equinox

half yearly investment magazine

CLIENT FOCUSED THINKING

Why we don’t follow the herd

FAMILY INVESTMENT COMPANIES

equilibrium

FIRST EDITION
April 2012

PLUS: An Enterprising Budget | In Profile: Neil Woodford | Expected Returns | 6 Monthly Review

Welcome

Welcome to the first edition of Equinox, our new look investment magazine.

Our aim is to keep you up to date with the investment decisions we have made over the last 6 months and how they have impacted portfolios. We also hope you find the articles of interest and, as always, we welcome your feedback.

Investments can sometimes be dull, complicated and confusing, but our aim is to provide you with content that is relevant, timely, interesting and easy to read! We hope we have succeeded and that you enjoy this first edition.

Colin Lawson
Managing Partner

Contents

Client Focused Thinking

Why we don't follow the herd

Benchmarks

Most clients want to achieve returns well ahead of cash and inflation, or perhaps achieve a specific income level or capital value. But how does this fit with the goal of your adviser or fund manager?

Mike Deverell explains why inappropriate benchmarking means many advisers are consistently disappointing their clients.

We often stress to clients that we do not benchmark our portfolios against any specific index.

Whilst we are happy to be compared against our competitors, the danger of inappropriate benchmarking is that it can lead to a mismatch between what you want to achieve and what your investment manager is trying to achieve.

For example, what if we benchmarked our portfolios against the FTSE?

What happens if the FTSE falls by 35% and our portfolios "only" go down by 32%? Would you be happy with this return?

Most of our clients would be very upset and angry if this happened and yet we have beaten our benchmark by 3%!

Other benchmarks often used by discretionary managers are the Association of Private Client Investment Managers (APCIMS) indices. These are composite benchmarks made up of various indices. The current makeup of the FTSE APCIMS Income index is shown below:

If our benchmark was to beat APCIMS, then the best way to do so would be to mirror this asset allocation, perhaps making very minor changes to it to try and outperform.

We would be wary of deviating too far away from the benchmark even if we thought an asset class was going to go down, just in case we were wrong and the decision had a negative impact on our performance against the benchmark. Because we don't benchmark, we have the freedom to completely eliminate an asset class that we think might fall in value.

Other drawbacks of this particular benchmark include:

- 100% of the fixed interest in the APCIMS Index is UK gilts, whereas we also use corporate bonds.
- Property exposure at 2.5% is very different to a typical 10% to 20% we might recommend in the long term.
- Sectors that APCIMS defines as property and hedge funds, we would define as equities.

Benchmarking against such an index would mean that our objectives would be out of line with those of most of our clients.

Asset Class	Index Used	% of Portfolio
UK Equities	FTSE Allshare Index	42.5
International Equities	FTSE World Ex UK Index	12.5
Fixed Interest	FTSE Allstocks Gilt Index	35
Commercial Property	FTSE All UK Property Index	2.5
Hedge Funds	FTSE APCIMS Hedge (Investment Trust) Index	2.5
Cash	7 day LIBOR -1%	5

Competitor Comparisons

Our main objective for each individual client has to be to achieve your individual goals.

Having said that, we appreciate that you need to know we are doing the best job possible in the market conditions, and you would like to know how we're doing against our competitors.

Our main competitors are "managed" or mixed asset funds, where a fund manager invests in various different asset classes as we do, or other discretionary investment managers.

To show how we perform compared to these competitors, we will show portfolio performance relative to the relevant "mixed asset" unit trust sector (the average managed fund), and the relevant Asset Risk Consultants (ARC) index (the average discretionary portfolio).

Details of these measures of assessing performance are shown below.

Unit Trust Sector - Mixed Asset 20% to 60% Shares

Funds in this sector must have between 20% and 60% invested in equities. In addition, at least 30% of the fund must be in fixed interest investments and/or cash investments.

This is an appropriate comparison for our cautious, balanced or adventurous portfolios because they all have equity exposure typically within the range of 20% to 60%, the main requirement of this sector.

Unit Trust Sector - Mixed Investment 40 to 85% Shares

Funds in this sector must have between 40% and 85% invested in company shares. There is no restriction on the amount that must be held in fixed interest or cash.

This sector is appropriate to compare with our speculative portfolios (which tend to have 70% equities or more).

Asset Risk Consultants (ARC) Private Client Indices

The ARC indices are a set of risk-based indices designed to be used by private clients and their advisers in assessing the performance of discretionary portfolios. These cover the following risk categories:

Private Client Index (PCI)	Risk Relative to Equity Market
ARC Cautious PCI	0 to 40%
ARC Balanced Asset PCI	40 to 60%
ARC Steady Growth PCI	60 to 80%
ARC Equity Risk PCI	80 to 110%

ARC contributors include most of the big discretionary managers, such as Barclays, Credit Suisse, Coutts & Co and Rathbones.

The ARC Sterling Cautious PCI is the most appropriate comparison for our cautious portfolios.

The ARC Sterling Balanced PCI is the most appropriate for our balanced and adventurous portfolios. The Steady Growth PCI is most appropriate for our Speculative portfolios.

One issue with using the ARC indices is that they are only published monthly. We will therefore use mainly the unit trust sectors (which are priced daily) as the main comparison with the ARC indices being a secondary measure.

Individual Asset Class Portfolios

Your investments are all made up of a mixture of our individual asset class portfolios.

Each of these is also shown against an appropriate sector (or composite) so you can see how each different part of your portfolio is doing compared to similar funds.

By setting appropriate "comparators" rather than formal benchmarks we can focus on achieving your goals rather than focusing on beating an arbitrary index. However, this will also allow you to see how we're doing against the competition, which we hope will give you comfort in our investment performance.

* The benchmark for property is a composite of the performance of all property funds in the unit trust property sector that would be eligible for Equilibrium's portfolio. This excludes all property share funds (which are really equity), illiquid funds, and exempt funds (those only eligible for use by charities or pension schemes).

Family Investment Companies

an estate planning vehicle

Deborah Clark CTA is head of the Mills & Reeve Private Tax & Trust team in Manchester. She specialises in advising individuals on estate planning, in particular entrepreneurs for whom their business and private affairs blur. During her 22 year career she has covered both personal and corporate tax work both in accountancy and legal practices. As a result her work is very varied encompassing wills, trusts, family investment companies, family charters, employee incentives and shareholders' agreements to name just a few areas. Legal 500 describes her as "proactive and forward thinking" and has said "she provides good communication skills and solutions in areas of changing complexity". The team were also voted Private Client Team of the Year, Manchester Legal Awards 2012.

Family Investment Companies ("FICs") offer a way to pass on family wealth tax efficiently whilst retaining control over the assets. They also assist protecting the family wealth from the impact of a divorce or other financial claims.

Part of the attraction of using a FIC is its potential simplicity. Cash funds can be invested in a FIC and shares passed to family members. The board of directors determine how the funds are invested and when dividends are paid to the shareholders. The gift of shares to family members triggers no immediate tax charges and provided you survive seven years from the gift, the value of the shares is entirely out of your estate for inheritance tax purposes. You appoint yourself to the board and therefore retain control of the funds. It really can be that simple.

To maximise the benefits of a FIC and achieve greater control and protection, the Articles of Association which govern how the FIC is operated, should be carefully drafted. For example, it is possible to increase the board of directors powers to make decisions without reference to the shareholders, enabling you to retain total control without having to retain a significant holding of shares (or indeed any shares). It is also appropriate to include strict controls on who can be a shareholder to avoid shares passing out of the family in a divorce or bankruptcy situation.

Changes in tax treatment for companies is also making FICs very attractive. From 1 April 2012 a FIC will pay corporation tax at 24% on its income and gains and this rate is set to reduce to 23% from April 2013 and 22% from April 2014. For income this compares to a 50% rate paid by trusts and high earners. Even more significant however is the fact that FICs do not pay tax on dividend income, allowing such income to be accumulated tax free. For capital gains, a trust or high earner will pay tax at 28% whilst a FIC will only pay 24% and gets the benefit of indexation allowance to reduce the effective rate even further. These low tax rates mean that accumulating wealth within a FIC is far more attractive than owning assets personally or in a trust.

It is important to note that income or gains are normally taken out of a FIC in the form of a dividend. The shareholders may have to pay further tax at this stage depending on their circumstances. Tax on dividend income is paid at either an effective rate of 36.11% for high earners or 25% for 40% taxpayers, basic rate taxpayers do not have to pay additional tax on dividend income. The combined effect of tax paid by the FIC and by the shareholders when income is distributed means that overall tax rates can be higher than holding assets directly. In view of this it is recommended that a FIC is only used where the expectation is that profits will

be accumulated over the medium to long term. In this scenario the benefit gained by reinvestment at low tax rates offsets any double tax charge that may arise.

In view of the tax on dividends paid out of a FIC it is advantageous to lend funds to the structure. The benefit of using loans is that capital can be repaid without triggering any tax charges. This gives the shareholders additional flexibility as capital repayments can replace dividends, providing a tax free source of income. It also means that income generated by the FIC can be reinvested, making the structure more tax efficient. Care is needed when structuring a FIC and particularly when using debt as there are anti-avoidance rules that could result in unexpected tax charges for the unwary.

It is envisaged that the FIC would be an unlimited company. The primary reason for this is that unlimited companies are not required to file accounts at Companies House therefore the accounts will not be publicly available. An unlimited company would not be recommended if it is envisaged that the FIC will undertake any trading activity.

As noted, a FIC is generally used as an estate planning tool as ownership of shares are spread between family members. However, the tax advantages that a company structure offers investors has now led to the development of Private Investment Companies (PICs). A PIC will generally have a single shareholder and most of the funds invested are lent to it. PICs enable investors to take advantage of accumulating income at much lower tax rates and using loan repayments to provide income needs.

In summary, whether you want to undertake estate planning or simply wish to have a tax efficient but flexible vehicle to help manage your investments, you should certainly be considering using either a FIC or a PIC.

Chris Fletcher

Deputy Chief Executive
Greater Manchester Chamber of Commerce

Chris Fletcher, Deputy Chief Executive of the Greater Manchester Chamber of Commerce which is the largest Chamber of Commerce in the UK. It's 5,000-strong membership provides business support through a range of sector-based membership services and networking opportunities.

"There were no surprises in the Budget as so many of the measures had already been leaked. There is some movement in the right direction, but in areas such as the 50p tax rate, the Chancellor has taken the half way line.

"The £1.2bn investment as part of the City Deal is very welcome and already some of that cash has been earmarked for delivery of the SEMMMS transport scheme near the airport and the extension of Metrolink to Trafford Park, both major campaign objectives of the Chamber for some time.

"On Corporation Tax and Enterprise Loans, he has made the right noises for growth and it seems people will have more money in their pockets, which will be good for the economy.

"The announcement around Northern Hub is on the face of it welcome, but it's not clear whether there is a major shortfall in funding, so the Northern Hub campaign continues and we have arranged for the Transport Secretary to come to Manchester.

"It was disappointing that there was nothing on business rates. However there is a real focus on media and faster broadband speeds, which is good for MediaCityUK and builds on our strengths.

"The extra 1% cut on corporation tax is welcome but the threat of a 3p fuel duty rise in Autumn hangs over all businesses.

"Overall there were more positives than negatives in the Budget and I'd give it six out of ten."

Naomi Timperley

Co-Director
Enterprise Lab

Naomi Timperley, Co-Director of Enterprise Lab which aims to bridge the gap between education, employment and enterprise to inspire young people in developing their skills and experiences for a more rewarding & progressive future.

"I was delighted to hear that Virgin Media Pioneers campaign to introduce Enterprise Loans for young people has been supported by the Government and was announced in the Budget. George Osborne said: "Young people get a loan to go to university or college, now we want to help them get a loan to start their own business." The Government will lend young entrepreneurs money to start their own business on similar terms to student loans, under a pilot scheme to be launched later this year. I've seen the campaign gain momentum on Twitter and to hear it being announced on Wednesday was a breakthrough for budding young entrepreneurs.

"The Business and Enterprise Minister Mark Prisk said: "This Government thinks that everyone should have a chance to turn their idea for a business into reality. That's why in the Budget this year we announced we are setting up a youth enterprise loan scheme." With youth unemployment at an all time high I say it's good news for young people who might not otherwise get the means to start a new business and jobs for the future generation.

An Enterprising Budget

Mark Mills
Entrepreneur & Chairman
HURST Accountants

Mark Mills, Entrepreneur & Chairman of the Manchester accountancy firm, HURST and founder of AIM and CardPointPLC. Mark recently appeared as a panellist for this year's Budget Live event which enlisted 150 entrepreneurs from across the North West to watch the Chancellor's latest policy announcements.

"The Budget lacked specifics especially concerning boosting employment opportunities which is vital for getting our economy moving. There were far more mentions of Manchester than ever before – that in itself is very encouraging. This puts Manchester on the stage in front of the global business community and can only be good for business. We will certainly benefit from being better connected with London thanks to the planned transport link improvements. With new tax credits in the pipeline, we're set to be the core hub for digital and creative industries – and with Media City taking off we're already leading the way in this field.

"There were some positive initiatives for start-ups such as the enterprise loan, but this is just a short term fix. I want to know about how we keep these start-ups going strong – we need long-term plans not just quick fixes. On a whole, the future looks bright for Manchester but I was disappointed some opportunities were missed. It's now a matter of watching this space as the devil is in the detail."

Colin Lawson
Managing Partner
Equilibrium

Colin Lawson, founding member of Equilibrium.

"Many of the post-Budget headlines focused on the effect of phasing out the age allowance for those over age 65. The negative comments were unfair in my view as, in reality, pensioners will not really be any worse off in monetary terms when the increased personal income tax allowance for everyone is increased. Those earning over £30,190 will actually be better off.

"I think the introduction of a cap on tax relief is an ill thought out political blunder in terms of the effect it will have on charities who rely heavily on large donations made by a small number of wealthy philanthropists (£1.67bn from the top 100 in 2010/11). I hope that the final rules will mean that contributions to charities will not be restricted by the cap but the uncertainty in the meantime has created problems.

"Good news about the reduced corporation tax rates and also the reduction in income tax for high earners. However, the introduction of the 50% rate in the first place meant that many wealthy individuals moved offshore as a result and I'm not sure that a subsequent reduction will be enough to tempt them back, having spent time and effort restructuring their affairs.

"One final thought: I'm glad I'm not buying or selling a property above £2m as £140,000+ is a lot of stamp duty to pay!"

In Profile:

Neil Woodford

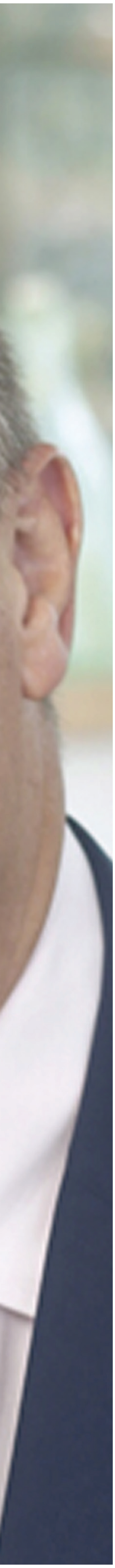
Invesco Perpetual

Invesco Perpetual's Neil Woodford is one of the best known and most successful fund managers in the UK.

In our exclusive interview, we speak to Woodford about his philosophy both on money and on life.

"

We focus on fundamentals rather than momentum, which means we're often doing the opposite of what the market is doing.



You now manage £26bn of assets across various funds. Does managing this amount of money pose a different challenge to when you first started out? Are there liquidity issues?

I feel my investment style is suited to running a large asset pool. We have an average holding period of seven years whereas the market average is more like seven months.

We focus on fundamentals rather than momentum, which means we're often doing the opposite of what the market is doing.

It really comes down to whether we can implement our strategy. Even when I was running £30 or £40 million I've always built positions slowly over time. We recently sold out of our Tesco holding over a two week period – this was quite a major shareholding – without issue.

There are benefits of our size too. We get privileged access to management and as major shareholders we can often exert quite a bit of influence on management of the companies we own.

How has the industry changed since you joined Invesco in 1988?

The amount of information we receive these days can be overwhelming. Our challenge is to filter out what is useful and ignore the rest.

Does the location in Henley-on-Thames, well away from the City, help you in that respect?

It certainly helps in that we don't get swept up with what everyone else is doing. We can just focus on doing our own thing.

It is conducive to individual thinking. Plus it's a really nice place to work!

You famously stuck to your guns in the technology bubble, refusing to buy stocks at overinflated prices. In the recovery from the credit crunch you also came in for criticism for short term underperformance. Was it easier to stick to your principles this time around?

We definitely had a difficult 2009 and part of 2010. Few funds have such an unconstrained approach as we do – if we don't like banks we don't own them at all. Sometimes this can be a lonely place to be!

However, we remained confident that our strategy works. Importantly, investors seemed to have that confidence and patience too.

We're always re-checking and re-analysing all our holdings and assumptions. However, the companies we owned were performing well operationally as businesses. If we'd decided to chase momentum and buy the stocks that were doing well we'd have had to sell one of the companies in which we had long term conviction.

Are there any overriding principles you apply when managing the fund?

Our priority is always capital preservation. We know that our investors are not going to be happy if we've beaten a benchmark but lost money.

We don't know which way the market is going to go and we can't time it. We just look for businesses whose future value is not fully reflected in their share price.

We know that dividend growth and earnings growth are the main drivers of returns in the long term. We therefore look for companies that can grow earnings and dividends. The impact of reinvested income on returns is significant.

Turning away from investing, if you could have dinner with anyone from history, who would it be?

Winston Churchill. He was a great man who was present at most of the significant events of the twentieth century. He fought in the First World War and led this country through the Second. I remember his funeral well.

Tell us something we don't know about you!

I'm into my fitness and find that a good session in the gym helps clear the head

We're quite a sporty company in general. Last year, three of us went on a "swim trek" in Greece, swimming between islands for six or seven hours a day, over six days. Each day we swam maybe seven or eight kilometres.

Unfortunately for me, Will, who signed us up for this had somewhat exaggerated my proficiency to the company running the trip telling them I was some sort of champion swimmer!

Equilibrium View

Neil Woodford's Invesco Perpetual Income fund has always been a core holding in our portfolios. It is probably the only fund we have always recommended, right back to the early days when we were Applewood Financial.

In past editions of our half yearly Investment Review we have highlighted this fund in our "Hold, Fold or be Bold?" section. As the fund underperformed in the recovery, we were forced to re-evaluate our faith in Woodford and defend our reasons for continuing to hold the Income fund. It is very pleasing to note that our faith has been rewarded by significant outperformance over the past 18 months or so.

Whilst all funds go through their ups and downs, it is difficult to argue with Woodford's track record, and we anticipate the Income fund remaining a core holding for the foreseeable future.

Supporting the Arts

> "
> Music can change the world, because it can change people.
>
> Bono

The Royal Northern College of Music is one of those magical places which inspires, energises and surprises each time you visit. Situated on Oxford Road between Manchester University and MMU, it is the unique home of a world-class music conservatoire as well as the fifth busiest arts venue in the UK. It is at the heart of a long and rich history of music in the North West, originally established by Sir Charles Halle to train musicians for his newly-formed orchestra.

Almost 120 years later, some 700 undergraduate and postgraduate students in all disciplines from piano to violin, percussion and composition mingle with the superstars of the musical world to learn and perform in genres ranging from classical to jazz and folk to world music.

If your children or grandchildren had a music teacher or you have ever listened to classical music or been to the Bridgewater Hall, then you have already enjoyed the talent which emerges from the RNCM, even if you have never visited the College itself.

Over the last 12 months, a select group of Equilibrium Asset Management clients have enjoyed VIP membership of the RNCM Friends and have had a chance to be a part of this sparkling jewel in the North West's cultural crown. Membership has given them access to hundreds of concerts and recitals as well as exclusive events and opportunities to meet staff and students.

Friends and Benefactors help shape the lives of RNCM musicians when they need it most. Most will need financial support during the course of their training and the College gives bursaries to those most in need. This is only possible thanks to the tremendous generosity of the many individuals, companies and charitable trusts who support the RNCM each year; many of those get their first taste of a closer relationship with the College through Friends membership or by direct student support.

We at Equilibrium Asset Management are committed to philanthropy and to guiding those clients who wish to add value and meaning to their portfolios.

You might not realise that the RNCM has charitable status which means that donations to the College are eligible for gift aid and legacies can offset an estate's inheritance tax liability.

It is clear that in today's economic climate, both the arts in general and young people in particular need our support more than ever. Certainly, if we want to continue to have access to world-class music in the North West, we can help secure that future by supporting the RNCM.

For further information, visit **www.rncm.ac.uk**

Expected Returns

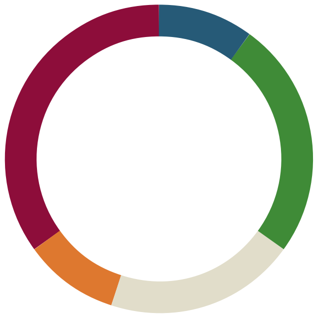
by Mike Deverell, Investment Manager

For any investment portfolio we manage, we will always say what we think the return should be over the long term.

We will also tell you what have been the historic best and worst 5 year returns.

The chart opposite shows our "strategic" balanced asset allocation (where we would invest in the long term if we were not making active changes):

For a balanced asset allocation we would expect a return over the long term of around 7.5% per annum. In the best 5 year period historically it returned 13.16%pa, and in the worst 5 years saw a return of 2.17%pa.[i]



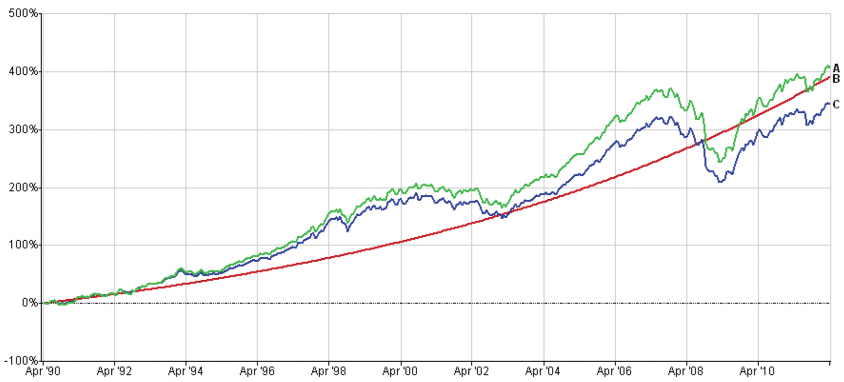
Cash	10%
Fixed Interest	25%
Property	20%
Alternative Equity	10%
Equity	35%

Clients often challenge our assumptions, asking how realistic they are. We therefore thought it would help to share some of the backtested data we use in constructing portfolios.

The chart shows a typical balanced asset allocation (blue line) compared to a return of 7.5%pa (red line).

It utilises index returns rather than funds. For example, the equity part of the portfolio reflects the returns of the FTSE Allshare Index.

The green line is the same portfolio, but rebalanced annually, banking gains and returning to the original allocation.



A - Balanced AA Indices Annual Rebalancing (404.52%)
B - 7.5% PA (385.96%)
C - Balanced AA Indices only (341.04%)

As you can see, just buying and holding this "portfolio" would have achieved returns above the target the vast majority of the time, only dipping below in the credit crunch. However, by regularly rebalancing, losses are reduced and returns increased, and the green line finishes above the target return.

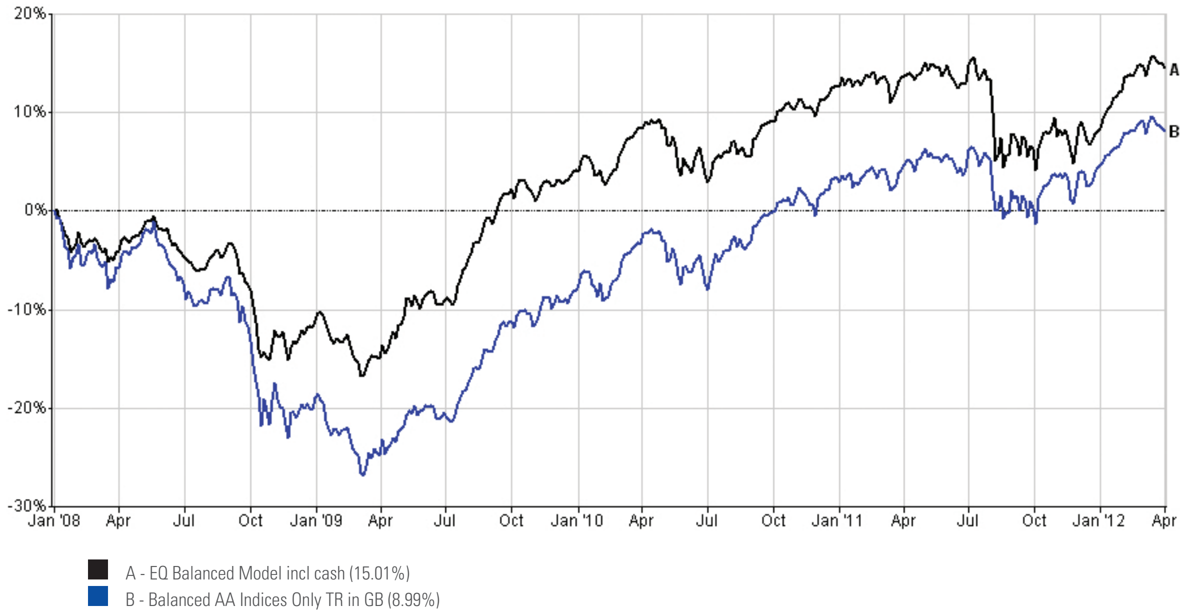
Narrowing the gap

The charts show that the returns we target are realistic in the long run, although over shorter periods returns can be much higher or lower.

It is our job to narrow the gap between the best and worst, improving on the worst when times are difficult, and positioning the portfolio to achieve the long term targets.

The chart below shows our balanced model asset allocation 5 (black line) compared to the index portfolio, since our model was launched on 1 January 2008.

The chart shows that our investment decisions have added over 6% to returns, comfortably beating a "buy and hold" strategy:



Back on track

We hope this provides reassurance that, not only are our assumptions realistic, but that our active management can enhance those returns still further.

However, after such a difficult period for portfolios, some investors are concerned that their portfolios may never get back on track.

One observation from the past data is that a very poor period is often followed by a very good one.

For example, the period from 1 March 1998 to 1 March 2003 is pretty much the worst period we can find. This period included the crash in technology stocks, the 9/11 attacks, and the beginning of the war on terror, and saw total returns of less than 9%.

However, the 5 years from March 2003 to 2007 were very good indeed, averaging more than 10%pa. Over the total 10 year period from March 1998 to 2007 the total return was over 81%. We would expect a discretionary portfolio to perform significantly better.

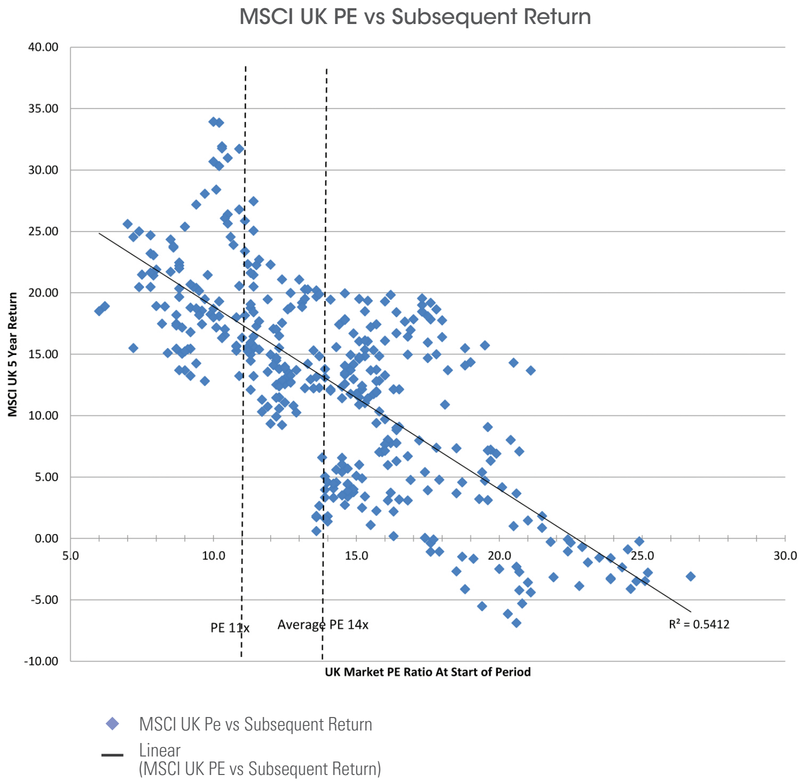
This illustrates that even after a very poor 5 year period, it is possible to get back on track fairly quickly.

The future is bright?

Despite the current media doom and gloom, we are optimistic about the future. In particular, we think we could see some excellent equity returns.

At 30 March 2012, the Price/Earnings (P/E) ratio of the UK stockmarket was 10.5, well below the long term average of 14. The P/E is just a multiple of the actual money made by the companies. The lower the P/E ratio, the "cheaper" the market is.

The chart below shows there is a strong correlation between a low P/E and a high return. Each blue dot shows a different 5 year period since 1975. Across the horizontal axis is the P/E ratio of the UK equity market at the start of that period. Along the vertical axis is the annualised return of the MSCI United Kingdom Index over that period:



The MSCI Index is used as it has a longer history than the FTSE Allshare, although the indices are similar.

Looking at every period where the P/E ratio at the start has been 14 or less (below the long term mean),[ii] the average return from the UK market over the following 5 years has been 17.62% pa.

The average return seen when the P/E has been at a similar level to now has been over 20% per annum. In 100% of 5 year periods since 1975 when the P/E has been the same or lower than it is now, we've seen a return of more than 10% pa over the next 5 years.

We can never predict the future but we can learn lessons from the past. History gives us some real reason for optimism with regard to portfolio returns over the next few years.

Best & Worst returns taken from Financial Express Analytics, looking at various 5 year periods since 1990. Equity is represented by the FTSE Allshare Index, Cash by the UT Money Market sector, Property by the IPD All Property Index, Alternative Equity by the Cautious Managed sector, Fixed Interest by a mixture of the UT Sterling Bond sector (80%) and UT Gilt sector (20%). Returns are assumed to be net as with good financial planning we believe we can keep tax to a minimum. The exception is cash, which is shown net of 20% tax.

[ii] P/E ratios from Thomson Reuters, FTSE Allshare Index returns from Financial Express Analytics. The research considers all full 5 year period beginning each quarter, since 1985.

Investment Review

Welcome to the investment review section of our magazine.

It is heartening to be writing to you after six months of great returns in both absolute and relative terms. The second half of 2011 was extremely challenging but it is very pleasing to have come out of the crisis ahead of where we were going into it.

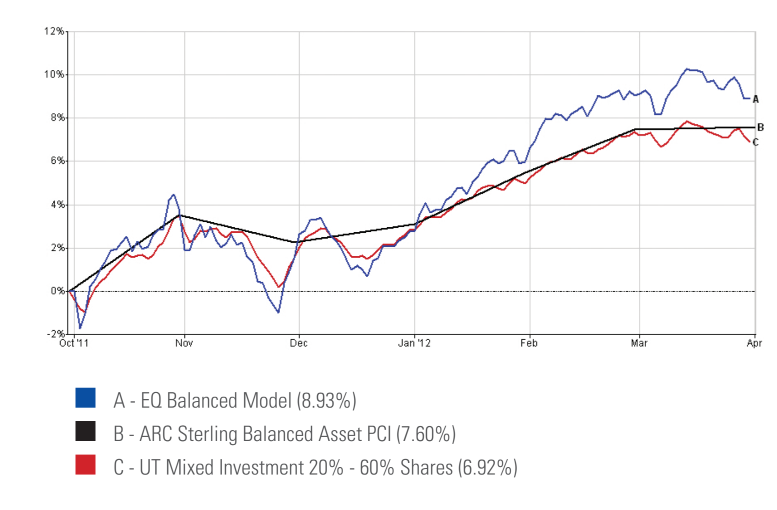
In this section we will review the events of the past six months, explain what changes we made to portfolios and the effect they had on performance, and tell you what we think will happen in the future.

6 Monthly Review

When writing our last investment review document in October, we were in the midst of a real crisis about European sovereign debts.

At 3 October last year the FTSE 100 closed at 5,075, almost 1,000 points below where it had been in July. The main theme of our last briefing was therefore how we were defending your portfolios against potential further losses, whilst at the same time positioning them to make profits when the recovery we expected happened.

We are very pleased that the second scenario was the one that played out and since then the FTSE 100 recovered to well above 5,900, before dipping back to 5,768 at close on 30 March. Portfolios have recovered substantially, as you can see from the below chart showing our balanced model portfolio asset allocation 5 (blue line) since 1 October:



It is pleasing that during this period our models have generally outperformed our main competitors. The red line shows the average "mixed asset" or managed fund, whilst the black line shows the average discretionary manager's balanced portfolio.

Our "volatility trading" (discussed elsewhere) and the new Defined Returns products have added significantly to client returns.

The main concern in the second half of last year was not so much that Greece may default on its debts, but that we may be heading into a banking crisis.

Last year we witnessed similar conditions to those we saw in the credit crunch. Banks were finding it more difficult to borrow from each other, and there was therefore a danger that a lack of liquidity could force a bank into insolvency. Although we felt this was unlikely, if this had happened we would have had another full scale financial crisis on our hands.

The main reason for the recovery in markets has not been the actions taken by politicians, but by the European Central Bank (ECB). Their Long Term Repo Operation (LTRO) may sound complicated, but effectively it means that they will lend pretty much as much money to a bank as it needs, for a period of up to three years.

As the ECB can print money to do this, it means that the danger of a bank going bust in the next few years has receded greatly.

This buys time in order for European governments to get their houses in order. It doesn't solve the problem, which is that they still have too much debt, but it gives them time to address those debts.

As a result, markets have stopped being driven purely by sentiment and have started focusing on fundamentals again.

Company earnings have held up well and often increased throughout this period. Even though Europe is almost certain to be in recession, growth in the US has re-appeared and emerging markets continue to expand.

All of this means that the outlook for the global economy is much more positive. The IMF is predicting global growth of over 3% in 2012. That is below trend but it is still positive, and indicates company earnings will continue to grow, even if only weakly.

With equity valuations well below their average on an earnings basis across most markets, we could still see some great returns even if the economy as a whole continues to struggle.

Asset Allocation

In 2011 we were more active with our asset allocation than ever before which made a big difference as a result.

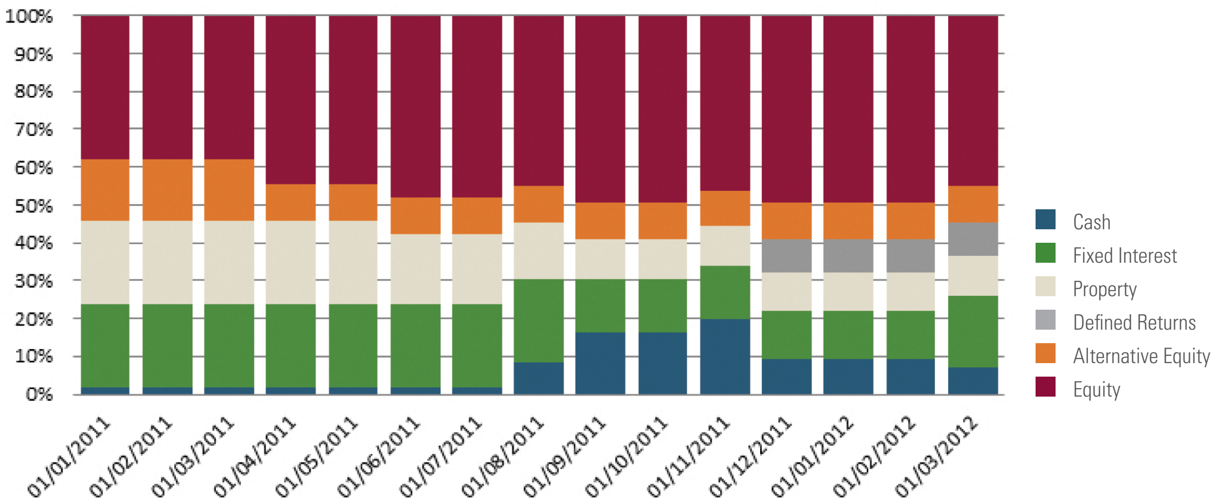
We used volatility to your advantage, increasing equities in most portfolios when markets fell and banking gains as markets rose.

When the European crisis began we also mitigated losses by reducing fixed interest and property and increasing cash.

Having defended against losses we then put this cash to good use, creating our Defined Returns plans and trading volatility.

The chart below shows how proactive we have been in managing the asset allocation of our balanced portfolio (excluding client cash) since the beginning of 2011:

We are still holding 5% tactical cash as, whilst we remain positive on markets we think volatility will be around for some time. If markets fall back, we want to use the opportunity to buy equities at a relative low.



> “
>
> We used volatility to your advantage, increasing equities in most portfolios when markets fell and banking gains as markets rose.

Performance

The chart below shows the performance of our balanced model asset allocation 5 against the Mixed Asset 20-60% (formerly cautious managed) unit trust sector, and the ARC Balanced PCI (the average performance of various discretionary managers), over the past three years.

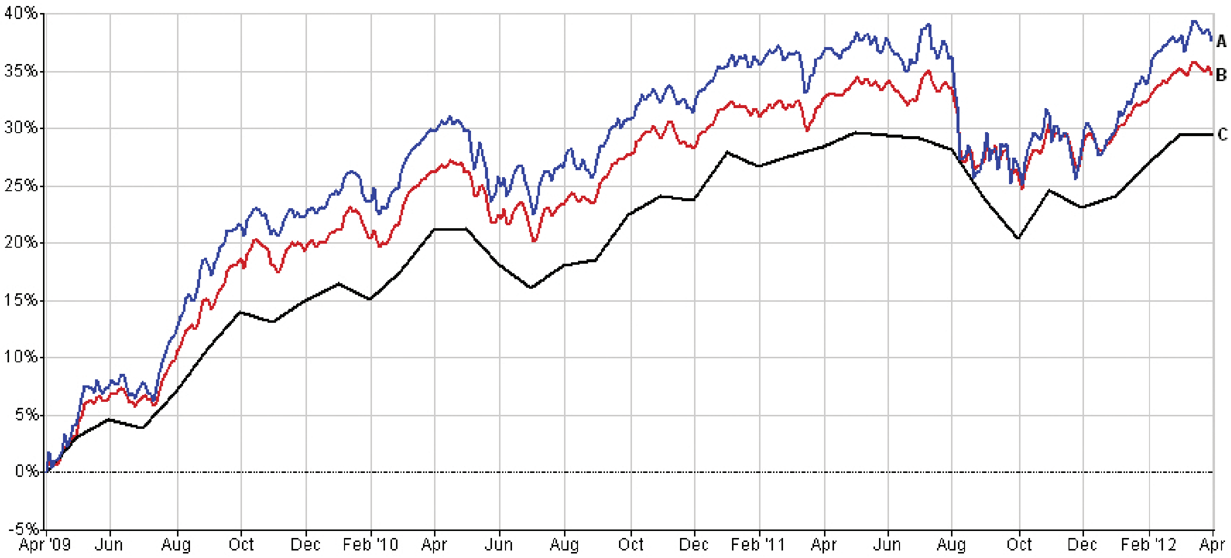
(Please refer to page 4 for details of the benchmarks used for portfolio performance.)

We are pleased to have outperformed both the average managed fund and average discretionary manager over this period (see also performance tables on page 27), however it is clear from the chart that we experienced a difficult period in mid 2011.

We were cautiously positive towards equity at the beginning of 2011. We also were avoiding gilts which we felt were very expensive. During the first half of 2011 this worked in our favour, but as markets fell in August, and the supposedly safe gilts rose, these two views hurt performance.

However, by quickly reacting to events and adapting portfolios accordingly, performance has very quickly recovered, and has been very strong since December. Our other portfolios performed in similar fashion to the balanced.

Below is a summary of the main steps we took and how this aided performance.



- A - EQ Balanced Model (37.67%)
- B - UT Mixed Investment 20% - 60% Shares (34.69%)
- C - ARC Sterling Balanced Asset PCI (29.53%)

A summary of the main steps we took and how this aided performance

1. Increased Cash

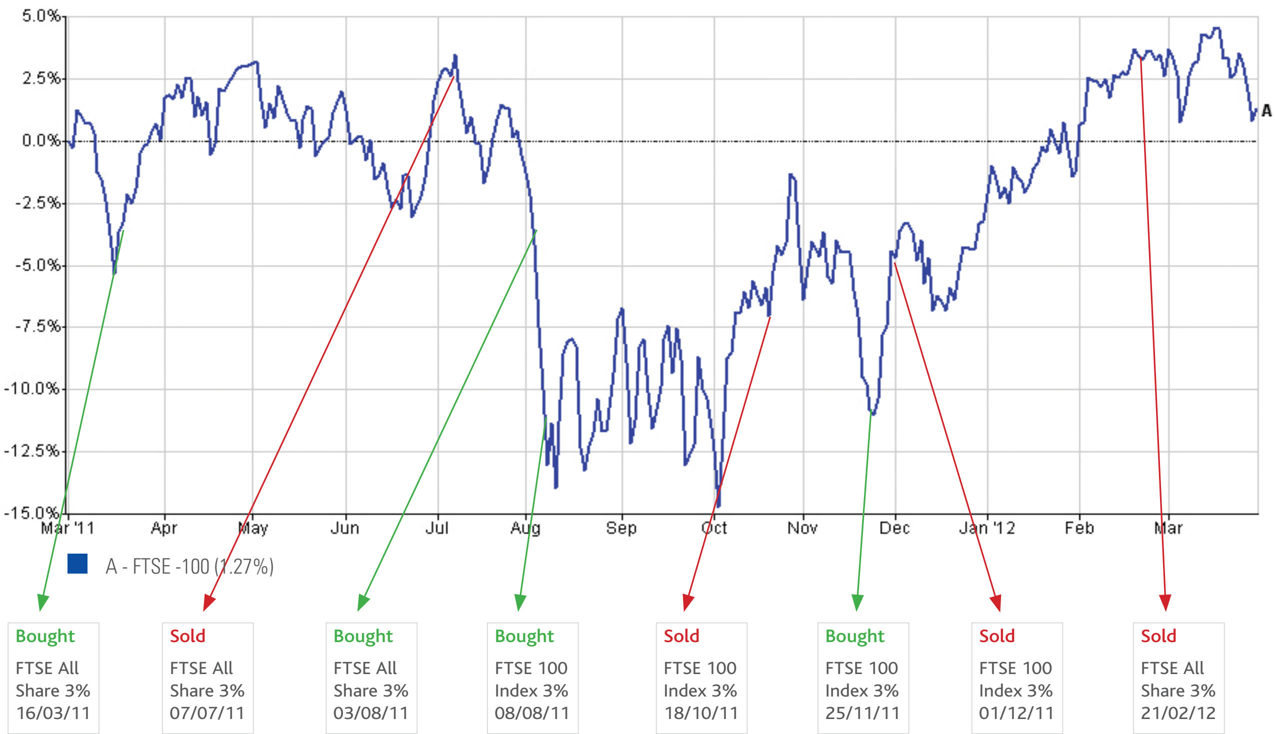
When the crisis hit we mitigated losses by reducing fixed interest and property, and holding the money in cash. This was partly to reduce risk in the portfolio in light of the European crisis, but by doing this we also had the liquidity to take advantage of volatile markets.

2. Volatility Trading

We generally traded in and out of markets as they rose and fell. Beginning after the Tsunami in Japan in March 2011, we continued this right through the European crisis, selling our last position at the end of February.

In total, clients have generally made around 13% on one set of trades, and 11% on the other. We have typically invested 3% of client assets in each set of trades.

“ ... performance has very quickly recovered, and has been very strong since December



3. Defined Returns

We created our Defined Returns products to take advantage of a short term opportunity. Firstly, low markets meant we felt confident that the products would “kick out” in October 2012 providing clients with a great return without the risk of equity investing.

To remind you, the products will “kick out” at their anniversary dates provided the FTSE is the same or higher than it was at the start. Ask for our guide to Defined Returns if you would like more details.

Because we created bespoke products and combined our clients buying power, we were able to obtain some great “rates”. For HSBC and Credit Suisse products clients will get over 11% if they kick out this year. For Barclays, our clients will get 12.75%. Compare this to the 8% or so they were typically offering retail investors just prior to this, or the miniscule interest the same banks are offering on their saving accounts.

These products are already up between 5.7% and 8.1% at 30 March for those clients who bought at launch.

4. Increased Fixed Interest

Having seen a recovery in equity markets, we no longer feel we need to hold so much cash to buy back into equities.

We have generally invested the excess cash into fixed interest where we expect returns to at least be better than cash.

Sector Performance

When reviewing the individual asset class portfolios it has been heartening to note that all except two of them are ahead of the benchmarks we have set for them since their launch. See page 27 for our performance tables.

Here we review the performance of different areas over the past 12 months.

UK Equities

Equities in general have experienced a turbulent time over the past year but all our UK equity portfolios are now showing very positive returns over 6 months.

Our most defensive equity portfolio, UK Large Companies, has returned 12.17% over 6 months compared to the UK Equity Income Sector at 12.64%. This is partly because we looked for "true" income funds which pay high levels of dividends, whereas some of the funds in the sector take more risk in search of growth. This meant our funds outperformed late last year and over 12 months the portfolio is up 5.79% compared to the sector at 2.19%.

Our best performer in this area has been the Invesco Perpetual Income fund. This fund underperformed over the past couple of years but we stuck by it and performance has been very impressive in 2011. You can read our exclusive interview with fund manager Neil Woodford on page 11.

As we would expect, the more adventurous portfolios suffered more when markets fell but have done better in the recovery. Our UK Dynamic portfolio is up 15.7% and UK All Companies up 15.26% over the past 6 months.

Global Speculative

With equities having such a difficult period, emerging markets were the worst performer. The Global Emerging Markets sector has dropped 6.41% over the past 12 months.

In 2011 we reduced exposure to emerging markets dramatically, instead investing in the Invesco Perpetual Global Equity Income fund. This worked well in the turbulence of last year. Over the period we held it, the Invesco fund dropped 7.3% (9 February to 12 September 2011), but it was much less affected by falling markets than the funds we switched out of, JP Morgan Emerging Markets falling 8.74% and Allianz RCM BRIC Stars falling over 14%.

During the market lows we took the opportunity to switch back into emerging markets. In retrospect we were too early, but these markets have been doing very well since the start of the year. Our portfolio is up 10.7% and the Global Emerging Markets sector is up 10.14% since 1 January.

We are positive about emerging markets and have recently added to weightings.

Global Established

The global established regions as we define them are North America, Western Europe and Japan.

With the turbulence of last year centring on Europe, it is hardly surprising that European markets have underperformed. The MSCI Europe excluding UK index fell 12.15% over the past 12 months. Contrast this with North America where the S&P 500 rose 8.27% and the Topix in Japan which grew 3.33%.

Our benchmark for this region invests 20% in Japan and 40% in both America and Europe. The benchmark return was 16.11% over 6 months and -1.31% over 12 months, whereas our portfolio returned 16.57% and -0.05% respectively.

As you may have read, we recently merged our Global Established portfolio with our more adventurous Global Dynamic portfolio which invested in the same regions. This was as a result of research into which types of funds do well in each region. For example, we decided we only wanted to hold index trackers in America, only active funds in Japan, and a mixture in Europe.

This merger reduces the number of funds in the portfolio so hopefully makes it easier for you to track, and importantly it also reduced the annual fund charges significantly.

We have recently taken the decision to underweight Japan, which looks less attractive than the other regions. We have instead gone overweight UK equities and emerging markets.

Alternative Equity

Alternative equity is designed to provide returns linked to the equity market but with less volatility.

In the second half of 2011, alternative equity did see falls of around 10% peak to trough but this was in a period when the FTSE Allshare Index fell around 18% from its peak. Importantly, we have also seen a great recovery in this portfolio and over 12 months it is up 4.04%, more than the FTSE Allshare (0.69%) and its benchmark (UT Mixed Asset 20% -60% Shares) which grew 1.84%.

Property

We have mixed feeling about property at the moment. On the one hand, returns have been poor over 12 months, with our portfolio making only 2.48% although this was ahead of our benchmark which returned 1.66%.

On the other hand, the stability in the asset class meant we had funds which held up well last summer. This allowed us to sell to cash and then use this to top up equities at market lows.

The main function of property is to beat cash and to provide stability in the portfolios, and we are pleased that it met these objectives, even if returns were unspectacular. We expect this situation to remain throughout 2012.

Returns have also been dragged down by funds "re-pricing"; moving down prices to reflect the potential cost of selling properties, which discourages outflows. If these funds return to bid price we could expect returns to improve quickly.

Fixed Interest

Without a doubt 2011 was our most difficult period of investing in fixed interest so far.

We had positioned our portfolio to expect rising inflation and interest rates, which did not emerge. We also felt that the value was in corporate bonds, particularly some of the higher yielding companies, and that there was no value in gilts.

These decisions proved painful in August with gilts rallying to record levels and corporate bonds selling off due to investor fear; the same thing that made equity markets fall.

We reacted quickly, cutting exposure to falling asset classes and holding cash instead.

Just as importantly, later on in the year we took the opportunities to increase risk again. Over 6 months our fixed interest portfolio is up 9.62% compared to the corporate bond sector at 5.44% and the FTSE Gilts index at 3.19%.

Over 12 months the portfolio has now returned 6.03% and so has made back all of the losses of last summer and more.

We still believe there is value in corporate bonds but no value in gilts, which will generally lose you money in real terms if held to maturity.

Views from the Frontline

In this section, we ask the managers from some of our favoured funds in each asset class to comment on markets and give us their outlook for the future.

Property

Gerry Ferguson

Scottish Widows Investment Partnership UK Property Trust

2011 was a fairly flat period for UK commercial property. However, in November capital values fell – albeit by a very marginal 0.02% – for the first time since July 2009. December and January have continued this downward trend, with values falling 0.1% and 0.2% respectively.

We expect 2012 to be a difficult year for the UK real estate market given the outlook for the UK economy and the effect it will have on the consumer and businesses. Income will be critical to total returns as capital values weaken further. Prices are expected to fall between 3% and 7% in 2012, with total returns likely to be between 0% and 3%.

We expect the UK real estate market to return around 5% a year over three years and 6% a year over five years. Prices for prime properties are expected to be less affected by the downturn as the gap widens between the best properties in the best locations, and the rest of the market.

Equity

Michael Konstantinov

Allianz RCM BRIC Stars

In 2011 the BRIC markets (Brazil, Russia, India and China) Index fell substantially, driven first by high inflation and then by a sell-off in the wake of the Eurozone Crisis.

In contrast, 2012 has started well with the MSCI Emerging Markets Index up over 15% at 2 March with the MSCI BRIC up over 19%. Emerging markets had their best start of the year since 2001, although they have dipped slightly during March.

We believe that this rally could continue throughout 2012 if key drivers stay in place. It is well supported by the improved inflationary outlook in the BRIC nations, strong fundamentals and low equity valuations. The major risks are the potential for the Eurozone crisis to flare up once again.

Ultimately, we believe the positives still outweigh the risks for emerging market investment as low expectations continue to be priced into the market. We believe that despite the good start to the year there is still significant upside potential in the emerging markets, and the BRICs in particular.

Equilibrium View

It has been a difficult period for UK commercial property and we expect this to continue. However, whilst returns are likely to be below trend, we still believe property will beat cash returns by a margin.

In this sort of environment the choice of fund manager is important, and we have confidence that Gerry and his team can enhance relative returns.

Equilibrium View

Emerging markets can be very volatile and the more focused "BRIC" regions can be especially so. However, these are the areas we see the greatest potential for long term growth.

Whilst the Allianz BRIC fund is a high risk investment, it is one we are confident will see substantial returns over the long term.

Fixed Interest

Paul Read & Paul Causer

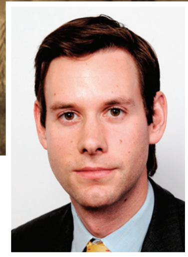
Invesco Perpetual Tactical Bond

Over the past year, bank and other financial capital has represented around 25% to 50% of the fund. The fund experienced difficult performance in the third quarter of 2011 when the banking sector was affected by risk from the Eurozone crisis.

Over the past few months the European authorities, including the European Central Bank (ECB), have taken important steps to support the Eurozone financial system authorities. This has led to an improvement in investor confidence in the funding of the banking system. Since the middle of December, credit markets have rallied strongly with banks and other financials seeing the best returns.

This rally has seen the fund perform strongly and regain ground lost last year. We remain confident that there is value to be captured for the fund in this area of the markets and financial capital remains a key part of the fund's strategy.

Alternative Equity



James Hanbury

Odey UK Absolute Return

On average, over the past year the fund was just over 50% net "long" (long positions benefit from a rising market). Despite volatile markets, the fund's short book (positions that make money if stocks fall) made over 10% in 2011 and this enabled us to give investors a positive return for the calendar year

Volatile markets also gave us the opportunity to add to our higher conviction long positions at lower prices, which has enabled the fund to have an exceptionally strong start in 2012.

Looking to the future, there are reasons for optimism. The US economy continues to exhibit a broad based recovery, with the employment situation improving quite meaningfully every month. According to the household survey this is the strongest 6 month period of job creation seen since 1983. We have some concerns about the UK economy, but the low valuations of high quality market leading franchises are over-compensating for the risks that go with owning them. Our net long exposure has come down slightly as the market has rallied but we still remain optimistic.

Equilibrium View

The Tactical Bond fund has been very volatile since the summer of last year. In August we saw some large falls and decided to sell it to reduce risk in the portfolio. In October, with the fund having fallen a further 6%, we felt the corner had turned and bought back in. Since 6 October 2011 the fund is up an astonishing 19.3% to 30 March 2012.

Whilst they have endured a difficult period, Paul Read and Paul Causer have a fantastic long term track record of managing fixed interest funds, and we continue to back their judgment.

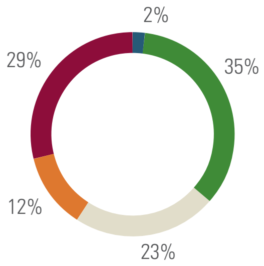
Equilibrium View

The term "absolute return" is perhaps not so appropriate for this fund, which has a similar risk profile to the equity market. We class it as alternative equity as it has the ability to make money from both rising and falling stocks.

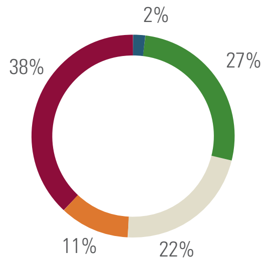
Like equity funds, there are periods where this fund won't do so well, but the ability to make money in falling markets as well as rising markets has really paid off over time. Since we first purchased the fund in late 2010 performance has been outstanding, and we remain confident in the fund manager going forward.

Model Portfolio Returns

It is very pleasing to note that all our models are well ahead of both the average managed fund and average discretionary manager over the past 6 months. In addition, all apart from one have produced returns in excess of the competition, over three years and since their launch in January 2008.

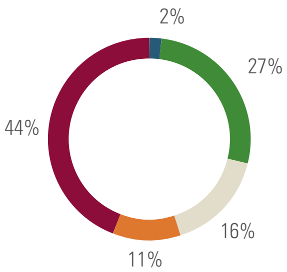


Cautious Models	6 Months %	1 Year %	3 Years %	Since Launch* %
Model AA 1 - Bluechip	8.55	3.14	41.53	23.31
Model AA 2 - Cautious	7.85	1.06	35.16	16.43
Model AA 3 - Growth	7.72	0.71	36.03	16.99
Mixed Asset 20-60% Shares Sector	6.92	1.84	34.74	8.75
ARC Sterling Cautious PCI	4.54	1.48	18.49	12.42



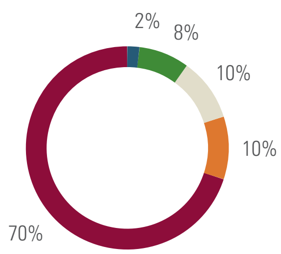
Balanced Models

Model AA 4 - Bluechip	8.84	1.67	38.87	15.14
Model AA 5 - Balanced	8.94	0.83	38.20	15.50
Model AA 6 - Growth	8.79	0.46	39.36	16.21
Mixed Asset 20-60% Shares Sector	6.92	1.84	34.74	8.75
ARC Sterling Balanced PCI	7.60	0.92	29.53	9.90



Adventurous Models

Model AA 7 - Bluechip	9.56	1.65	39.44	12.97
Model AA 8 - Adventurous	9.67	0.66	38.62	13.37
Model AA 9 - Growth	9.50	0.23	39.82	14.05
Mixed Asset 20-60% Shares Sector	6.92	1.84	34.74	8.75
ARC Sterling Balanced PCI	7.60	0.92	29.53	9.90



Speculative Portfolios

Model AA 10 - Speculative	11.47	-0.8	-	18.19
Mixed Asset 40-85% Shares Sector	9.29	0.73	-	22.38
ARC Sterling Steady Growth PCI	10.16	1.00		21.04

* Launch date 1 January 2008 except Speculative Model AA 10 launched 1 September 2009

All data to 30/3/12

Cash Fixed Interest Property Alternative Equity Equity

Figures are highlighted in green where they are in excess of the relevant "Mixed Asset" sector

Sector Portfolio Returns

	6 Months %	1 Year %	3 Years %	Since Launch* %
Equity Portfolios				
UK Large Companies	12.17	5.79	60.19	4.83
UT UK Equity Income Sector	**12.64**	**2.19**	**63.38**	**3.93**
UK All Companies	15.26	0.35	72.03	5.31
UK Dynamic	15.70	-0.40	75.50	6.84
UT UK All Companies Sector	**15.36**	**0.23**	**69.08**	**4.75**
Global Established	16.57	-0.05	47.25	7.94
**Global Established Benchmark ** **	**16.11**	**-1.31**	**48.71**	**6.43**
Global Speculative	12.94	-11.56	67.40	2.15
UT Glbl Emerging Mkts Sector	**15.14**	**-6.41**	**68.80**	**9.33**
Cautious Equity Mix	14.11	1.34	60.77	5.04
Cautious Equity Benchmark * **	**14.03**	**0.00**	**59.88**	**3.98**
Balanced Equity Mix	14.19	-1.20	57.02	5.13
Balanced Equity Benchmark * **	**14.24**	**-0.63**	**55.54**	**4.41**
Adventurous Equity Mix	14.63	-1.59	56.62	5.05
Adventurous Equity Benchmark***	**13.77**	**-2.25**	**59.42**	**5.80**
Alternative Equity	10.62	4.04	26.14	17.26
UT Mixed Asset 20-60% Shares	**6.92**	**1.84**	**34.74**	**8.75**
Fixed Interest Portfolio	9.62	6.03	35.96	27.35
UT Sterling Corp Bond Sector	**5.44**	**7.02**	**39.56**	**18.76**
Property Portfolio	0.33	2.48	-	19.07
Property Benchmark ****	**0.72**	**1.66**	**-**	**22.20**

* Launch date 1 January 2008 except Property Portfolio 1 July 2009

** Global Established Benchmark is 40% UT North America, 40% UT Europe Ex UK, 20% Japan

*** Cautious, Balanced and Adventurous Equity benchmarks are an appropriate composite of the benchmark for each component of that equity mix

**** Property benchmark is a composite of all eligible funds in the UT Property sector

Market Returns

	6 Months %	1 Year %	3 Years %	Since Launch* %
Equity Markets				
FTSE 100 Index (UK)	14.47	0.57	70.71	5.20
FTSE Allshare Index (UK)	15.01	0.69	74.69	6.95
FTSE 250 Index (UK Mid Cap)	18.72	1.71	101.11	22.44
MSCI Europe Ex UK Index	12.06	-12.15	39.86	-13.01
S&P 500 Index (USA)	22.40	8.27	66.07	27.72
Topix (Japan)	4.65	3.33	21.25	8.32
MSCI Emerging Markets Index	15.65	-7.83	75.60	14.79
Fixed Interest				
IBOXX Sterling Corporate Bond Index	7.31	7.99	49.88	23.57
UT Sterling Corporate Bond Sector	5.44	7.02	39.56	18.76
FTSE British Government Allstocks (Gilt) Index	3.19	14.44	21.37	35.74
UT Gilt Sector	3.87	14.47	20.70	33.25
UT Sterling High Yield Sector	11.55	2.18	70.16	26.42
Property				
IPD UK All Property Index	2.26	7.31	33.68	-1.42
Property Benchmark*	0.72	1.66	17.75	-9.18
Other Measures				
Bank of England Base Rate	0.25	0.50	1.51	6.55
RPI Inflation	0.84	3.18	13.54	13.75

* Property benchmark is a composite of all eligible funds in the UT Property sector

Common Sense Risk Warnings

Past performance is never a guide to future performance. Investments may (will) fall as well as rise.

Any performance targets shown are what we believe are realistic long term returns. They are not guaranteed.

None of the information in this document constitutes a recommendation. Please contact your adviser before taking any action.

Notes on performance charts:

- Data is taken from Financial Express Analytics, an independent performance analysis system.
- Performance of portfolios includes all our recommended changes from the date we made the decision. Individual client performance may vary depending on actual transaction dates, particularly for advisory clients.
- All performance data is as at 30 March 2012 unless otherwise stated.
- All portfolios launched 1 January 2008 unless otherwise stated.
- Performance of model portfolios is shown net all charges including the maximum Equilibrium fee of 1.5%pa. The discounts we receive on fund charges are factored into this cost. Discounts are based on the average rebate received over the life of the portfolio.
- Performance of asset class portfolios shown net of all fund management fees at full retail price, with no adjustment for discounts, Equilibrium fees or wrap charges.
- Performance charts assume income is reinvested however we often have it paid out into a wrap cash account for efficient management and to aid rebalancing. Therefore individual performance may vary from charts.

Awards Cabinet

New Model Adviser Firm of the Year 2010
Northern Region

This award is given by Citywire based on a firm's overall expertise as well as our success as a business. This is a very prestigious award and one we really wanted to win. It's a great reward for all the hard work by everyone in our team and many thanks to all our clients for their support.

Our Investment Manager, Mike Deverell collected the award from England Rugby World Cup winner Will Greenwood.

Macclesfield & Wilmslow Business Adviser of the Year 2011 Winner

We were exceptionally pleased to have won this award as it was given on the basis of a firm that provided first class service, whether corporate, financial, accountancy or solicitor to enable the business to meet its strategic objects in 2011.

Investor in Customers 3 Star Accreditation 2011

This award was given to us to mark the quality of client service and relationships, grading the results at one, two or three stars. The assessment involved a series of rigorous benchmarking exercises to show customer satisfaction levels for businesses.

We were extremely pleased with the final result as it shows how both staff and clients rate our level of customer service so highly.

Equilibrium Events 2012

Our forthcoming seminars are informative and educational events which are relevant for existing clients as well as prospective new clients wanting to find out more about our approach. We'll donate £100 to our Equilibrium Foundation for every guest you bring so please feel free to invite friends or acquaintances if you think they would be interested in learning more about investing, tax planning and, of course, Equilibrium.

Successful Lifetime Investing

22nd May	The Hunting Lodge, Adlington Hall, Macclesfield
30th May	The Mere Golf & Country Club, Mere, Knutsford
28th June	The Hunting Lodge, Adlington Hall, Macclesfield
17th July	The Hunting Lodge, Adlington Hall, Macclesfield

Live Well & Leave a Legacy

15th Aug	The Hunting Lodge, Adlington Hall, Macclesfield
10th Oct	The Mere Golf & Country Club, Mere, Knutsford
18th Oct	The Hunting Lodge, Adlington Hall, Macclesfield

Managing Risk & Meeting Expectations

12th Sept	The Mere Golf & Country Club, Mere, Knutsford
20th Sept	The Hunting Lodge, Adlington Hall, Macclesfield
20th Nov	The Hunting Lodge, Adlington Hall, Macclesfield

Demand is expected to be high so RSVP as soon as possible to avoid disappointment by simply emailing rsvp@eqasset.co.uk or calling Emma on 0161 486 2250

equilibrium