

PRESS RELEASE

US Equities – Where do we go from here?

Dublin, Geneva, Guernsey, Isle of Man, Jersey and London

23rd March 2009: **Collins Stewart's US Equity Focus Fund managed by Mark Donovan of Robeco Boston Partners believes that investors should not be walking away from the US equity markets from the perspective of a value approach to investing. Mr. Donovan believes current valuations are excessively pessimistic based on his bottom-up analysis of individual companies and discussions with management. At current levels the market is assuming a severe decline in corporate earnings, comparable to the Great Depression of the 1930s.**

Mr. Donovan believes a value bias is most important for investors in the current climate, for three principal reasons. First, value strategies have a long history of outperforming growth strategies during both recessions and bear markets, according to research by the Leuthold Group, LLC. Second, value is a way to mitigate earnings risk and performs well when earnings are depressed, which is typical of a recession. Finally, returns to value investing have traditionally doubled when valuation spreads are wide, as they are at present.

In January the National Bureau of Economic Research confirmed what many commentators already suspected: the US is in recession and has been for over a year. While recessions have become shorter since World War II – on average less than 12 months – those triggered by financial crises tend to be twice as long and twice as severe. Without question, the US economy will continue to weaken as we move further into 2009.

Yet we do not believe that investors should be walking away from the US equity market. While more bad news concerning output and employment is inevitable, the market is already discounting most of it. If we look back to the recession of 1990/91, the US economy hit bottom in the latter half of 1991 but financial stocks had reached their nadir one year earlier. While we do not claim to be able to call market turns, we would make **two key observations in support of US equities from the perspective of a value approach.**

1. First, the dispersion of valuation spreads is even wider now than it was at the time of the 2000 market peak. **But there is one crucial difference. Eight years ago, the record dispersions were caused by highly priced stocks becoming even more expensive. Today the situation is reversed. It is the massive undervaluation of stocks that is prompting the extremes in valuation spreads.** A wave of selling based on sentiment liquidity needs has left a raft of very inexpensive stocks in its wake.
2. Second, our research shows that, historically, as spreads widen going into a recession, growth strategies win out over value as investors are increasingly willing to pay for the shrinking supply of companies able to maintain growth. But as **the recession becomes more pronounced and spreads compress, value stocks outperform** since they are less exposed to worsening fundamentals and earnings disappointments.

The US Market: Near Bottom?

Our analysis of the US equity market is based on three critical and interlocking factors: **momentum, fundamentals and valuation.** Regarding **momentum**, we believe the massive fiscal and **monetary stimulus provided by the US authorities in recent months has a good chance of easing conditions in the credit markets over the long term.** While government intervention

PRESS RELEASE

on this scale may appear unprecedented, there are historical parallels for such action and, equally to the point, they have ended successfully.

We will not dwell on the detail of those measures already announced. However we would underscore the key role of the Federal Reserve in its ability to boost aggregate demand in the economy. It is a myth that the Fed relies on interest rates as a “blunt tool” with which to stimulate demand. It has a wide range of very precise monetary instruments – the commercial paper funding facility and the primary dealer credit facility, to name just two – that will enable it to prevent any deflationary spiral.

The Fed has also done its part in attempting to improve the housing sector which is critical to stabilizing the economy and financial markets. We believe a decline in new home starts and a reduction in foreclosures will stem the increase in supply and cause a shift to net demand sometime in 2009, ending the decline in prices. But recovery will be weak until 2011-2012. The keys to any eventual rebound will be lower mortgage rates, a bigger thaw in credit markets, and further measures to curb foreclosures.

As mentioned earlier, the economic **momentum** in the US will continue to slow this year. But as the stock market traditionally discounts such weakness, when might it reach bottom? There is no certainty but **historically extreme volatility of the kind seen recently – average daily changes in the S&P 500 Index of around 4% – is associated with the end of a decline. In each of the nine bear markets since 1950, the S&P 500 Index’s low point coincided with a spike in volatility and frequent “ultra high” volatility days.**

How Are The Fundamentals?

As mentioned above, **at current levels the market is assuming a severe decline in corporate earnings, comparable to the Great Depression of the 1930s. We believe this is excessively pessimistic**, based on our bottom-up analysis of individual companies. Certainly there will be casualties, especially on the employment front, but consider these **positive factors**:

- Free cash-flow yields on US equities, particularly in the technology sector, are currently attractive compared to bond yields.
- Earnings quality remains very high, with capital expenditure and accruals running at reduced levels.
- Overall, corporate balance sheets are very strong and liquid.
- The dramatic fall in commodity prices, especially the price of oil, is easing cost pressures on many companies. Furthermore, the oil price slump will provide a major stimulus to the US economy as a whole.

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PRESS RELEASE

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¹ as at 31/12/08

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