

Hi,

This has become a little lengthy and I may be guilty of telling you more than you want to know. I would be grateful for feedback. I have divided it into sections so you do not have to read all my ramblings. In particular the first section (the Clive Ward view of the world) may be "old hat" to many of you.

1. [Economic outlook. - My crystal ball is no better than anyone else's but for what it's worth.](#)
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1. ECONOMIC OUTLOOK

As the war in Iraq finishes the world finds itself in a war with the SARS virus. More accurately China and the Far East are at war with it and the world's press needing something to keep people buying papers now the Iraq war is over are fuelling worldwide panic. The economic consequences of this could be more severe than the war as it is restricting travel and this slows economic activity and severely affects the tourist industry. Airlines and hotels in the Far East will be in very real trouble if it continues, but then many of you don't need me to tell you this.

The American and European economies are less affected. It could be that the pendulum will now swing from economic growth in SE Asia back towards the west. The US economy does appear to have bottomed. Although the indicators are conflicting, economic activity appears to be picking up and consumer confidence is coming back after the war, despite unemployment continuing to rise. This is Largely due to large companies spending the last 3 years cutting costs and strengthening their balance sheets. Share buy backs, refinancing debt at lower rates & over longer time periods and private equity/management buyouts are frequent occurrences. Most companies that are profitable in the current climate will almost certainly offer significant returns in the next part of the economic cycle.

The stock market is close to sensible valuations again and some technology stocks are good value again. Any growth in this sector will probably be driven by the increasing use of broadband internet services. However the market is still volatile. The S&P 500 has had a series of 30-40 day swings between 800 & 950 since it crashed last July and it looks very much as if we are at the top of another swing at the moment. as it is back to 950 after nearly 40 days since the last trough. I suspect this trend of volatility will continue for some time as different sectors of the economy show signs of growth at different times. Investor confidence is still very weak and institutional buyers are still sitting on the sidelines.

The US balance of payments deficit is at record levels and with tax cuts on the agenda is unlikely to come down in the near future. Capacity utilisation is low and this reduces the prospect of major corporate investment over the near term. When combined with the collapse of the stock markets and the unattractive low interest rate leading to capital flight over the past years, then the USD is likely to remain weak for some time to come, which should help the US economy but it will not help the Asian economies dependent on exporting to the US.

Oil prices have come down which will help the world economy but it will take longer than expected to get Iraq back to full capacity of 2 million barrels per day as the oil fields have lacked investment for years. Russia is pumping for all it is worth and the recent merger of 2 of the largest Russian oil companies is likely to keep prices high. The investments they are making in increasing Russian capacity will still take another 2 years or so before they deliver increased production so the oil price may go up again.

The UK economy looks as though it is heading for a fall. This view is not shared by Gordon Brown however as he is still forecasting good growth, although he has revised his estimates down. The economy has been expanding on the back of consumer spending as they have been taking the capital gain out of their properties by borrowing heavily as house prices have shot up in the past 3 years. The property market has now turned. Figures for April showed the first drop, this was mostly in the south east as the north is still gaining. However the press jumped on it and again this will influence the market. It is now a buyer's market. From the analysis I did at the end of last year it looks as though the domestic UK property market is at least 25% above its long term trend line. This means it has to go flat for a long time, or more probably drop. As consumers cut back their spending and company profits are down, so tax revenues will decrease. The UK balance of payments is also running very high and the government has introduced many stealth taxes – National Insurance increases, council taxes, car tax, congestion charges etc. Public services are in bad shape, the railways, health service, education and fire service are all either under-funded or poorly managed or both. Doesn't it make you glad you're an expat? (With apologies to those who have repatriated)

There is a trend amongst some of the larger UK pension funds and insurance companies to switch out of equities and into property and bonds. The company pension funds are doing this because legislation changed last year and companies now have to show profit/losses on their pension fund in their balance sheet. With the drop in the stock market, the average pension fund (in US and well as UK) is down around 25-30% and this loss will affect company balance sheets and reflect in their own share valuations. Bonds may return less in the long term but they are more stable and will not affect company balance sheet valuations. The insurance companies have also been switching their with profits funds as these have been so badly hit by the drop in stock prices they want to be cautious until there is some long term upwards direction in the stock markets. This may account for the FTSE 100 rising only 3.6% in April whereas the Dow Jones was up 6.1% and the S&P500 8.1%.

This does not mean that with profits funds are a bad buy. They were over optimistic in their predictions some 10 years ago which has led to many endowment policies not earning enough to repay the mortgages they were purchased to cover. The returns are still safe and still beat a building society.

The pound is strong against the USD but as the UK balance of payments deficit grows it may get weaker. After many years of a strong pound, British industry has had to become more streamlined in order to compete abroad and the UK economy is one of the strongest in Europe. Despite this, the Euro has gained against both the USD and Sterling. This probably has something to do with Europe having the highest interest rates by a long way and it is benefiting from a (temporary) loss of confidence in the USD.

Some people think Japan is showing early signs of a recovery but it will probably not take hold until the Yen devalues even further. The Collins Stewart Aggressive fund has made a small investment in Japan.

The only region that has been steaming ahead of late is Russia and Eastern Europe, largely on the back of oil. They were driven by the announcement of a merger in the oil sector between Yukos and Sibneft. The enlarged Yukos will be one of the world's largest oil companies

This may sound gloomy, but on balance there is every indication that SARS is under control outside of China & Taiwan, which goes to show it can be contained with determination. Investments trends tend to go in cycles and just as pessimism reaches its peak the markets usually turn round, as there is nobody left to sell anymore. People do have short memories and whereas the travel industry has been hit this year, it should recover next year. The US economy is at a turning point. It is rather like a supertanker and takes a long time to change direction but I think the steering wheel has been turned. This will provide direction for the rest of the world and slowly other regions will be sucked into the wake – which can make for a bumpy ride.

2. INVESTMENT OUTLOOK

I know I keep banging the same drum but the statistics prove that over the long term the stock markets have always outperformed other investments. I have some graphs of the UK property market compared with the FTSE 100 over the last 20 years to end of March 2003. Now with the stock markets at their lowest for nearly 7 years and with the property market bubble about to burst, then over 10 years to the end of 2002 the domestic property market returned the same as the stock market. In the last 5 months the property market has risen and stock fallen so property is ahead. However over 15 years stocks are now 66% higher than property and over 20 years stocks are nearly double at 94% higher than property. Commercial property is the exception and the stock market has returned only 5% more than commercial property over the past 20 years. Remember that we are comparing at the most unfavourable time for the stock market.

Not everyone can afford to buy an office block so most people invest through property funds and I can offer some good ones. Student Accommodation (regular payments or lump sum) at around 8.5% pa, Glanmore Property (lump sums only) at nearly 10% pa and Premier Diversified Property Fund (lump sums only) a recently launched fund tracking 13% pa. These are all Sterling funds.

Although the stock markets are very low and at a sensible valuation again, nobody can predict how long it will take stock markets to show serious recovery. It will require companies to show good profits and these are likely to appear in sectors of the market at first and possibly in different regions. That is why I am a big fan of the fund of funds approach as the fund managers have more liquidity and flexibility to change their asset allocation and direct money to asset class and areas of the world that are growing. It helps protect against volatility and saves the worry about being invested in the wrong regions. Both Lanson and Collins Stewart manage funds of funds for Friends Provident and all have beaten the major indices by a long way. Friends Provident are the only major offshore life company to offer funds of funds.

Most investment fund managers pick a benchmark and then allocate their assets according to that benchmark but at the same time trying to beat it. They also restrict themselves by predetermining how much of the fund has to remain invested, even in bad times and this is usually around 85-90%. This does not show much imagination and explains why most funds fail to beat their benchmarks significantly. Most funds of funds do not have a benchmark allocation, they can invest wherever they find growth and they can also go heavily to cash or bonds in bad times. That is why these funds have beaten the indices. Yes, I know that still means that most have lost money recently but bear in mind they are equity based funds and therefore carry a degree of risk.

It does not hurt to diversify and hedge funds have become very popular, as many have had good returns over the past few years. Most hedge funds dropped in March as many trends reversed when the war started and then had very small gains in April. There are nearly as many types of hedge fund as varieties of mutual fund. However they differ in that they do not have the same restrictions on what they do. They can make money in falling and rising markets, invest in derivatives, debt instruments, commodities, futures, mergers, and many more. I can supply more information if you are interested. The average return of all hedge funds in the first quarter of 2003 (ref MCSI) was 1.8% whereas the world index of stock markets was down -5.5%. In 2002 hedge funds averaged 2% growth, not impressive but better than the average stock market fund at -24%.

There are 2 hedge funds I recommend. One is a fund of funds, Momentum All Weather Fund, which is a low risk fund and the other is Quadriga which is a commodity futures fund averaging 50% pa but is volatile and high risk. The latter is really only suitable as a small part of your portfolio. These are mentioned again below.

For those who want lower risk investments, particularly those with a shorter time horizon then there are 2 good choices, both of which involve buying 2nd hand life insurance policies and endowment plans: the Premier Low Risk fund which is a fund of endowments and with profit bonds with about 20% in commercial property. The other is Mutual Benefits viaticals which buys life insurance policies from terminally ill people giving them cash before they die and giving you a share of their life policy when they eventually die. Sounds morbid but it is very popular with both sellers of the policies (who's families might not be able to keep the policies going until death and so lose out, or they need money now to pay for treatment, world cruise etc.) and investors as a safe investment with fixed returns, which average between 10-12% pa.

If you simply want a long term cash deposit then National Western Life Company in Texas are currently paying 3.35% pa with an extra 3% in the first year.

With the USD weak it is a good time to be buying USD investments.

3. FUND PERFORMANCE YEAR TO DATE

	1 month	2003 ytd	1 year
Lanson International Growth	3.0%	1.9%	-5.8%
Lanson Optima Fund	5.1%	0.0%	-11.5%
Collins Stewart Aggressive USD	1.0%	1.2%	-3.3%
Collins Stewart Growth USD	3.0%	0.2%	-9.1%
Student Accommodation	0.6%	2.6%	8.2%
Momentum All Weather	0.6%	2.2%	2.7%
Premier Low Risk Fund	0.1%	1.0%	4.2%
Quadriga GCT USD	1.1%	76%	97%
S&P 500 Capital Return	8.1%	4.2%	-13.4%
Dow Jones Indust Cap Return	6.1%	1.7%	-15.0%
FTSE 100	10.7%	-1.3%	-14.3%
FTSE World Index			-14.0%

4. LANSON FINANCIAL

During the latter part of March 2003 the managers gradually increased the exposure of the funds to the equity markets and made their first investment into the UK for over 3 years. During the last 3 years the UK market has fallen more than 40%. The new fund is the Merrill Lynch United Kingdom Fund (MLIIM UK) which is a dynamic/focused fund typically holding a maximum of 50 stocks. The fund has a high beta to the UK market and has overweight positions in the banking/finance sector but has avoided the life insurance companies, which have been hit so badly over recent months. From the 1 March to 15 April the MLIIM UK fund returned 10% compared to a FTSE 100 return of 5.8%.

The holding in Mellon Global Bond was sold (at a profit) in mid March following a rise in international bond yields as they reacted to the events in Iraq. International bond markets are currently struggling with two strongly opposing views, low growth & low inflation versus large increases in government spending (US especially) which may have an inflationary effect.

The managers also sold the complete holdings in Schroder Taiwan and JF Pacific Technology.

In April the MLIIF UK Equity holding benefited from the strong rise in UK equity prices. The Fidelity Europe holding rose 14% in the month (USD Terms)

The best performing holdings during April were Schroder Eastern Europe and Clariden Russia with both funds returning more than 18%.

Some Far Eastern markets suffered a SARS effect. The funds have no exposure to China, Japan or SE Asia at present.

Over the coming months the managers will continue to invest in single sector/country funds exhibiting growth and regional funds where the underlying managers employ an active management process.

Optima & International Growth Holdings 1 May 2003

	% Market Value Optima LIG	
Investments		
Merril Lynch UK	12.7	15.3
Fidelity European	12.7	15.3
Investec Wired Index	12.4	14.8
Parvest US Small Cap	12.4	14.8
Schroder Eastern Europe	1.1	7.2
Clariden Biotechnology	0.8	5.6
JPMF US Technology	0.8	5.5
Clariden Russian Equity	0.5	3.6
Equities	0.1	0.6
Cash & Deposits		
Cash (\$ Deposit)	<u>46.5</u>	<u>17.3</u>
Total	100.0	100.0

Source: Friends Provident International

5 COLLINS STEWART

I met Phil Eyre the Investment Director of Collins Stewart and he went through their strategy. Their speciality is portfolio management and fund selection. This is why they run funds of funds. They employ exceptional talent and use a defined, disciplined approach. They only invest in funds where they have met the manager and understand his strategy. Their strategy is to take a consistent long term approach and using economic analysis they identify best funds that are showing growth in various regions of the world. They review their fund selection constantly. If the market fundamentals have changed since their investment selection they will make a switch. When markets are performing badly they aggressively increase their cash holding.

They believe as we do that a multi manger (fund of funds) approach gives better performance as they can select the funds managers who perform best, diversify and change their asset allocation as market conditions change and go to cash or bonds when necessarily.

Aggressive USD Fund did not make any change to its holdings in March. However the AHL Diversified hedge fund holding did drop as the war caused all hedge funds to drop. Over March and April it as gone up and down a little but ended up a fraction higher.

At the end of March the holding was
37% Cash
15% Thames River Eastern European
11% AHL Diversified Futures
11% Dresdner RCM Little Dragons
9% HSBC Chinese Equity
9% Schroder Japan
8% GS Wired Index

Growth USD Fund slowly increased its equity positions during March and is only 8% in cash. Consequently it benefited from the rally in April.

The largest holding is 20% in the Vanguard US 500 Index tracker. Followed by 12% in Thames River Eastern European.

6. MOMENTUM ALL WEATHER FUND

I had a meeting with their Global Relationships Manager last month and she confirmed their strategy remains the same as I have explained before. They focus on the underlying strategy of a large number of hedge fund managers around the world. As each phase of the economic cycle unfolds and market conditions change they allocate assets to the most

successful manager in that asset category. They try to construct a portfolio that balances different risks to prevent the fund being volatile and in this they have achieved great success. The fund has very low reaction if any, to any single event. It only dropped 1% after September 11th for example and was unaffected by the recent war. Their main strategies at present are asset backed lending, distressed securities, even driven (multi strategy), merger arbitrage and trading.

7. STUDENT ACCOMODATION FUND

There is nothing new to say about this fund. It plots along very successfully renting UK university halls of residence to students.

8. OTHER FUNDS AVAILABLE OUTSIDE OF FRIENDS PROVIDENT

I did mention these in my last email but to remind you, if you have a lump sum you want to invest somewhere other than stock markets there are a number of alternatives. The safest revolve around the trading of second hand life insurance policies and endowments. There is a strong international market for these policies from people wanting to cash in early and they are very low risk and give comparatively good returns. I am working with a UK based and a US based fund.

The UK fund is the Premier Low Risk Fund which is 80% traded endowments and 20% commercial property, based in the Isle of Man. It gives a better return than purchasing a with profit bond for almost the same level of security.

The US company is Mutual Benefits who buy up life policies from terminally ill people. They are the biggest company on the market and have a clean track record. There have been many companies trying to compete but ending up with many complaints. They are proving very popular at present as they offer fixed returns 42% for a 3 year policy, 50% for a 4 year policy for example. The risk is that you only get paid out when the policyholder dies and he might live longer than expected. He might also die early and then you still get paid early.

If you simply want a long term cash deposit then National Western Life Company in Texas are currently paying 3.35% pa with an extra 3% in the first year.

For those with an appetite for risk and volatility then the best performing hedge fund for the past 2 or more years has been Quadriga. It is an Austrian based leveraged commodity futures fund that has averaged 50% pa but it has 30% volatility. For example, from end of November last year to end February this year it gained 73% but then dropped 23% in March.

This letter is getting too long to give more detail here but do come back to me if you are interested in knowing more about any of these.