



ST. JAMES'S PLACE  
WEALTH MANAGEMENT

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HALF-YEAR REPORT  
OF THE ST. JAMES'S PLACE  
INVESTMENT COMMITTEE

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— 2010 —

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# Chairman's Statement



A year ago, the FTSE 100 stood at 4,249: at close of business today it is 4,917; representing an increase of almost 16%. However, even in the short period of this half-year it has traded between a high of 5,825 and a low of 4,914. What does this tell investors? Very little in my view, other than that the stock market is, in the short term, an imperfect pricing mechanism, subject to the vagaries of financial and geopolitical events.

One example is the market concern about sovereign debt markets in the eurozone and more specifically the possibility of Greece *et al* defaulting on their debt obligations. Should this happen, then many European banks would be under duress and possibly need to be bailed out by eurozone governments. The market is concerned about these possibilities and endeavouring to price the risk into share and bond prices – hence the volatility we are seeing.

I think it is helpful to express my view on the difference between volatility and risk. As I have stressed in earlier reports, the only times the price of an investment is relevant to an investor are the date at which the investor buys the investment and the date at which he or she sells it. Movements in price between these two dates may well elate or worry the investor but profit or loss only arises when the investment is sold.

This underlines the basic premise of the St. James's Place Approach to Investment Management: that investment should be regarded as a medium- to long-term exercise, with the investor retaining sufficient assets in cash or other liquid form to avoid the risk of having to sell a long-term investment at an unfavourable time.

It is worth bearing in mind that, on any particular day, the price of a share does not essentially reflect the value of its business, whether measured by its sales, profitability or asset value. In the short run, the price of a share is simply the price which balances the desire of some investors (who believe the share is undervalued) to buy the share and the desire of other investors (who believe the share is overvalued) to sell the share on that particular day. The movements in the balance between those two types of investor are reflected in the short-term volatility of share prices.





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The balance of investor sentiment can, and does, swing rapidly in either direction, according to the latest news comment: growth in China is accelerating or cooling off; the crisis in Greece threatens to derail the euro or is under control; the problems in the housing market in the US are coming to an end or are resurging, and so on.

We have asked a respected financial editor, Anthony Hilton, to address the implications of current economic issues on the prospects for the market and his article is included in this report.

Whilst these issues have dominated the economic background, I also want to return to some key issues about which the Investment Committee has been concerned following the financial crisis of 2007–09 and its legacy effects. From our clients' perspective there are three major investment pinch-points: a loss of income because of ultra-low interest rates, the risk of higher inflation as a result of *quantitative easing* (the euphemism for 'printing money') and an increased aversion to risk and market volatility. Last year, I explained that we were focused on addressing these concerns for our clients and I'm pleased to say that some of this work came to fruition in April of this year, with the introduction of three new funds and the addition of five new fund managers to our wealth management proposition.

Income is a priority for many of our investors and will become so for many more as they reach a point in life when they wish to draw down the wealth they have accumulated. In the UK, interest rates are at historical lows which means the returns that can be earned from keeping money on deposit are very small and once adjusted for inflation are, for all intents and purposes, either zero or negative. Investors will continue to hold cash, of course – it is one of the fundamental tenets of investing – but for many they will not want to be overweight (in an asset allocation sense) in an asset class that is under-performing. I always steer clear of making predictions, but if one listens to the policy makers such as the Bank of England governor Mervyn King and US Federal Reserve Chairman, Ben Bernanke, then the interest rate mantra of "lower for longer" echoes loud and clear from central banking halls. Until economic growth becomes firmly established, it appears to us unlikely that we will see any upward movement of interest rates here in the UK.

So how does an investor address this issue of increasing income and preferably with as little risk as possible? In last year's report, I highlighted our 'Income Now' portfolio, which is a very diverse portfolio by fund manager investment style, geography and asset class. This portfolio currently yields 4.5% net of basic rate tax and has been hugely beneficial to many of our clients. So, to complement the existing corporate bond fund range and our range of income options, we launched our new International Corporate Bond Fund managed by Babson Capital, with an objective of providing higher levels of income. You will see in the report by Stamford Associates,



the independent investment consultants who advise the Investment Committee, a summary of the search process to find this and the other new managers.

I now want to turn to the threat of inflation, which in the long term can cause irreparable damage – again, something I’ve discussed at length before in earlier reports. To protect you against the impact of future inflation you should have the greater part of your investments in assets that offer the prospect of growth over the long term: this is a key fundamental. The dynamism of the emerging economies and their long-term growth potential are irrefutable facts – the 44 countries that make up the developing world account for half of global GDP and this proportion will continue to grow in coming years. It follows that many investors should have some exposure to these markets if they are to stand any chance of growing their assets in real terms. But there are risks associated with this approach – the stock markets of these countries are notoriously volatile, which means significant daily fluctuation in values is the norm.

There are two strategies to capture this future growth opportunity. Many of our clients already invest in our global Managed funds so they will have some geographic exposure to emerging markets already. Predominantly though, these fund managers will seek to gain access via stock selection. In other words, by owning a company whose earnings are in part – and for some it could be the majority – derived from international emerging markets: the UK-listed company Unilever comes to mind. The other strategy is to consciously invest in a specialist fund that seeks to target a specific country or region, albeit with more risk. The second of the new funds introduced in April is the Global Emerging Markets fund, which allows the manager the widest possible mandate to invest in suitable companies in any of the 44 emerging market countries. These two strategies are, fortunately, not mutually exclusive and as part of a diversified portfolio we believe this new fund can complement a client’s investment approach.

One of the key concerns of investors post the credit crisis was the need to mitigate, where possible, excessive volatility within their portfolios. None of us needs reminding that, in the depth of the crisis, there were few hiding places for investors – most assets failed the uncorrelated asset behaviour test by all falling in tandem. Some investors – with the benefit of hindsight – took the view that their investments should have been switched into cash with the intention of re-entering the markets at a low point. Our longer-established clients will be familiar with our long-held view that experience has shown that it is *‘time in the market not market-timing’* that ultimately wins out. Nevertheless, we took the view on the Investment Committee that we should, if possible, find a fund that aims to perform to expectations regardless of market conditions. This type of approach is widely known as an ‘absolute return’ strategy: in other words, one in which the investor can expect – but is not guaranteed – positive investment returns in all market conditions.





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This is a very specialist, small and relatively new part of the investment marketplace so we were especially careful and demanding in our search for a fund manager who could demonstrate a proven ability to work in this field. Later, Stamford report on their search for a manager who could successfully fulfil the very stringent criteria set by the Investment Committee. The new UK Absolute Return fund enables the manager to operate a *long/short strategy* and aims to deliver, but not guarantee, cash-plus returns in all market conditions for our clients. Again, we see this fund forming a strategic component of a diversified portfolio. Whilst it is early days and one should be wary, the increased market volatility witnessed in the second quarter of this year has been a useful test of the fund's ability to demonstrate its effectiveness. I mentioned earlier that already the UK market has traded in a broad range in 2010: at its low point, it registered a fall of some 15% from the high, but the fund fell only 2.5%. More meaningfully and reassuringly, is the fact that from inception five years ago a similar fund run by the manager has successfully delivered on its objective of beating cash, despite one of the worst bear markets in living memory.

Away from the equity, bond and cash markets there is another asset class that we are able to offer our clients and that is commercial property. As I alluded to earlier, there were few assets that were unaffected during the crisis and property was not one of these. Despite the fact that our own property fund had no borrowings, held only cash and high-quality, prime property throughout the UK, it too was affected by the severe downturn as market values were marked down indiscriminately. Fortunately, conditions have improved, with the fund delivering positive total returns over the last year and I have once again asked our independent property adviser to the Investment Committee, Keith Goulborn, to comment on the fund manager's performance and strategy, together with an overview of the market.

I commented earlier that the three new funds introduced are just part of the work currently being carried out by the Investment Committee – there is still more to be done and I intend to talk about some other key development areas in my final, end of year report. In the meantime, I can assure all of our investors that we remain very focused on maintaining the safest possible environment for those assets entrusted to us by our clients.

**Sir Mark Weinberg**  
30 June 2010



# Stamford Associates'

## Half-Year Report to the St. James's Place Investment Committee to July 2010

Dear Sirs,

The Chairman's Statement already addresses the key investment issues. Short-term stock market volatility continues as it has always done. When asked what the stock market will do, J.P. Morgan once answered, "It will fluctuate." This is the only safe prediction and we are cautious of investors who purport to have 'expert' insights on the short-term direction of market movements. Irrespective of the uncertain economic and stock market outlook, we continue to believe that a solid focus upon fundamental investing and a long-term mindset remain critical.

Your fund managers consider both the economic backdrop and the individual investment/business characteristics when conducting their research. They are also looking to create a balanced portfolio to withstand a variety of economic conditions. Their focus is primarily on the fundamental merits of individual investments and finding opportunities where these investments are available at attractive discounts to intrinsic value rather than taking large macro-economic bets.

Famous US investor Ben Graham likened the market to a moody fellow ('Mr. Market') who turns up every day at the shareholder's door offering to buy or sell his shares at a different price. Often, the price quoted by Mr. Market seems plausible, but often it is ridiculously high or low. The investor is best off concentrating on the performance of his companies and receiving dividends, rather than being too concerned with Mr. Market's often irrational behaviour. Therefore, we continue to firmly believe that a disciplined and consistently applied long-term fundamental stock selection approach executed by exceptionally talented and seasoned professionals remains the most suitable way to seek long-term investment success.

Against this backdrop, we are pleased to report on our investment manager related activities over the first six months of the year. We conducted approximately fifty meetings in total with all of your equity and bond managers over this period. Our emphasis is on assessing and discussing managers' 'investment footprints': that is, the fundamental investment characteristics of their portfolios, their transaction activity and the consistent application of their investment approach. We believe there is little value in assessing the short-term, relative performance without considering the managers' investment footprints. The future results of the managers bear little resemblance to recent past success or failure, but will invariably be a direct result of the successful application of their chosen investment strategy.





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We are always keen to understand changes in the managers' working environment and this is a key feature of our monitoring programme. We dislike changes that might impact upon their ability to invest successfully going forward. We also consider whether the investment managers are able to spend their time predominantly on the management of their portfolios rather than spending undue amounts of time on marketing, administration or business management. Change is not always a bad thing in life, but changes in managers' investment approach, employment status, organisational structure, responsibilities, asset base, etc. can be highly disruptive. It can lead to distractions that detract from the ability to generate superior results, which remains as challenging as it ever has been. Changes in investment approach are particularly worrying and we are aware that your funds should continue to reflect the approach when you chose a particular manager.

Due to the close relationship between Stamford Associates, the Investment Committee and the underlying managers, we are able to monitor the portfolios and their individual holdings at all times. As a result, we are not reliant on backward-looking performance figures or risk statistics to draw conclusions and do not have to wait until after the horse has bolted to close the stable door. The managers of your funds understand the unusually demanding nature of Stamford Associates' initial investment assessment, due diligence and on-going monitoring requirements. The process remains predicated on full transparency and their cooperation has been exemplary in the past six months as it has been in previous years. This enables us to form a dispassionate view of the investment managers' ability to achieve their investment objectives going forward and to advise the Investment Committee accordingly.

We have been delighted to witness improved investment returns from some of the funds within the range that suffered during 2008. It is only with the benefit of time that we are able to see the losses as temporary rather than permanent. Whilst we dislike all losses, we emphasise that the longer-time horizon is best for assessing managers and their portfolios. Therefore, it is very encouraging to observe the swift recovery for investors who maintained or even added to their investments. In particular, Bernie Horn's Worldwide Opportunities fund, which suffered in 2008, has rewarded patient investors with first-quartile performance since the market lows in March 2009 and out-performed the sector average by approximately 30% (source: Analytics 06/03/09-30/04/10). Through this difficult and testing period for the manager, Stamford Associates was able to monitor the portfolio, question the investment management team and provide reassurance for the Investment Committee that the investment proposition had not changed despite the adverse conditions. We are also encouraged by the improved investment results of the Greater European Progressive and the UK & General Progressive funds since the changes of investment managers were implemented in September 2009.



In addition to our in-depth monitoring programme for your incumbent investment managers, we also continue our search around the world for additional superior investment resources. In conjunction with the Investment Committee, we identified several opportunities to expand the investment range to give more investment choices to St. James's Place's clients. Firstly, we located an exceptionally talented emerging markets investor. Secondly, we brought a unique high yield bond strategy to the UK retail market which exploits credit opportunities and credit spreads through careful selection of senior secured credit instruments. Finally, we brought the first long/short equity fund into the fund range with an excellent track record of creating absolute returns for investors in both rising and falling markets. These searches for the best investment manager talent were exhaustive in each case. Over one hundred emerging markets managers were initially reviewed and over two hundred long/short equity funds before narrowing the options to a dozen or fewer for much more intensive research.

We continue to meet formally with the Investment Committee on a regular basis in order to provide a written and verbal update of our views of the investment managers. Equally, we continue to address any issues we consider relevant with the Committee on an ad hoc basis whenever necessary. We remain confident in the robustness and integrity of your investment platform. The process the Investment Committee follows is based on the long-proven investment discipline which is unique to St. James's Place. We believe that, given the dynamic nature of the investment management industry, manager-related changes will be inevitable from time to time. We look forward to working with the Investment Committee on maintaining and enhancing the superior quality of your investment offering.

**Stamford Associates Limited**  
**June 2010**



# Report on the St. James's Place Property Funds

The improved conditions for UK commercial property have continued in the first five months of the year, albeit at a slower pace than was the case in the last quarter of 2009. At 7.4%, capital value increases in that fourth quarter were the highest recorded by the property performance measurer, Investment Property Databank (IPD). Value increases for the market to the end of May total a further 5%, of which the majority was achieved in the first three months of the year. The market is showing eleven consecutive months of positive capital growth, but according to IPD, this slowed in May.

Notwithstanding this, the recovery has been polarised and is concentrated at the prime end of the market. In all sectors, apart from Central London offices, which have experienced rental uplifts, value increases are due to yield compression as investor demand has exceeded supply. Yields are now at or close to the long-run average, albeit off a lower rental base than prevailed prior to the downturn.

The recovery has been more rapid and steeper than forecast, but the divide between prime and secondary quality property investments has widened. Quality of tenant covenant and duration of income stream are weighted as heavily as location and specification. Most investors are risk-averse, as a result of which there is limited trading activity in the secondary and speculative markets. Central London offices have led the recovery in returns, particularly the City and Mid-town where a shortage of supply of larger buildings has resulted in rental increases and stricter lease terms. In the West End, yields have been driven down to a level which may not be sustainable without improved rental values.

Letting activity across the whole market is polarised too and at a slower pace than the fourth quarter of 2009. The total amount of available floor space has risen slightly, more in the retail sector than offices and industrial, but the rise is reducing as new development activity declines. Overall, the value of tenant inducements continues to decrease and lease lengths are reducing, but at a slower pace than last year. The slight overall improvement in letting activity is mainly due to the Central London contribution.

Investment volumes are down compared with the fourth quarter of 2009 due to reduced activity across all sectors and regions outside Central London. Overall, rental growth expectations continue to decline; not helped in the retail sector by the planned rise in VAT. Even so, the rate of decline is reducing, due in part to the recovery in GDP but the underlying situation remains difficult.





The high levels of spare capacity in the economy are reflected in the oversupply of commercial property and raised vacancy rates. Add this to the poor prospects for employment growth and the need for companies to build profit and control costs – and the expectation for overall rental growth in the short and medium term is weak.

Against this background, performance of the St. James's Place property funds continues to compare favourably. The key performance indicators of the funds, including void rate and lease lengths, are also better than the peer group. The initial yields for the Life and Pension funds are slightly lower than the market as a whole, which is to be expected as the assets are generally superior to those contained in the benchmark group. In contrast, the Unit Trust initial yield is higher than the peer group, reflecting a combination of a high industrial weighting and little new asset management opportunity.

Sales and acquisition activity in the combined portfolios has been restricted to the disposal of an office building at Portman Square in London and the purchase of a retail investment in Nottingham, which leaves the cash weighting in both portfolios at a high level. Prime investments remain in short supply and are much in demand; secondary space is in over-supply and few want it or are able to raise finance for its purchase. Until such time as the supply of better stock improves this situation will prevail and despite the market's expectation that the banks would start to release reasonable investment property by now, as yet, there is little evidence of them doing so. One would expect a healthier two-way market to develop as debt becomes due for refinancing this year and further financial breaches occur. Your fund manager is in negotiation on a number of acquisitions but none are currently under contract.

Asset management activities continue to be key contributors to performance. The successful delivery of business plan targets for each property – even if they are simply achieving the fundamentals of full occupation, the collection of rent on time and maximising income – is vital to delivering or exceeding required returns. In addition, there needs to be effective action where any property fails to meet these requirements. Examples of this in the portfolios include the letting of the remaining 20% of the space at the newly completed Carmarthen shopping centre, the presentation to local occupiers of the space available at the Pinnacle in Crawley and negotiations with a prospective occupier of the development site at Enfield.





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Finding value will remain a challenge as demand exceeds supply for better stock. Paradoxically, the best-performing assets are likely to be those currently avoided by the majority of investors: that is, those that fall outside the increasingly narrow definition of prime. There is risk attached and it is essential the manager understands the local market in which the investment is situated and how it is likely to be affected by the varying dynamics of economic growth, and delivers on robust management plans.

Despite the uncertainties that lie ahead and the recent improvement in values, UK commercial property shows an average yield of about 7%, still a historically high premium over equities and gilts before any capital growth, provided the income is kept secure. With a sensible approach to pricing and a continued strong grasp of fundamentals by the manager, the portfolios should deliver a sustainable source of out-performance.

**K M Goulborn FRICS**  
**June 2010**

*Data sources: Invista REIM, Investment Property Databank, Cushman & Wakefield and De Montfort University*



# Looking Ahead

by Anthony Hilton



When they come to write the story of these times, future historians may surprise us with how little of the blame gets laid at the door of the bankers. They will get a mention of course, as will regulators and politicians who ‘failed to fix the roof when the sun was shining’; but none of these were the fundamental cause of the turmoil. Even more counter-intuitively as history lends perspective, today’s crisis might well come to be seen, as have many periods of shock, as a time of huge opportunity.

What has upset the apple-cart is the shift in economic power from West to East; from the developed to the emerging nations. The tectonic plates of the world economy have moved, and the earthquake caused a financial tsunami. On one level it is all very scary, but on another we should expect the odd bump because we are going through what is, in effect, a second industrial revolution. And just like the first, which ushered in the Victorian era, it is a wonderful time to be a capitalist.

Of course, there are casualties and Greece has become a touchstone for the pessimists. To many, the euro has always been the Deutsche Mark with a few disreputable friends. The lazy assumption was the disreputable would mend their ways; Greece now suggests that instead the southern Europeans have chosen to squander their inheritance.

But because this has come as a nasty shock, people have lost sight of the positives. In spite of the pain of the last few months, mainland Europe has arguably been a lot better with the euro than it would have been without it. One who holds this view is former EU Commissioner and UK Chairman of Goldman Sachs, Peter Sutherland, who says that without the single currency going into the financial crisis, “Europe would be an economic wasteland.” Competitive devaluations would have led to economic chaos. By this measure, today’s uncertainties are a small price to pay.

It is also true that Europe only ever addresses its problems when it can no longer procrastinate. So, far from seeing the temporary bailout of Greece as a doomed attempt to stem the inevitable tide, Sutherland sees it as the necessary spur to genuine reforms to make the system work better. While most commentators write off Europe as mired in recession and low growth, he sees this crisis as marking the floor. And even those not wholly convinced have to accept that, when expectations are





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so low, there is huge opportunity for European stock markets to surprise on the upside. For all its difficulties, the European Union is the world's largest and richest trading block and home to a raft of really great companies, many of which, remember, will benefit from a lower euro.

The eurozone debate is replicated in the UK, with the recent Budget telling us to slim down now so we will be fit enough to grasp the opportunities of the future. And that, of course, is why the business world is supportive of the measures proposed by the coalition government. It understands the risk that in the short term demand will fall when the cuts begin to bite. But it knows too that the country, and indeed its citizens, can no longer seek to solve every problem by piling up more debt. It's time to blow off the froth and refocus on what provides real value.

Sound government finance is an integral part of this, and sound finance will be welcomed by investors. Interest rates are likely to stay low for a long time yet, but corporate bond issues are replacing hard-to-find banking finance and offer opportunities for people who need steady income. There is hope too on other fronts. In Opposition, George Osborne said that equity finance needed to be made more attractive in comparison to debt. If he follows through on this he could easily tweak the corporate tax system to incentivise companies to refocus on growing their dividends.

There are other reasons for optimism. We have had recessions before and one of the abiding lessons is that economies recover far faster than you would ever think likely in the dark hours before dawn. Economic growth for all of six years after the 1983 recession averaged 3.7%. In the six years after the 1992 recession it was only slightly lower at 3.6%. Both these figures should be set against the 2.5% norm which the Treasury believes is the long-run growth potential for the economy and which it suggests is likely for the life of this parliament. They may of course be right, but history suggests we should expect significantly better. If not, that even at 2.5%, with a competitive boost from a lower pound, a lot of companies should be able to grow profits and dividends. Hard times never affect everyone equally. There are always winners and losers.

Remember how black things looked when Tory Chancellor Ken Clarke presented his bleak austerity Budget in November 1993. Yet, by May 1997, Labour came to power with a glittering economic inheritance – a strong economy, a strong pound and strong government finances. The turnaround was that quick – just three and a half years.

The key investor judgement is to accept that the world has changed and things will not go back to as they were, but to recognise at the same time that the underlying conditions for successful investment remain the same – good companies with good products in growing markets. And if the West appears temporarily to have lost some of its self-confidence, emerging markets have



it in spades. For them it is already as if the downturn never happened. And in contrast with an earlier age – say when Japan was in the ascendant in the 1950s and 1960s but the growth took place behind a wall of protectionism – today’s emerging markets are open and accessible to outside private investors in ways which just have not happened before. Whether your favourite pick is India or China, Brazil or Mexico, equities or bonds, real estate or commodities, there is an opportunity for you, albeit not a risk-free one.

The watchword for today’s investor is *carpe diem* – “seize the day”.

**Anthony Hilton**  
**June 2010**





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