



As we promise our clients that we will always try to keep our “eye on the ball”, we feel that it might be appropriate to share some of our thoughts on the current volatile and difficult times that have engulfed the markets.

Since the latter part of July, the financial markets have exhibited increased volatility and have given up much of the gains made this year. Markets in North America, Europe and Asia have been rattled by the turmoil that has evolved because of problems within the U.S. sub prime mortgage market. The link between repossessed properties in the U.S., hedge funds and global financial institutions has become painfully apparent. The current market turbulence is the direct effect of large speculators being forced to pare bullish bets or unwind speculative long positions. One of the casualties has become investor confidence as the complacency which existed only a month ago has evaporated and risk aversion is back.

In spite of this the world economy continues to grow and leading economic indicators and other statistics have moderated only slightly. The continuing theme of strong Asian demand offsetting weakness elsewhere remains a dominant factor. Latin America, Emerging Markets and Europe (although slowing from high levels) continue to do their part. The biggest risk to the global economy lies with the debt-laden American consumer who has been battered by falling housing prices, tightened lending standards and rising gasoline prices. Previous financial crises have taken considerable time to feed through to the broader economy. A weakening U.S. economy is inevitable, but we are not ready to forecast a full blown downturn and a recession.

In our end of June commentary we warned of “unusual complacency” and of markets being “less accommodating” should problems arise, which is exactly what has occurred. Our philosophy of being stock pickers rather than “closet indexers” has helped to insulate our portfolios somewhat from the current downturn. Over the last twelve months our portfolios have performed rather well, and continue to do so on a year to date basis. Prudent stock selection and a broad diversification policy have been the main contributors. We have had no exposure to hedge funds, derivative products or mortgage based securities. Moreover, our decision to be underweight the financials as well our preference for insurance companies over banks in this heavily weighted sector has worked in our favor. The majority of our holdings enjoy strong balance sheets and have valuation multiples well below the market. On the fixed income side, our strategy to keep our maturities short and focus on quality issues has paid off.

Capital preservation has been and remains our number one focus. With this in mind, we continue to be concerned with the financial markets as fear itself will continue to drive market action in the short term. In recent months we have taken money off the table, and now intend to keep our powder dry. Market conditions seem to have changed and the pace of growth that we had become accustomed to may no longer be sustainable. We feel it would be prudent to bring expectations back in line with historical averages.

More than ever, you can expect C.F.G. Heward to maintain the same discipline in managing your portfolio.