

Financial Commentary Number 77

Act 1

Scene 1 A desert place

1st Witch - *When shall we three meet again.*

In thunder, lightning, or in rain?

2nd Witch - *When the hurleyburly's done,*

When the battles lost and won

3rd Witch - *That will be ere the set of sun*

"Macbeth" - William Shakespeare

One can almost imagine the frantic transatlantic telephone conversations that have taken place recently between the worlds pre-eminent Central Banks and Governments.

The Economy

Over the course of the last two months we have experienced the most volatile and unpredictable market conditions seen for possibly the last 70 years. The August Financial commentary described the movement in money market rates as "roller-coaster like". Recent events have left that analogy as at best highly inadequate. The fact that CPI inflation has reached 4.7% whilst oil prices have gyrated has gone almost un-noticed as the ongoing repercussions of the "Credit Crunch" have continued to be felt across the world. The American Governments nationalization of Fanny Mae and Freddy Mac, followed by the bankruptcy of Lehman Brothers, left economists and market participants reeling. This in turn led, once again, to a lack of liquidity as banks (worried about over exposing themselves) reduced lending to each other in the wholesale markets. The forced sale of Merrill Lynch to Bank of America and the rescue of AIG were to follow as world financial markets lurched from one crisis to the next. The worries concerning banks' abilities to fund themselves culminated in HBOS (the country's largest mortgage provider) being forced into the arms of Lloyds TSB. Just as we seemed to be at the edge of a precipice salvation appeared in the guise of "Hank" Paulson's \$700 Billion rescue package, by which the US Government proposes to buy up the toxic bonds at the heart of the crisis and transfer them to what amounts to a state-owned 'bad bank'. With the Senate having passed it we all await both the House of Representatives and the markets response.

The Market

The effect on money market rates has been acute. As cash has become less available and liquidity has tightened deposit rates have firmed, with one year pushing about 50bp higher to 6.50%. All available inter-bank lending has taken place in the short dates with a reluctance to commit to longer investments. As a result of Central Bank intervention, in particular, supply has at times exceeded demand, and thus short term investment rates have fallen. In the longer end of the market both swap spreads and the margins demanded by prime lenders have widened. This has had the effect of making long term funding more expensive.

Tradition

As a result of the continued success of the Tradition Cash Management Scheme, Stuart Selleck and Paul Ewles have moved away from the day-to-day management of the Public Sector desk. They will concentrate their efforts solely on the Cash Management Scheme. The Public Sector desk will be managed from 1st July 2008 jointly by David Ingram and Nicholas Tant.

Cash Management

Cash is still king! As one of the few remaining managers offering a segregated fund service, we continue to provide clients with a consistent performance with total transparency using only cash deposits. The experience of the two managers has been a tremendous asset in these difficult markets which is ensuring that the income of clients is protected as interest rates are predicted to decline over the next two years. Funds under management now stand at £730 Million.

David Ingram

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