. They need to increase capital to maintain balance sheet ratios in order for them to transact normal levels of business;
2. As the banks don't know each other's exposures to the sub prime market, they lend less and less to each other. Hence borrowing costs rise in the interbank market. These increased lending rates are then passed on to businesses and consumers.

Most banks have successfully increased their capital through Sovereign Wealth Funds taking the opportunity to buy into fundamentally strong companies on the cheap – i.e. Abu Dhabi Investment Company buying into Citigroup.

Lehman's problem was that they could not find an investor to support their business.

Merrill Lynch, another well known US bank, was purchased over the weekend by Bank of America for USD 50bn. This can be seen as a positive step because Merrill Lynch has a solid business franchise and Bank of America has the strength to make such a purchase.

As a further consequence of the sub-prime problem, the US economy has slowed and being the largest economy in the world, this has caused the global economy to slow down. The UK, Germany and Spain are now in recession whilst Italy and France stagnates and whilst the emerging markets continue to grow their stock markets have not gone unaffected.

Since July 2007 Equity markets globally are down over 30% .



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Where Now?

Firstly and crucially, governments and Central Banks are aware that the financial system underpins the global economy. It is in their interests to ensure a robust financial system. It is not their job to bail out badly managed banks hence the US Fed did not bail out Lehman's. However, the Central Banks will ensure that there is enough liquidity in the banking system to allow bank operations to run smoothly so that ordinary companies can go about their business.

What does this mean for markets?

Markets move in cycles. Currently we are at the bottom of the business cycle. We know from history that markets always rebound to higher level. What we don't know is when the rebound will begin or how long it will take to fully recover.

This will be determined by economic activity from the US. Particularly with a new administration about to be elected in the US, we may see the beginning of economic resurgence in 2009 although this is extremely difficult to predict. A recovery in the US will lead to global economic growth, which in turn leads to an overall increase in global stock market values.

How does this affect you?

Dollar cost averaging is the most commonly used tool to take advantage of volatile markets, as you buy cheap stocks through the downturn and profit considerably from the rebound.

We strongly advise all clients to be saving regularly.

Forth Capitals viewpoint has consistently been that for medium to long-term investors that to remain in the market is best advice and that timing the market is not possible. We attach some documents supporting this argument.

We do however appreciate that investors are becoming more nervous as their portfolios lose value and we would like to invite any investor who has concerns to contact us immediately to discuss their personal portfolio with us.