"Traversing the financial markets in 2011 will be more straight forward but we must remain vigilant as to the path we follow"

Lester Petch – CEO TAM Asset Management

TAM Outlook for 2011

We believe that 2011 will be another year of good opportunity for investors able to proactively position themselves to deal with transient volatility and market dislocation we can anticipate. The fragile economic recovery which started in 2009 gathered strength last year and proved resilient enough to overcome a number of obstacles thrown in its path. There are unprecedented global efforts firmly underway to maintain the momentum of the recovery and we expect economic and corporate earnings growth to remain a positive factor. We believe this will lead to a clear polarisation between the performances of individual asset classes and, in our opinion; Asset Allocation will be the key to performance in 2011.

- **Equity Markets:** will end 2011 higher by some 12-18% with sporadic periods of volatility. We expect leadership from larger capitalisation stocks able to benefit from global growth. **OVERWEIGHT**
- **Fixed Income markets:** will continue to struggle throughout the year as inflation and eventually interest rate hikes will have a negative effect. Whilst government bonds will potentially erode wealth, there will be some opportunity in higher yield and international bonds. Trading opportunities in Government Debt will appear in times of market stress **UNDERWEIGHT**
- **Property:** having made some welcome gains from the sector last year we see little to encourage us to re-enter either the residential or commercial real estate space this year: **UNDERWEIGHT**
- **Commodity:** inflation fears and developing economy demand led a surge in precious metals, energy and soft commodities. We do not expect these drivers to abate. **OVERWEIGHT**
- **Absolute Return:** Will improve on their 2010 positive performance and act as an ideal replacement to exposure in Fixed Income. **OVERWEIGHT**

The Story of 2010/11 - European Troubles to Continue?

Given all the turmoil of the financial markets last year, one theme continued to dominate headlines and sway investor sentiment; the sovereign debt crisis in Europe. 2010 clearly demonstrated that the global economy was dragging itself out of recession but the impact of 2008-2009 remains. In a similar way to which household budgets had been affected Governments around the world faced growing financing problems particularly, it transpired, in the Euro zone. When Government outlays exceed their tax receipts in a fiscal year they are said to being running a deficit, which necessitates borrowing money to make up the difference. Such borrowings comprise selling 'sovereign debt' to foreign and domestic creditors. If those creditors are unsure whether a government is able, or willing, to repay those borrowings then they demand a higher interest rate. Creditors may even refuse to purchase any bonds at all in which case a government would have no choice but to cut expenditure, raise taxes, or borrow from international agencies such as the International Monetary Fund (IMF). This is the situation Greece unfortunately found itself in last year and the catalyst for Euro-wide fears.

Basically Greece had borrowed too much money during the previous years and was living beyond its means. (Like Many Others) The global recession exacerbated this, and as the economy slowed and tax revenues decreased this made it even harder to make the debt payments. This at a time when its debt-to-GDP ratios rose to near 115%, which means its debt was higher than its annual gross domestic product. This figure, although high, was actually only a little higher than that of the UK's. However what alarmed investors was the question, could Greece manage to maintain this ratio or would it simply spiral out of control? Matters were made even more uncertain because, unlike the UK, Greece was a member of the European Union. This meant it could not independently devalue its currency, nor indeed implement unilateral monetary policy decisions (we must be mindful of the pitfalls of 'one size fits all' monetary strategy across Europe). Ultimately the other Euro zone countries and the IMF agreed to a €110 billion loan for Greece. This was swiftly followed by the European Financial Stability Facility, a rescue package worth over a trillion Euros aimed at, as the name suggests, financial stability across Europe.

Greece's problems, though serious, were not the real cause for such concern: contagion to other countries was. As Greece's troubles increased other peripheral European countries finances were placed under the microscope. Four countries quickly became a focus of concern, Portugal, Ireland, Italy and Spain or as commonly known the "PIIGS" when Greece was included. As we now know this was, and is, cause for concern; with Ireland succumbing to its own indebtedness and received an €85 billion bailout towards the end of last year.

So will this be the final chapter of the story? Unfortunately not, a lack of political will (especially following the many strikes and civil disturbances across Europe) to enforce urgent austerity measures across the indebted nations continues to highlight the imbalances across the euro zone. More austere countries, such as Germany, the largest and now the strongest growing economy in Europe, are being forced to finance its more frivolous neighbours. European finance ministers have engineered a plan to hopefully end speculation against its member's states once and for all, but one must remain doubtful to its effectiveness. **This story will continue to add to market volatility throughout 2011. However, as and when there is clarity, we may get to the point where PIIGS may fly??**

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

Will the fear of recession remain a licence to print money?

The announcement of a new round of quantitative easing by the US Federal Reserve proved the catalyst investors were looking for to increase their risk appetite and banish (albeit temporarily) from their thoughts the problems rife in the Euro zone. Confirmation that the US Fed would start to intervene in treasury markets was enough to ensure that equity markets recovered from their summer lows and continued to move into positive territory for the year. However it was not until the beginning of November that firm details of the new programme were announced; **Six hundred billion US dollars of longer-term treasuries would be bought by the end of June 2011.**

Such action is unprecedented and clearly underlined the US government's intention to underpin financial markets and support economic growth whatever the cost. Indeed at a time when many are imposing strict austerity measures to reduce their liabilities the US balance sheet will swell to a near eye watering three trillion dollars by the time this round of easing is complete. This figure may even continue to grow if the US feels compelled to increase their programme; certainly comments in the New Year that the level of economic growth was no yet sufficient enough for them to reduce their level of easing led many to speculate that QE3 may not be far away.

Inflation, the true cost of quantitative easing? There can be no doubt that one of the many costs of any accommodative policy will be upwards pressure on inflation. Printing fresh money increases the money supply, and can, if unchecked, devalue a currency thereby pushing up import costs. For most developed economies this will

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

increase the price of food and energy. In addition all the newly printed money must find a home. With interest rates at near zero levels, saving is not an attractive option and money will find its way into higher-yielding equity markets and speculative investments, again inflating their prices and adding to the overall inflationary effect.

Inflation in the UK now appears unchecked, with the Bank of England putting their inflation-targeted approach to monetary policy firmly on the back burner, preferring to stimulate economic growth instead. UK inflation above the government imposed upper limit seems to have become the norm (the Governor of the BoE must be running out of new reasons in his now frequent explanatory letter to the Chancellor of the Exchequer). Indeed the latest consumer price index rose at an annual rate of 3.7% rise (against a target of 2.0%) and with the January VAT rise and recent acceleration in energy prices can be expected to hit 4.0% in the first quarter. Although the Bank of England will be loathe to do so, one must expect that both political pressure and economic sense will dictate they begin to tighten monetary policy by the second half of the year, at the latest.

Should we be concerned about this seemingly 'runaway inflation'? As we will explain later in this report there will be negative consequences for certain asset classes, (fixed income for example) which will shape our overall asset allocation modelling. However, one must keep the current situation in context; as we suggested the inflation we are experiencing now is different from that which caused so many long-term economic and structural problems in the past. Initially, the sheer magnitude of the problem is far less. Inflation is expected to peak at no more than 5% (though BoE forecasts have been notoriously wrong) far below the 20% level reached in the early eighties (when interest rates passed 15%pa!). It is not a fair comparison.

Secondly, the drivers behind the recent inflation are not due to an 'over-heating' economy. We do not have full employment; with the consequential upward wage pressures, nor are we in a situation where raw material prices are being inflated by excessive production demand. We are actually facing inflation caused by a VAT increase (up to 20% in January) and a rise in the world price of oil (nearing $100/barrel) and rising food prices (mainly due to numerous crop failures). Therefore, will an increase in UK interest rates have any effect on these factors? We would suggest not.

The positive effects of inflation at this time however cannot be ignored. Today we are facing a 'debt-crisis' and as identified by Keynes in the thirties, inflation can be the least painful solution to easing debt related problems (deflation, default and debasing of a currency being the others). As inflation rises the real value of debt is eroded, indeed Inflation running at 4%, for instance, would virtually halve the debt burden in less than ten years. In addition to this an upward wage pressure would move some into higher tax brackets (increasing much needed tax revenue). Wage increases could actually fall behind inflation, as many firms abandon an inflation-pegged pay policy, easing pressure on firms and critically reducing overall demand within an economy without actually increasing unemployment. Nobel Prize winning economists Franco Modigliani and Robert Solow once suggested that society as a whole probably functions better and is happier with 5% inflation and 5% unemployment than with 1% inflation and 9% unemployment. Let us not forget the lessons of Japan where twenty years of near zero (and often negative) inflation has saddled the country with a debt burden of almost 200% of GDP (the UK is nearly half of this) with no possibility of reducing it in sight.

We therefore believe that modest inflation will actually prove beneficial for the UK economy and, if kept at levels below 5%, will aid our ascension from the current crisis. It is worth noting that inflation in the US and Europe is far lower than the UK making their debt issues even more serious. We do not believe therefore that we are heading towards the abyss of 'stagflation'; negative growth and rising inflation and that our theory of positive economic growth for the UK this year remains intact.

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

How Do We View the Various Asset Classes in 2011?

EQUITY MARKETS, in our opinion, will post a third year of solid gains, though they will be subject to similar volatility that we witnessed throughout 2010. Overall, we would expect equity markets of developed countries to range higher and end the year with estimated gains of between 12% and 18%. It would be foolish to predict this to come as a result of a steady gain month on month but rather, as last year, to be generated by periods of strong performance followed by periods of fear and uncertainty. Further shocks to the market cannot be discounted and when they arrive many will question the ability of the markets to bounce back; but bounce back they will. A concerted effort by central banks and governments around the world to underpin the current recovery will ensure that the markets are given every opportunity to prosper. Both companies and individuals have taken advantage of historically low interest rates to reduce debt and rebuild their balance sheets. Corporate profits continue to improve, which combined with the observation that stock market performance is now lagging behind a noticeable recovery in GDP, suggests that further appreciation is highly likely. With governments effectively making every other asset class unattractive, through low interest rates and warnings over inflation, investor appetite for equities will remain unabated during 2011. We expect strong inflows from bond funds back into equities over the coming year. With alternatives to equities seemingly less and less attractive we see a liquidity driven impact on equity returns.

An unconstrained approach to UK equity investment will generate higher gains. During such a period we believe that UK focused fund managers that are unconstrained by tracking any specific benchmark will again find rich pickings within the equity universe and generate positive alpha during the year. A clear divergence has, and will continue, to emerge between those companies positioned to benefit from a new era of economic growth and the international growth that will continue. Managers that can identify and exploit these trends will outperform managers more tied to index tracking methodologies. We expect a number of themes to emerge; international presence and economies of scale, for example, will have an important bearing on company valuations and revenue growth during 2011. These characteristics are typical of many of the larger capitalisation stocks listed on the UK stock market – expect them to outperform smaller capitalisations stocks for the first time in two years.

Dislocations in international markets will offer significant opportunity. As in 2010 international markets will not react equally to economic developments or always move in unison, often resulting in temporary dislocations than can be profitably exploited. In many situations the currency effect can be as meaningful as the stock market appreciations (e.g. our US exposure at the beginning of the year), whereas in others it can be detrimental. Under such conditions we attempt to hedge the currency effect as has been the case with our European and Japanese equity exposures of late. We believe that these periods, when others resolve is being tested, is when we can generate positive gains through active asset allocation and fund selection.

TAM Conclusion and Action for Equities in 2011: *We will start the year with a mildly overweight equity position however we will remain vigilant for any repeat of the first quarter 'correction' that we have witnessed in each of the last three years. In each of these years markets have staged a strong start only to turn negative, bottoming in February/March before recovering in April/May However, we are now in the third year of a four year presidential term (for Obama in US. Statistically this has not produced a negative return since the 1940's, due to the incumbent officials willingness to throw every weapon in the arsenal at the market to ensure a positive outcome, and positive sentiment when election year arrives.*

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

FIXED INCOME MARKETS will struggle to produce any capital gains during the year and offer unattractive yields compared to other asset classes. We began 2010 with a negative outlook for fixed income and expected a clear polarisation within the sector to emerge. We were not disappointed but have to concede our conviction was tested during the summer months when an irrational (we believe) fear compressed yields on government securities to all time lows before finally capitulating as the year drew to a close. This year our outlook is little changed from last year.

The Only Good Bond in 2011?

Expect inflation in the UK to remain in excess of the Bank of England target of 2%, and presently well above the 3% upper limit that prompts the Banks Governor to send a letter of explanation to the Chancellor of the Exchequer. Indeed inflation has now been above target for many months and above the upper boundary for the recent past. Given the continued quantitative easing programmes in force around the world, the continuing demand for goods and commodities from developing economies, one can see firm reasons to expect continued high relative inflation. Such events will seriously undermine any argument for further easing and may even force the BoE’s hand into monetary tightening and higher interest rates before the end of the year. The US with far lower inflation (and lower growth levels) is not so similarly constrained and may even extend their current quantitative easing programme further. We will follow this dichotomy with interest.

It is pleasing to note that others agree with our assessment of the risks in the fixed income markets as we see the proceeds of rising net outflows from corporate and sovereign bond funds mostly flowing into equity funds. This positive supply/demand dynamic, (advantages for equity, disadvantages for bonds) adds to our investment conviction for equities.

As fears of a ‘double dip’ recession recede and are replaced with inflationary and monetary tightening expectations the attractiveness of bonds will falter. Government bonds, which attracted so much ‘safe haven’ interest last year (despite the ever present risk of a credit rating downgrade to the UK), will continue to fall in value. Investment grade and higher yielding securities may offer some pockets of opportunity but similarly will ultimately offer little performance during the year. The bull market for Fixed Interest is well and truly over!

TAM Conclusion and Action for Fixed Income in 2011: *We start the year with a negative outlook for the fixed income markets as a whole and will retain a significant underweighted exposure against our allocation benchmarks. We favour the higher yielding corporate bond sector over the investment grade and sovereign markets but even view this as only a medium term opportunity. One caveat to this scenario however is the ‘safe haven’ appeal that bonds, particularly sovereign bond, can offer in times of stress. During the last recession fearful investors were even willing to purchase bonds with negative yields! Should we witness investor sentiment waning we will re-enter the gilt market on a short-term opportunistic basis.* ***In 2011 we view the fixed income market, therefore, as one that offers a more ‘trading’ opportunity than a long-term buy and hold investment.***

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

PROPERTY INVESTMENTS will face many headwinds throughout 2011 and will not, in our opinion offer the same opportunity we benefited from in 2010. From a pure investment perspective we believe that much of the 'easy' gains in the sector have been realised. Massive inflows and the value increase already observed have eroded many valuation discounts and pushed yields down towards 3%, which, when considered against current equity income yields of near 5%, do not appear overly attractive. With commercial rental rates down nearly ten percent over the last two years and increasing vacancy rates, our medium term outlook is not as encouraging as we outlined in 2010. (Please see our November 2010 note – Safe as Houses) Several property fund managers with few commercially profitable projects on their books are finding it difficult to source new opportunities (some running over 25% cash balances) and are struggling to maintain the yield in their portfolios. We believe there are further headwinds on the horizon; more than £160 billion of commercial property debt matures over the next five years, with concerns now surfacing regarding how the industry will refinance itself given the still stagnant credit conditions. With the severe cuts to public-sector property spend also in the government's recent Comprehensive Spending Review one must ponder where future demand and growth will emanate. Our fears also relate to the fact that there may be a small chance of a repeat of the debacle that occurred in late 2008. Falling property values combined with investor redemptions led to liquidity issues for a number of property funds, increasing bid/offer spreads (or the instigation of redemption penalties) in an attempt to dissuade investors from asking for their money back and protect remaining investors. One will never know if there was an element of "profiteering" – a point we highlighted at the time. In more severe cases funds became 'locked' offering little or no liquidity to investors still invested. Frighteningly, some of these funds are still locked to this day.

TAM Conclusion and Action for Property in 2011: *Given our negative short-term outlook for the sector and fears that we again may witness detrimental liquidity issues we are not recommending any property exposure at this time. However, should either the market fundamentally improve or we identify a compelling short-term opportunity (as in 2010) we may enter the market in a limited way.*

ABSOLUTE RETURN INVESTMENT will again offer us the opportunity to generate positive returns with a low correlation to other major asset classes. We have long been supportive of quality 'absolute return' investment funds, as an alternative to Bond style returns. These funds typically use some form of 'hedging' to reduce the losses, or even profit, from falling markets as well as rising ones. Although not always achieved by selecting an appropriate fund, following a strategy compatible with prevailing market conditions can, and has, produced excellent risk adjusted returns and enhanced the same characteristics of our portfolios.

An expanding universe. The number of absolute return funds has grown year by year and we now have significant choice when identifying suitable investments. Although there is currently only one IMA classification into which all these funds fall, one must be aware that there are actually many sub-strategies followed by these funds. Many invest in the equity markets using a long/short approach, many the bond market, or multi-strategy approaches. One must assess each of these for the characteristics that are conducive to our future outlook. Indeed if we review the performance of our absolute return funds held throughout last year we can see a similar divergence in strategy and subsequent performance (which ranged from +2% to +10% for the year).

TAM Conclusion and Action for Absolute Return in 2010: ***We view Absolute return funds as a recommended core asset class in its own right and, for 2011, as a suitable substitute investment for our underweight fixed income exposure.*** *By selecting appropriate funds we aim to create a bond-like return (under normal positive bond conditions) and are therefore recommending an overweight allocation this year. Further we expect even more funds to be launched throughout the year and envisage a more comprehensive strategy classification system to be introduced.*

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

COMMODITY MARKETS will remain fractured with clear winners and losers during the year. In theory the world will demand and consume even more commodities from energy producing ones, to precious metals as it emerges from the recessionary mire. We have already discussed our heightened inflationary expectations, partly driven by commodity demand and partly by the excess liquidity now flowing around the monetary system. High inflation will certainly encourage producers to demand higher prices for their commodities which will continue the spiral. These dynamics should be extremely conducive for a commodity focused investor. However, we are not facing a level playing field and should expect pronounced winners and losers.

Precious metals, for example, will be continued beneficiaries of the increased demand for jewellery (as discretionary income increases) but more importantly will benefit from the continued uncertainty and market volatility that will prevail during the year. Gold, already reaching historic highs, will not easily relinquish its place as the 'currency of last resort'. Industrial metals, however, may not fair so well. Copper, which has risen so dramatically last year, has many substitutes; plumbers are already turning to polymer pipes rather than the more traditional copper ones. Elasticity of demand will be an important factor to watch.

The differences within the energy market must not be ignored. The still positive dynamics which look certain to propel crude oil back over the $100/barrel mark, such as limited supply and growing demand (just consider the recent cold spell across Europe and US). In stark contrast to the outlook for natural gas, which, though much in demand, is available in abundance with no potential supply risk on the horizon?

Expanding our emerging market theme produces a very positive dynamic for agricultural commodities in 2011 and beyond. The global population continues to increase with demand for food stuffs, the commodities needed to grow them and commodities for energy production, just to name a few, higher than ever. One can only postulate that prices must go higher? Add to these natural disasters (flood in Australia for example) and other potential supply disruptions and an even stronger investment case develops. We remain very bullish on the longer term outlook for soft commodities

TAM Conclusion and Action for Commodities in 2011: *We reallocated our commodity exposure towards the agricultural sector last year; a move that proved highly profitable. Given our outlook for the sector this will remain a core exposure within our portfolios. Of the other commodities crude oil, may again hold an attraction for us, but as with many of the US dollar prices commodities, the currency effect for non-US investors will prove an important component of performance.*

As a note of caution however we remain focused on two main issues. The first is the method by which we gain exposure as not all investments/funds are equal. Secondly we appreciate that markets are extended, with some predicting a hard correction. – In this context we must remember the commodity sector is one where many investors look to profit from falling prices as well as rising ones and moves can be exaggerated. We will therefore maintain an Overweight outlook for the sector but only maintain a modest suitable exposure across our portfolios.

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

CASH DEPOSIT: As in 2010; the historically low interest rates available for cash investment (negative if you consider the current rate of inflation) make cash investment a very unattractive proposition in 2011. However, 'cash' will again form an integral part of our asset allocation modelling. Firstly, cash offers security; should the parallel market rallies not continue, we will actively move to cash to limit exposure (and loses). Secondly, Cash offers liquidity; without a modest cash balance within portfolios we will not be able to efficiently exploit many of the short term opportunities that avail themselves during the year.

TAM Conclusion and Action for cash Deposit in 2011: *We will begin the year with an underweight cash position within all but our most liquidity focused portfolios and will not actively seek 'cash' investments. However, we will show no hesitation in using cash deposits as a short-term sanctuary should fear imminent market declines.*

Flexibility Will Be the Key to 2011

As witnessed by the general return in 2010 for our clients we believe that the key to a successful investment approach in 2011 will be flexibility. The volatility we have witnessed over recent years will not abate fully, nor will the threat of one identified (or even one of a yet to be identified) event derailing the current positive sentiment surrounding the modest economy recovery. Should market conditions change simply maintaining "old" asset allocation structures will certainly not extract the best value from the opportunities that present themselves.

This is why TAM only manages discretionary portfolios. When conditions change we need to be able to remain responsive and react in the best interest of our clients. Each portfolio we accept to manage has been awarded a risk/return classification agreed to by both the client and Advisor. Nonetheless, TAM retains the discretion to manage the underlying asset exposure within predefined limits. Our balanced portfolio, for example has a neutral asset allocation of 50% invested in directional equity and 50% invested with non-equity assets (this includes, fixed income, absolute return and cash for example). Around this neutral position we have the flexibility to decrease the directional equity component between a minimum of 15% and increase to a maximum 65% of the portfolio. Similar limits are placed on the non-equity allocation as summarised in the table below.

TAM Portfolio Flexibility		Directional Equity Exposure		Non-Equity Exposure	
TAM Balanced Portfolio	TAM Benchmark	50%		50%	
	TAM Flexibility	Min.	Max.	Min.	Max.
		15.0%	65.0%	35.0	85.0%

Working within these limits has helped us return attractive returns for our clients year on year. Last year reacting to the ebbs and flows of both the equity and fixed income markets helped us produce solid returns for clients in the calendar year 2010.

In Conclusion we look forward to another positive year in investment terms but are not unaware that we will encounter occasional lumps and bumps along the way. We therefore expect a third successive year of Growth for Equity markets and may even witness an upsurge should the appropriate conditions converge later in the year. The European theatre problems will continue to test the resolve of Global Investors and China may need to reign in its growth but with corporate earnings on the rise and equity alternatives hard to find we remain positive on the outlook for the year. Last year we climbed a "wall of worry" this year we are looking to remain vigilant as we climb a solid upward slope.

For Further Information Contact:
TAM Asset Management
7th Floor, City Tower
40 Basinghall Street
London, EC2V 5DE
Tel: +44 (0)207 549 7650
Fax:+44 (0)207 549 7786

Or Visit **WWW.TAMASSETMANAGEMENT.COM**