



COMPASS

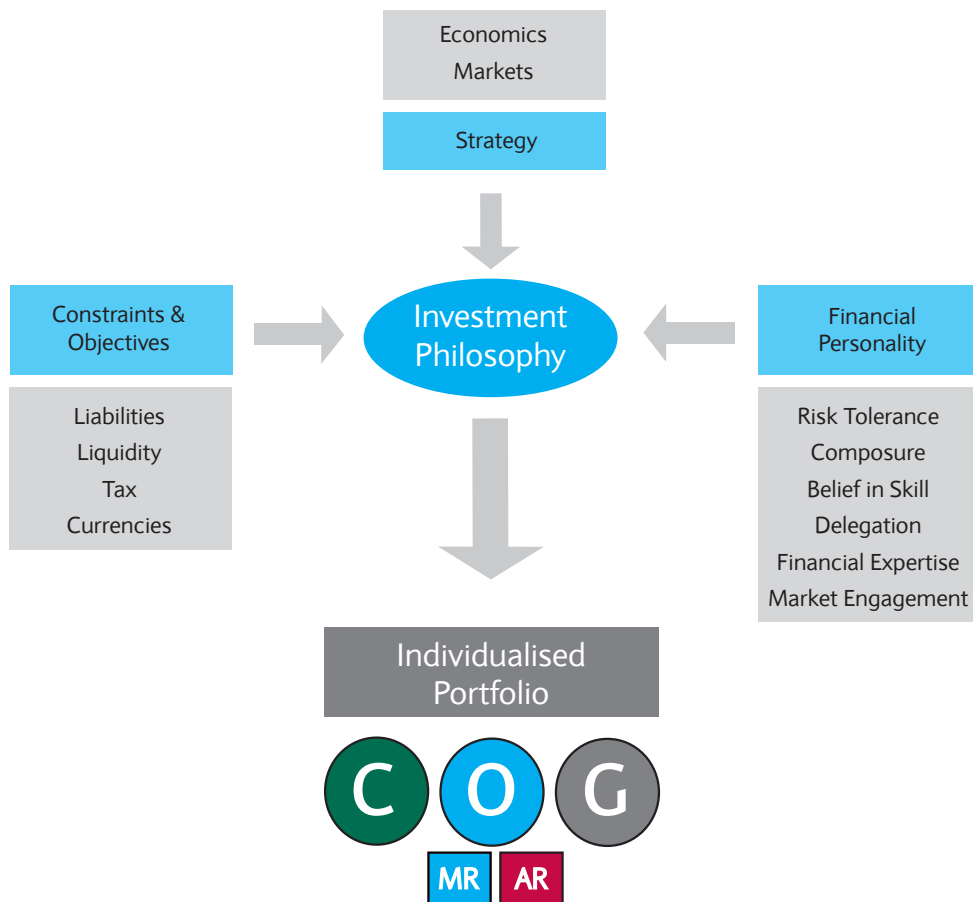
Investment Strategy
Europe, Middle East & Africa

OCTOBER 2009

The Barclays Wealth Investment Philosophy

The structure of this *Compass* publication reflects that of the Barclays Wealth Investment Philosophy.

The Barclays Wealth Investment Philosophy enables us to combine clients' individual financial personalities with their investment constraints and objectives, taking into account market conditions. Using it, we can construct with each client an individualised portfolio that balances their desire for security with their interest in investment opportunities.



The **Cash Allocation** is to meet clients' short-term needs, and maintain their level of comfort and security.



The **Optimised Portfolio** is the core of a client's portfolio. This portfolio consists of market return (MR) and absolute return (AR) investments.



Market return investments are an optimised asset allocation that tracks the market.




Absolute return investments are an optimised blend of strategies that aim to deliver smoothed performance above cash rates.



The **Guided Portfolio** lets clients explore a wide range of investment opportunities. It typically includes:

1. Alternative long-term less liquid investments such as private equity and real estate
2. Tactical opportunities based on Strategy views, focused on more directional investments



Dear Client,

We no longer face the prospect of a prolonged recession or even depression. Relieved markets have responded with a surge of optimism, although the possibility of a double-dip recession cannot be fully ruled out. But financial markets can still propel higher on abundant liquidity, expanding confidence and investor regret.

What is clear is that we are entering again a more normal environment for investing. There are easily identifiable structural trends, such as the rise of Asia. There are also a great many tactical opportunities, as dislocated markets continue a gradual process of price adjustment, while interest rates remain low for a prolonged period. Moreover, significant opportunities exist *because of* (rather than despite) the fact that a significant proportion of the investment community will take time to forget the traumatic events of last year. Some investors are now questioning the most basic ideas about investment, but may soon regret delaying their return to the markets. This is not to deny, however, that there are some basic lessons to be learnt immediately from the crisis, such as a greater respect for portfolio liquidity, greater scepticism over the benefits of leverage, and a greater appreciation of the virtues of cash.

This is a key turning point, when market uncertainty coexists with some clearly identifiable upside potential. By balancing risks and expected returns through a proper asset allocation process, we believe strongly that we can mitigate concerns and exceed clients' expectations. *Compass* presents the results of this process, so I hope that you find it both interesting and useful.

Kevin Lecocq, CFA

Chief Investment Officer, Barclays Wealth

Contents

Our current investment themes and ideas – [page 4](#)

Overview: Post traumatic stress disorder – [page 5](#)

Macro outlook: Confidence in recovery builds – [page 8](#)

Cash Portfolio:

Use government-related and supranational bonds instead of treasuries – [page 10](#)

Optimised Portfolio

Market return: Q4 tactical asset allocation – [page 11](#)

Absolute return: Reaffirming on the role of Global Macro – [page 13](#)

Guided Portfolio

In the US, start thinking small – [page 15](#)

Commodities: Buy a diversified portfolio of commodities – [page 17](#)

Opportunities on short rates – [page 19](#)

Buy 'First to tighten' currencies – [page 21](#)

Glossary – [page 22](#)

Our current investment themes and ideas

| Investment themes |
|---|
| Move past the crisis |
| Position for <i>this</i> economic recovery |
| Seek diverse exposure to Asian economic growth |
| We believe short-term interest rates will remain very low for a long time, but longer-term yields will likely start rising sooner |

| Investment ideas | | | |
|---|----------------|--|-----------------------------|
| | Inception date | Exit plan / reason for exiting | Performance since inception |
| New Calls this month | | | |
| Buy US small cap stocks. ^a | 07/09/2009 | When relative valuations more to one standard deviation expensive relative to the 5-year mean. | |
| Buy a diversified portfolio of commodities. ^a | 25/09/2009 | Exit when commodity price trend moves back into line with performance in previous recoveries | |
| Invest in inverse floating-rate and capped floating-rate notes. ^a | 25/09/2009 | Exit when we expect a near-term policy reversal or when forwards are pricing closer to our forecasts | |
| Buy "first to tighten" currencies, specifically the Norwegian krone and Australian dollar. ^a | 11/09/2009 | Exit when we expect a near-term policy reversal by G3 central banks, or a downward revision to our forecasts for tightening in Australia and Norway. | |

| Live Calls from previous months | | | |
|---|------------|---|------|
| Buy an Asian Fusion portfolio. ^b | 07/08/2009 | Exit when no recommended shares have significant Asian exposure | Gain |
| Invest in regulated implementations of arbitrage strategies ^b | 04/08/2009 | Exit when return indicators signal "sell" | Gain |
| Add Brazil exposure. ^b | 27/07/2009 | Exit this call when USD/BRL trades through fair value of 1.72; Stop loss at 2.50 | Gain |
| Overweight German equities within Europe. ^c | 18/05/2009 | Exit this call when the structure hits its cap/ceiling | Loss |
| Buy a "representative" basket of Asian infrastructure stocks. ^d | 18/05/2009 | Exit when the EM basket reaches fair value or if the global economy relapses and risk aversion starts to rise again | Gain |
| Buy a basket of emerging currencies vs. a basket of developed. ^d | 18/05/2009 | Hold on to this position until the region's relative valuation starts trading at the top end of the recent ranges | Gain |
| Seek high quality, low duration alternatives to cash. ^{a,b,c,d} | 18/03/2009 | Idea remains attractive until we anticipate near-term Federal Reserve policy reversal | Gain |

| Calls exited in the last three months | | | |
|--|------------|---|------|
| Buy sterling vs. the euro. | 18/03/2009 | Short-term headwinds to sterling preventing movement to fair value vs. euro (exited 18/09/2009) | Gain |
| Invest in soy and corn. | 04/06/2009 | Upside surprises on the supply side (exited 29/07/2009) | Loss |
| Take exposure to senior and subordinated bank debt. | 18/05/2009 | The spreads between financials and non-financials tightened to August 2008 levels (exited 21/08/2009) | Gain |
| Overweight Asia ex-Japan equities. | 02/04/2009 | Valuation at a premium; switch to more selective and indirect strategies (exited 30/07/2009) | Gain |
| Hold a diversified, actively managed portfolio of corporate bonds. | 18/03/2009 | Exit the trade when spreads revert towards historic means (exited 21/08/2009) | Gain |

^a Discussed in this issue of *Compass* ^b Discussed in the September edition of *Compass* ^c Discussed in the July/August edition of *Compass*
^d Discussed in the June edition of *Compass*

Aaron S. Gurwitz
Head of Global Investment Strategy

Questioning of basic investment ideas...

...eventually risks becoming counterproductive...

Overview

Post-traumatic stress disorder

Our main investment themes for the fourth quarter of 2009 are:

1. Move past the crisis.
2. Position for *this* economic recovery.
3. Seek diverse exposure to Asian economic growth.
4. We believe short-term interest rates will remain very low for a long time, but longer-term yields will likely start rising sooner.

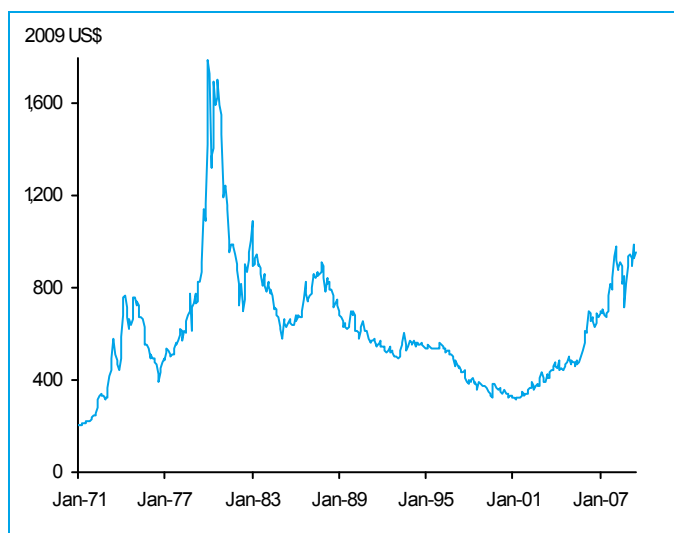
1. Move past the crisis

On the first anniversary of the financial crisis, it remains unclear how much long-term damage has been done to the global economy and financial markets. The consensus view among economists, to which we subscribe with some modifications, is that the recovery will continue but will be weaker than usual.

What is more apparent is that last year's huge losses have left many of our clients questioning the most basic ideas about investments and portfolios. Should I even hope to maintain my standard of living while growing my wealth over time, or is that a fantasy? Are bonds really less risky than stocks? Can diversification really reduce risk? Is gold bullion the only reliable store of value?

Questioning one's fundamental assumptions from time to time can lead to clearer thinking. But it is important not to let such questioning divert attention away from the underlying realities. Consider, for example, the four questions posed above. In an expanding global economy it is not unreasonable to expect to grow a portfolio over time while supporting an appropriate life style. Bonds are less risky than stocks and have been through the crisis. Diversified portfolios of risky assets lost money last year, but much less than they might have if the owner had held only a portfolio of, say, bank stocks. Finally, it is worth remembering that the purchasing power of gold has fluctuated between 200 and 1,800 2009 US dollars since 1971 (Figure 1); gold is not the reliable store of value that it might appear to be.

Figure 1 – The real price of gold in 2009 US dollars has fluctuated widely



Source: Barclays Wealth Research

Figure 2 – Corporate bond yields have fallen sharply this year, while government yields are little changed

| Security | Yield 2 Jan 09 | Yield 17 Sep 09 | Change |
|-----------------------------------|-------------------|--------------------|--------|
| US 3 month Treasury | 0.09% | 0.09% | 0% |
| US 10 year Treasury | 2.36% | 3.39% | 1.03% |
| EMU 3 month Government | 1.73% | 0.36% | -1.37% |
| EMU 10 year Government | 2.97% | 3.36% | 0.39% |
| Barclays Capital High Yield Index | 19.40% | 10.53% | -8.87% |

Source: Barclays Wealth Research

...although some basic lessons need to be learnt

Time to focus again on a “normal” portfolio”...

...while remembering that each economic cycle is unique

Economies to focus on

This is not to say that there are no long-lasting lessons to be learned from the crisis. We have, for example, developed a more profound respect for portfolio liquidity as a positive value, much greater scepticism regarding the potential benefits of leverage, and much greater appreciation of the virtues of cash in a conservative portfolio.

In our view, however, it is time to move beyond last year’s trauma and take a business-as-usual approach to investment decisions. The trajectory of economic growth over the next year remains quite uncertain, but that is always the case. Readers may not agree with our constructive attitude toward equity investments or our recommendation to target portfolio risk a bit above strategic norms. That’s fine. But the baseline for individual tactical asset allocation should be a “normal” portfolio: the mix one held, for example, in October 2007, when the outlook was clouded but there was little thought of a looming crisis. Some investors might want to target their portfolio’s risk level a bit below where it was then. Some, like us, would opt for a bit more risk. What would be inappropriate, in our view, would be to hold much larger proportions of cash or government bonds than were in the portfolio two years ago.

2. Position for *this* economic recovery

As Barclays Wealth’s Chief Economist, Michael Dicks, indicates on page 8, we are increasingly confident that the world has begun a period of economic growth. We recommend, therefore, that investors hold more than usual in asset classes and sectors that do well in the early stages of recovery and less in those that don’t. On the broadest level, in our view, conditions call for holding more in stocks and less in bonds than one usually would. Beyond this general point, however, we do not want to paint this picture with too broad a brush because each economic cycle is unique. Prices of some typical early-cycle winners, such as emerging market equities, high-yield bonds, and European small cap stocks, already reflect the expectation of a recovery. Others, such as small cap US stocks, have underperformed early-cycle expectations. We favour the latter, as detailed in Dean Turner’s discussion on page 15.

National economies that did not experience a particularly severe financial implosion and/or entered the downturn with strong national balance sheets and/or benefit from close linkages with robust economies, should recover relatively quickly. We’ve favoured German equities within Europe for this reason for several months, and Brian Nick highlights two new recovery-related exchange rate opportunities, the Norwegian krone and the Australian dollar, on page 21. We expect to add more names to this list over the coming weeks and months.

Economic turning points and diverse national economic trajectories create opportunities that skilled global macro fund managers can exploit to generate attractive risk-adjusted returns. Despite the average macro manager’s positive but unspectacular year-to-date performance, we continue to believe that this strategy is an important component of a well-diversified absolute return portfolio, and Michael Crook reiterates this view on page 13.

Look for the most effective ways to maintain Asia exposure

3. Seek diverse exposure to Asian economic growth

We are moving to a neutral allocation to emerging Asian equities from the previous overweight, as Manpreet Gill indicates in his discussion of our fourth quarter Tactical Asset Allocation (TAA) changes (page 11). This does not reflect any loss of confidence in our view that the Asian economies are and will remain the most dynamic in the world. The reason for the TAA shift is that we now believe that exposure to this region's stock markets, while still an essential component of a well-constructed global equity portfolio, is neither the only nor at present the most effective way to maintain exposure to the "Asia growth factor." There are several better ones from a risk-return point of view including a diversified portfolio of commodities (page 17). In previous editions of *Compass* we have presented an array of ways of implementing Asia exposure, including thematic portfolios, the stocks of good developed-country companies that generate most of their revenues in Asia, Brazilian bonds, and so on.

More generally the question, "Does buying this give me exposure to Asian growth?" should be on every portfolio manager's mental check-list of decision criteria. An answer of "No" will not necessarily mean rejection, nor will a "Yes" check be an automatic buy signal. But now and for the foreseeable future, the question should always be asked and a "Yes" will be better than a "No".

4. We believe short-term interest rates will remain very low for a long time, but longer-term yields will likely start rising sooner

Changes in three factors drive returns on fixed-income portfolios: (i) the level of interest rates, (ii) the relationship between short-term and long-term yields (the yield curve), and (iii) credit spreads. From the beginning of the crisis until very recently the third of these has been the most interesting. Short- and long-term Treasury yields now are close to where they were on year ago, but yields on corporate bonds, as measured by the Barclays Capital High Yield index, have declined by almost nine percentage points since their peak last November (Figure 2).

Fixed income spotlight will now shift to the yield curve

We believe that the fixed-income spotlight will now begin to shift to the yield curve. Credit spreads are about where they should be. Further, we believe that the level of short-term "official" interest rates will remain close to zero for at least the next several quarters; convincing evidence of a robust economic recovery will be slow to materialise and central banks won't start implementing their exit strategies until it does. But longer-term interest rates are likely to start increasing well before central banks start raising short-term rates. Put simply, we expect the yield curve to steepen, perhaps substantially, perhaps sometime soon.

On page 19 Vanshree Verma explains a couple of ways in which investors can position to profit from a combination of stable, low short-term interest rates without buying long-term bonds.

Most data now close to economists' expectations

Variance of US growth projections is reduced

Confidence in recovery builds

Almost everywhere, economists are upping their growth forecasts for 2010. They are also exhibiting greater confidence in their predictions. At the same time, emerging markets are living up to their description – providing evidence of a quicker and more forthright recovery than their developed counterparts. Policymakers are however reticent to show too much enthusiasm, pointing out that a number of headwinds will limit the pace of pickup.

Growth forecasts for 2010 edge up; downside risks downplayed

The summer has been a kind one to economic forecasters – with most data turning out fairly close to professionals' expectations. Indeed, if anything there has been a tendency for slightly better-than-expected numbers, as opposed to worse-than-expected ones. This dataflow has had three main consequences:

- **Expectations for GDP growth in 2010 have been raised a little.** The accompanying table provides details. But the message is a fairly simple one: despite some downward revisions to previous estimates of GDP, which have left a few countries in the position of probably experiencing slightly greater contractions in economic activity this year than seemed likely a few months ago, almost every major economy is now expected to do better in 2010 than was expected three months ago. Moreover, at a global level, it is now expected that next year's expansion will be greater than the decline experienced this year.
- **Confidence in recovery has grown.** It is not just their "best guess" (or "modal") forecasts that economists have revised up a tad. On top of that, they now generally place less weight on possible downside risks to these projections. And they judge the likelihood of things turning out somewhere in the ball-park of their modal forecasts as higher than previously. One example of this is the lowered variance of projections for US growth next year: economists currently assess the chances of growth being very high (above 4%) or very low (below 1%) at about 25% – which is just three quarters of what they thought the probability to be back in the spring.
- **Inflation risks still appear to be limited.** Despite greater growth being pencilled in for 2010 than previously, most economists expect only a limited amount of upward pressure on consumer prices. Almost all developed countries, for example, are expected to register sub-2% inflation next year. Only Japan looks worrying – as deflation seems to be taking root again, with persistence right through 2010 now generally expected.

Figure 1 – Consensus growth and inflation forecasts (%)

| | June | | | | September | | | | Changes | | | |
|-------------|----------|------|-----------------|------|-----------|------|-----------------|------|----------|------|-----------------|------|
| | Real GDP | | Consumer prices | | Real GDP | | Consumer prices | | Real GDP | | Consumer prices | |
| | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 |
| US | -2.8 | 1.9 | -0.6 | 1.7 | -2.6 | 2.4 | -0.5 | 1.9 | 0.2 | 0.5 | 0.1 | 0.2 |
| Euro area | -4.2 | 0.3 | 0.4 | 1.2 | -3.9 | 1.0 | 0.3 | 1.2 | 0.3 | 0.7 | -0.1 | 0.0 |
| UK | -3.7 | 0.7 | 1.7 | 1.8 | -4.3 | 1.1 | 1.9 | 1.8 | -0.6 | 0.4 | 0.2 | 0.0 |
| Switzerland | -2.5 | 0.4 | -0.5 | 0.5 | -1.9 | 0.9 | -0.5 | 0.7 | 0.6 | 0.5 | 0.0 | 0.2 |
| Japan | -6.6 | 1.3 | -1.2 | -0.6 | -5.7 | 1.5 | -1.3 | -0.8 | 0.9 | 0.2 | -0.1 | -0.2 |
| Brazil | -0.9 | 3.1 | 4.1 | 4.2 | -0.4 | 3.7 | 4.4 | 4.3 | 0.5 | 0.6 | 0.3 | 0.1 |
| China | 7.5 | 8.4 | -0.3 | 1.6 | 8.3 | 9.3 | -0.5 | 2.1 | 0.8 | 0.9 | -0.2 | 0.5 |
| India | 5.8 | 7.0 | 5.5 | 5.6 | 6.2 | 7.2 | 6.2 | 5.9 | 0.4 | 0.2 | 0.7 | 0.3 |
| Global | -2.6 | 2.0 | 1.2 | 2.2 | -2.3 | 2.6 | 1.4 | 2.4 | 0.3 | 0.6 | 0.2 | 0.2 |

Source: Barclays Wealth Research

Major developing economies lead the turnaround...

...helped by their dependency on global trade

Worries remain about a future squeeze on US incomes

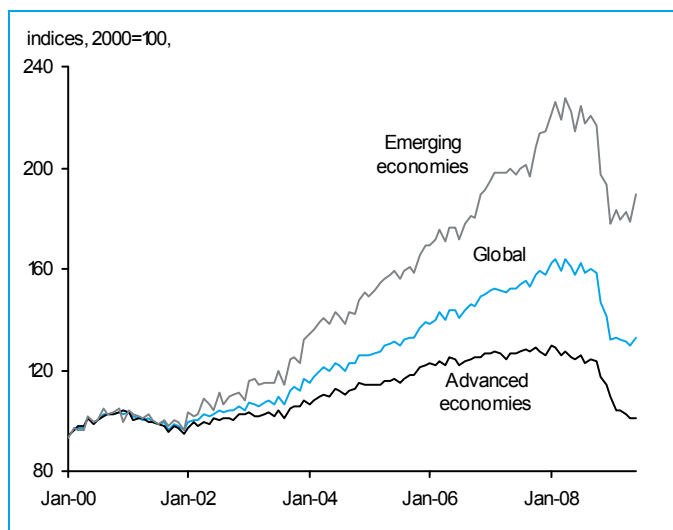
The good news on growth expectations is one that we share: in our forthcoming edition of *Signpost*, we will detail more up-revisions than down ones to our “old” (July) forecasts. When it comes to the main geographical split, between developed and emerging economies, we also share the consensus view that it is the “new” world which has performed rather better than the “old” through the course of this recession, and subsequent recovery. Thus, it is economies such as China, India and Brazil (the “BICs”) that have been quickest to turnaround – helped especially by the Chinese authorities’ prompt, and major, policy shifts. Thus, whereas we are hoping – and expecting – to see third-quarter GDP reports registering mild expansion in the cases of the United States, euro area and much of the developed world, the (already published) second-quarter GDP ones for the BICs show that they were at least a quarter ahead in terms of turning around.

Asia, being the workshop of the world, has benefitted – as have many emerging markets – from a recovery in global trade (Figure 2). As a result, all of the major economies in the region have resumed growing, and many at a double-digit annualised rate. Part of this acceleration is a natural pay-back for the sheer speed and scale of the preceding decline in economic activity. (For example, an inventory cycle will benefit overall GDP as many firms appear to have grown overly pessimistic about future demand and now need to rebuild stocks more in line with the new demand trajectory.) Some of it will, therefore, prove to be only temporary. The longer term profile for real GDP, by contrast, is very much dependent on both the level of consumer demand and on firms’ willingness to invest again in order to build their businesses.

Will the recovery lose momentum in 2010?

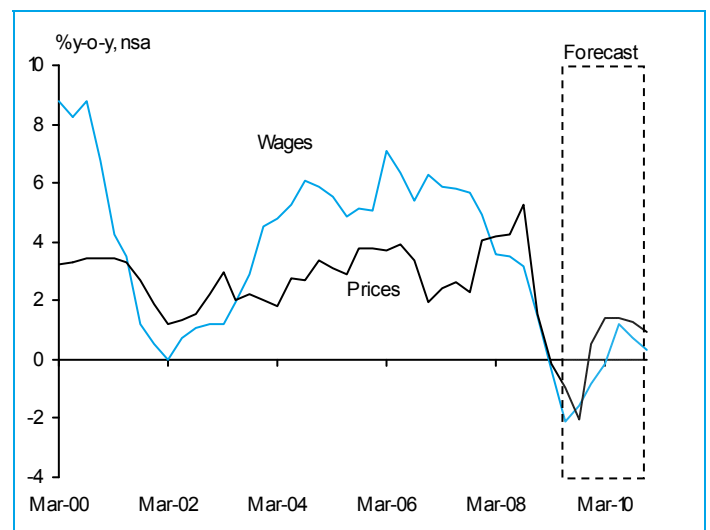
Increasingly, investors are focussing not on this year’s GDP data but on 2010’s – asking themselves if the recovery will build momentum or lose it, perhaps even to the point of looking more W-shaped than V-shaped. We worry about how US consumers will face up to a second squeeze on real incomes emanating from high unemployment putting downward pressure on pay settlements; a realignment of headline with core inflation leading to the annual rate of increase in the cost of living to go back to close to 2%; and an end to fiscal hand-outs, if not even a step or two being taken towards fiscal tightening being mooted if not yet passed by policymakers. Figure 3 shows our projected real wage tightening. Accordingly, while comfortable that the macroeconomy should continue to provide broad support for recoveries in riskier asset classes a while yet, it may not prove to be quite such plain sailing further downstream.

Figure 2 – The emerging economies benefit most from the revival in world trade



Source: Barclays Wealth Research

Figure 3 – US wage growth may soon start to lag the increase in prices



Source: Barclays Wealth Research



Cash Portfolio

Use government-related and supranational bonds instead of treasuries

Cash yields are likely to remain near 0% for a prolonged period, so we recommend that investors take prudent liquidity, duration and credit risk for funds currently still in cash. Short-duration government-related and supranational bonds offer higher-yielding alternatives to direct sovereign obligations. Although these are slightly less liquid than traditional money market funds, they allow investors much flexibility of choice.

Yield gains can be appreciable

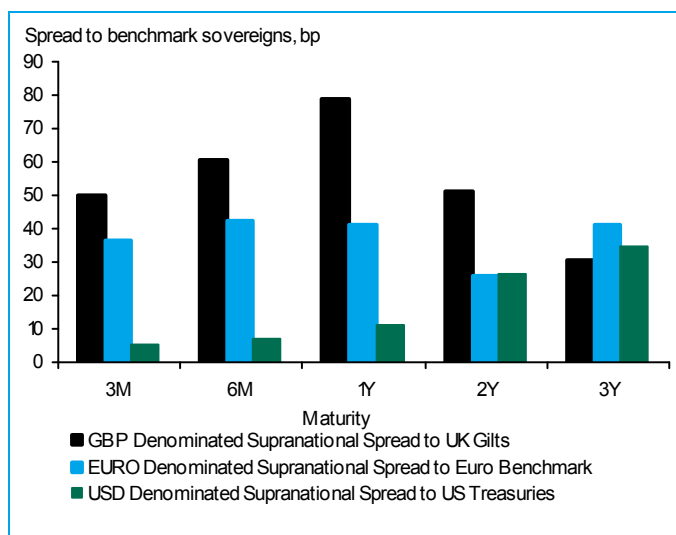
Our expectation is that cash yields are likely to remain near 0% for a prolonged period. Given our outlook, we continue to recommend that investors take prudent liquidity, duration and credit risk for funds that at present linger in cash.

Short-duration government-related and supranational bonds are higher yielding alternatives to direct sovereign obligations. For example, euro-denominated supranational bonds out-yield equivalent maturity euro benchmark sovereign bonds by 30 to 40 basis points while sterling-denominated supranational bonds offer a 30 to 80 basis point yield pick up over similar maturity gilts between 6 months and 3 years. In the US dollar market, the spread ranges between 5 and 30 basis points over US treasuries (see Figure 1).

Liquidity may be slightly less, but many choices exist

Figure 2 provides descriptions of several of the largest, most liquid AAA-rated issuers. Although supranational debt securities are slightly less liquid than traditional money-market funds, the issuers offer flexibility for investors to choose from numerous maturities, currency denominations and structural features.

Figure 1 – Noticeably higher yields more than compensate investors for slightly lower liquidity



Source: Bloomberg

Figure 2 – Government-owned or govt.-backed issuers: an attractive alternative to direct govt. debt

| Issuer ¹ | |
|--|--|
| European Investment Bank (EIB) | EIB's ownership by all EU sovereigns leads its bonds to offer diversified sovereign class exposure. |
| Fannie Mae (FNMA) and Freddie Mac (FRE) ³ | The Federal Housing Finance Agency placed FNMA and FRE in conservatorship, meaning that the US taxpayer now stands behind both agencies' debt. |
| Federal Farm Credit Bank (FFCB) | Has an insurance fund to insure the timely payment of principal of and interest on Farm Credit Debt Securities. |
| Federal Home Loan Bank (FHLB) | By regulation, FHLB's investments must be investment-grade and nearly all investments are triple-A rated. |
| Intl. Bank for Reconstruction & Development (IBRD) | IBRD is backed by the capital commitments of its 186 shareholder governments. |
| KfW Bankengruppe (KfW) | KfW Bankengruppe is the fifth-largest capital market issuer in Europe after the governments of Italy, Germany, France and the UK. |

Source: Barclays Wealth Strategy



Growing more comfortable
with risk

Optimised Portfolio

Market return: Q4 Tactical asset allocation

In April we began a process of gradually increasing tactical risk in our model portfolios, although at that time we were still recommending a basically defensive posture. In July we continued that process and recommended a neutral posture with target tactical risk about equal to strategic norms. That process should, in our view, continue in the fourth quarter of 2009, and we now recommend targeting portfolio risk and equity allocations at levels somewhat above strategic norms. Specifically, in our model portfolios we have removed our tactical asset allocation (TAA) tilt on credit, and shifted most of those funds to the equity portfolio. At the same time we recommend a reallocation within the equity portfolio away from emerging markets into the developed world. This reallocation into less volatile regional markets offsets some of the effect of the shift from bonds to stocks.

We have become more and more comfortable with risk as we've become increasingly confident that, whatever the trajectory for the global economy over the next several quarters, we have avoided a depression scenario. Now, although a "W-shaped" path remains a distinct possibility, the "upside" potential of a robust recovery has increased. With our base case economic forecast gradually improving (see page 8) and with the upside and downside probabilities equally balanced, we are now recommending a moderately bullish posture in market allocated portfolios (Figure 1). We remain concerned about the longevity of the current recovery, but we don't expect signs of any "double-dip" to become apparent until sometime in 2010, beyond our three-month horizon for tactical asset allocation.

Risk and the equity portfolio: some give and take

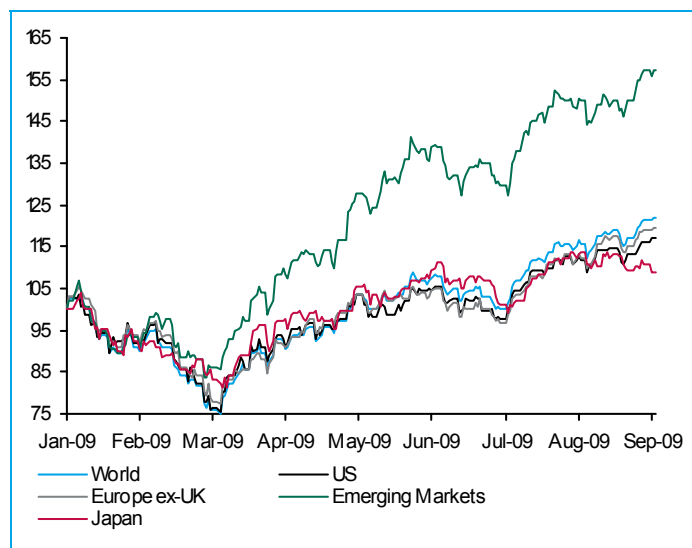
We are mindful of the massive rally that this asset class has witnessed since March this year (Figure 2) and we would not be terribly surprised to see some "correction" early next year. Our model portfolio indicates how we think portfolios should be allocated for most of the fourth quarter. The exact path by and pace at which any specific portfolio shifts from where it is now to where we think it should be will depend on micro market timing considerations that are Global High Yield beyond the scope of this publication.

Figure 1 –Q4 strategic asset allocation (SAA) & our tactical asset allocation (TAA) tilts; stylised portfolio, medium risk

| Q4 TAA | SAA | SAA + TAA | TAA |
|-------------------------------|---------------|---------------|-------------|
| Cash | 5.0% | 0.0% | -5.0% |
| US Treasury | 7.0% | 7.0% | 0.0% |
| G7 Treasury ex US | 6.0% | 6.0% | 0.0% |
| Global Corporate | 13.0% | 13.0% | 0.0% |
| Global High Yield | 4.0% | 4.0% | 0.0% |
| Global Emerging Market | 2.0% | 2.0% | 0.0% |
| Global Gov Inflation linked | 4.0% | 4.0% | 0.0% |
| | 36.0% | 36.0% | 0.0% |
| UK Equity | 8.0% | 8.5% | 0.5% |
| US Large Cap Equity | 14.5% | 14.0% | -0.5% |
| US SMID Cap Equity | 10.5% | 12.0% | 1.5% |
| Japan Equity | 6.0% | 7.0% | 1.0% |
| Europe (ex UK) | 12.0% | 12.5% | 0.5% |
| Pacific Rim (ex Japan) Equity | 3.0% | 5.0% | 2.0% |
| Emerging Markets Equity | 5.0% | 5.0% | 0.0% |
| | 59.0% | 64.0% | 5.0% |
| | 100.0% | 100.0% | 0.0% |

Source: Barclays Wealth Strategy

Figure 2 – Equity market performance for major indices. MSCI indices, indexed 1 January 2009=100



Source: Bloomberg, Barclays Wealth Research

Look to the less volatile equities markets

Credit spreads are now fairly priced, given default risk

The allocation changes within the equity portfolio are also quite important. We have focused most of our increase in equity allocation to developed markets, and have made a distinction in the US between small-and-medium-cap and large-cap. This allows us to assign a specific TAA overweight in US small- and mid-cap stocks (see page 15). An underweight on US large caps allows us to keep our total US market exposure at a small overweight. We recommend moving from neutral to overweight in Japanese equities, and assign smaller TAA overweights to UK and European stocks. We continue to believe that the developed Asia Pacific ex-Japan (Hong Kong, Singapore, Australia, and New Zealand) regional markets should be assigned a large overweight, but scale back our call on emerging market equities in general, including those in Asia.

The logic behind these reallocations is fairly simple. We are focusing on regions that have lagged the market recovery this year to date. These are the less volatile – lower “beta” – markets. As we move past the crisis and its immediate aftermath, we expect a more normal equity market performance. We’re comfortable moving to an overweight on the asset class, but want to target the beta of that allocation closer to 1.0 than we had been in the second and third quarters when we recommended a large overweight on the volatile emerging equity markets. The somewhat larger proportionate overweight on Japan reflects the fact that that market has lagged quite badly, our belief that an actively managed Japanese stock portfolio can offer cost-effective access to Asian growth, and the chance that a completely new government might rouse “animal spirits” in this market.

Cutting back on bonds

As noted above, we have removed our TAA overweight on fixed income, bringing investment-grade credit, high-yield credit, and emerging market bonds all back to a neutral weight. In the wake of the sharp corporate bond market rally that began last November, we believe that credit spreads are now appropriate given the elevated level of default risk. As of late-August, for example, US investment-grade and high-yield spreads have narrowed to 220bps and 820bps, respectively, not far off from their post-1994 respective averages of about 170bps and 603bps. Bankruptcies have already begun to rise, and while the magnitude has so far been consistent with what the market has been pricing in, the fact that we are likely at a point in the cycle when they tend to peak could mean that further spread tightening may be less easily forthcoming.

To keep total portfolio risk at appropriate levels, we balance this shift out of credit and into stocks by eliminating what had been a substantial underweight in G7 government bonds. We have also trimmed our allocation to inflation-linked bonds from the previous overweight. Yield differentials between fixed-rate and inflation-linked governments are now about where we think they should be.



Absolute Return Reaffirming the role of Global Macro

In last month's edition of *Compass* we discussed our positive outlook for a pair of arbitrage trading strategies: momentum and short-term reversal. These and other strategies, such as distressed debt and event-driven, that aim to benefit from systematic market inefficiencies have, indeed served investors well in 2009 to date. Nevertheless, we believe that a well-diversified absolute return portfolio should include both arbitrage and directional trading strategies. In particular, despite modest year-to-date returns relative to other strategies, we continue to recommend a substantial proportion of Global Macro funds within diversified Absolute Return portfolios. Global Macro managers take long or short positions across a range of asset classes, including equities, currencies, commodities, credit spreads and interest rates. Our constructive view is based on our belief that 1) the strong performance of high-quality managers will persist, 2) allocations to Global Macro managers continue to provide important diversification within portfolios, and 3) the market environment for these managers has improved.

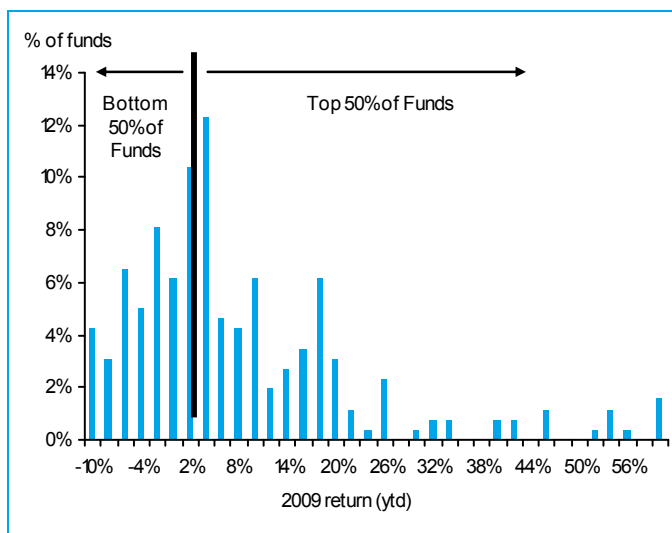
Recent performance

A cursory look at hedge fund indices suggests that average Global Macro fund returns in 2009 to date have been positive, but low; the HFRI Macro (Total) Index has returned only 2.68% year-to-date through August 2009. This compares poorly with the returns achieved by a number of other different absolute return strategies that aim to benefit from systematic market inefficiencies.

However, it is worth digging deeper than this average return figure. Positive Global Macro returns are almost entirely predicated on manager skill, not on the performance of individual financial markets. Some fund managers have skill, others don't, and investment decisions should be based on primarily whether one has identified a high-quality manager rather than on market conditions. This can make the indexed, or average, return for Global Macro quite misleading. Top-quartile managers have, on average, returned almost 30% year-to-date whereas their bottom-quartile counterparts have returned -7%. This wide range of outcomes can be clearly seen by looking at a distribution of individual fund returns in 2009 for the universe of Global Macro funds (Figure 1). Clearly, skilled managers have performed very well over the last nine months. We expect this outperformance to continue.

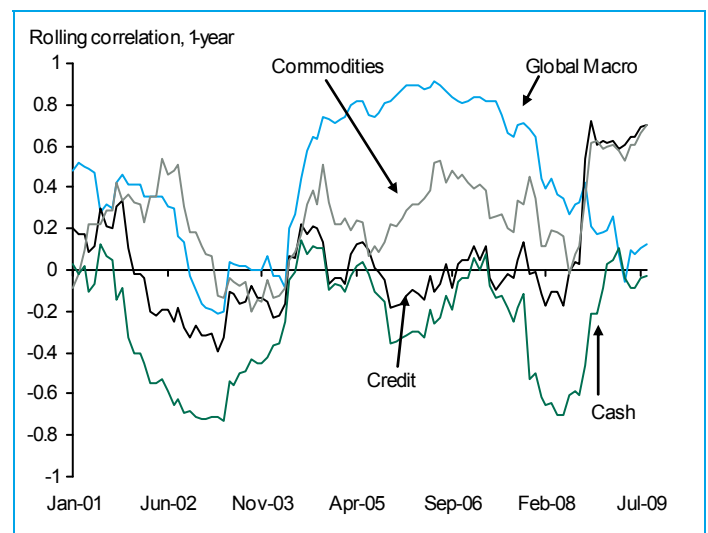
Skilled managers have performed very well this year

Figure 1 – Distribution of Global Macro fund returns January-August 2009



Source: Lipper/TASS

Figure 2 – Asset class correlations to global equity



Source: Bloomberg and Hedge Fund Research Inc.

Portfolio diversification: two ways

In addition to being a source of portfolio returns, an allocation to Global Macro serves a diversifying role in a portfolio. It is well-known (and true) that correlations among risky asset classes increase during times of crisis, reducing the beneficial impact of portfolio diversification in managing risk. Because the market exposure that Global Macro managers have can be either long or short and can change quickly over time, however, the returns of Global Macro strategies can remain uncorrelated with other asset classes, even during periods of crisis. Indeed, through the last year – a period when correlations among almost all asset class returns rose sharply and portfolio diversification failed to reduce risk – global macro fund returns actually became less correlated with other investments.

Figure 2 shows the rolling 1-year correlations of cash, credit, commodities, and the HFRI Global Macro index to global equities. Correlations ebb and flow through time, but it is clear that the correlations of credit and commodities to equity (the risky assets) jumped in mid 2008 and have remained elevated. Over the same period, the correlation of Global Macro and equities was reduced to nearly zero as managers decreased their positive directional exposure to risky assets. Cash, a riskless asset, also maintained a negative or low correlation.

Importantly, Global Macro also provides diversification relative to other strategies in an absolute return portfolio (Figure 3). Since 2000, Global Macro has been relatively uncorrelated to other absolute return (AR) strategies. This fact remained true, and, in fact, became more pronounced, during the crisis period from August 2007 to March 2009.

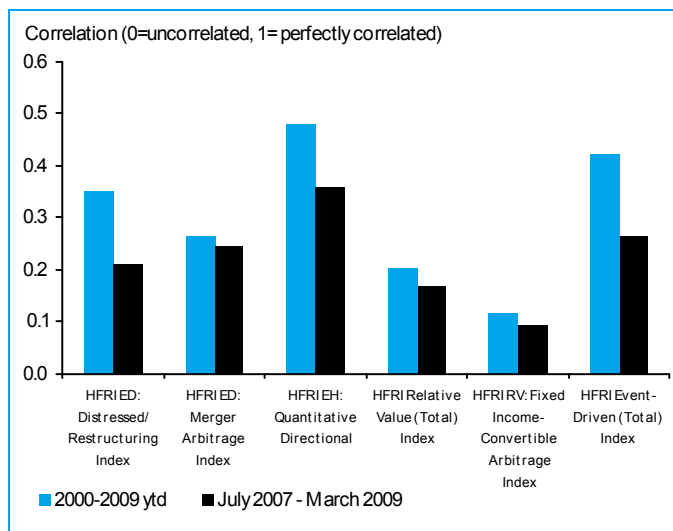
Supportive market environment

One positive development for Global Macro is that asset class correlations are declining, putting additional value on nuanced positions within or between markets. This and further performance divergence among markets is a bullish development for global macro managers.

Although we believe the direction of returns (positive or negative) for global macro managers is contingent on skill, the magnitude of those returns tends to be dependent on market volatility. Across a variety of asset classes, market volatility has stabilised in a range that is slightly above average (Figure 3), where we expect it to remain for the foreseeable future. Overall, an expectation of stable but elevated volatility is positive for global macro, and reaffirms our recommendation to position this strategy within diversified absolute return portfolios.

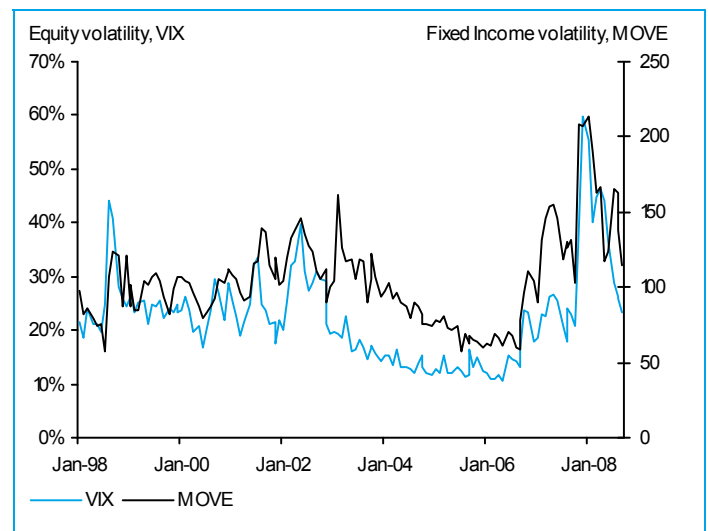
Magnitude of returns tends to be dependent on market volatility

Figure 3 – Global Macro has been relatively uncorrelated to other asset classes since 2000



Source: Hedge Fund Research Inc.

Figure 4 – Equity and fixed income volatility stabilises in a range that is slightly above average



Source: Bloomberg



Cyclical sectors' companies tend to be smaller

Guided portfolio In the US, start thinking small

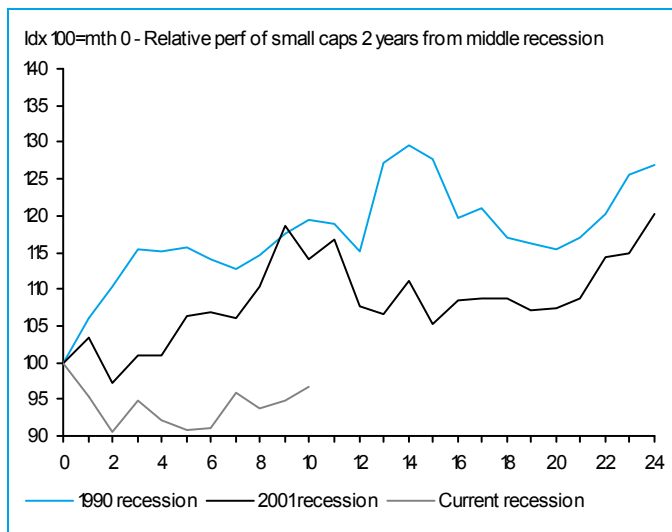
Small cap stocks usually outperform larger issues by a very wide margin during the early phases of a post-recession equity market rally. That has been very much the case in the UK and Europe in this cycle, but since the current market rally started US small cap stocks have, indeed, performed better than large caps, but by much less than we would have expected them to given the strength of the rally and its causes. Therefore, we recommend that investors increase exposure to US small cap stocks. We advise looking at the best active managers aiming to beat the Russell 2000 index .

The case for small caps in a recovery

Smaller listed companies ("small caps") tend to be particularly sensitive to the economic cycle as measured by both top-line revenue and profits growth. There are many reasons for this. For example, because of their size they may be focused on only a few product lines, limiting the diversity of their revenue streams. They also tend to have a high ratio of fixed costs as a percentage of total costs in their business, meaning that their profitability is more sensitive to changes in revenue. Small caps stocks also tend to be more reliant on traditional bank lending for financing unlike large caps which can access the capital markets. All of this explains why in previous periods when the US economy has recovered from recessions, we have seen the small cap sector outperform the large cap sector (Figure 1).

Companies in cyclical market sectors tend to be smaller on average than the non-cyclical industries. Figure 2 shows the sector weightings of the S&P 500 and the Russell 2000 indices and the differences. As can be seen from the table the Russell 2000 index has relatively high weightings in the cyclical financials, industrials, and consumer discretionary sectors. The S&P 500 has relatively higher weightings in the defensive sectors such as utilities, telecoms, and consumer staples. With the economy on the road to recovery, we would expect that the cyclical companies see their earnings recover sharply and these sectors should continue to lead the recovery. Other things being equal, this would favour small relative to large caps; indeed earnings for the Russell 2000 companies are expected to rise by over 150% next year and nearly 50% in 2011, according to

Figure 1 – Small caps have previously outperformed in a recovery



Source: Datastream, Barclays Wealth Strategy

Figure 2 – Small cap indices have higher cyclical exposure

| Sector weightings | S&P 500 | Russell 2000 | Difference |
|------------------------|---------|--------------|------------|
| Financials | 15.1% | 20.8% | 5.7% |
| Industrials | 10.1% | 15.7% | 5.6% |
| Consumer discretionary | 9.2% | 13.8% | 4.6% |
| Health care | 13.3% | 14.1% | 0.8% |
| Materials | 3.5% | 4.2% | 0.7% |
| IT | 18.5% | 18.8% | 0.3% |
| Utilities | 3.8% | 2.9% | -0.9% |
| Telecoms services | 3.2% | 1.2% | -2.0% |
| Energy | 11.8% | 4.7% | -7.1% |
| Consumer staples | 11.4% | 3.8% | -7.6% |

Source: Bloomberg, Barclays Wealth Strategy

consensus, which compares favourably to the 24% and 22% expected to the S&P 500. (Figure 2 shows the sector weightings of the S&P 500 and the Russell 2000 indices and the differences. As can be seen from the table the Russell 2000 index has relatively high weightings in the cyclical financials, industrials, and consumer discretionary sectors. The S&P 500 has relatively higher weightings in the defensive sectors such as utilities, telecoms, and consumer staples.)

Concerns about US small caps

Year to date most equity markets are now trading in significant positive territory and this is especially true of the small cap indices in Europe. The anomaly so far is the US, where the small cap index is only marginally ahead of the large cap index so far this year (Figure 3).

Clearly there are some concerns about whether small caps can outperform in the current recovery, especially as in the current cycle the domestic US recovery is forecast to be weaker than usual. Furthermore, given that we are in a deleveraging phase for the US banking sector concerns are high that small caps will struggle to find funding. But all of these concerns apply to the European and UK markets as well, and these so far are doing well.

One specific US concern is the health care legislation currently being debated in Congress, which might require smaller companies to provide health insurance for their employees or pay a penalty. But the publically-listed companies in the small cap indices aren't that small, most already do provide health insurance, and the legislation might in fact enable them to obtain coverage at better rates.

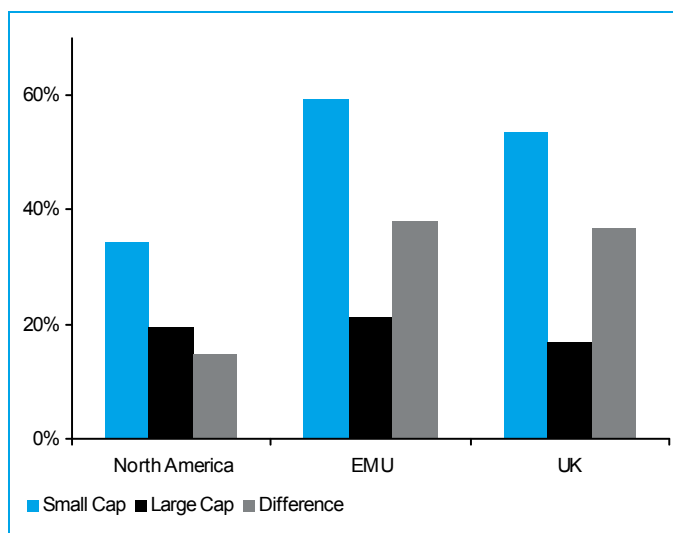
Likely factors behind future outperformance

In addition to the cyclical recovery argument, we would also point to the relative valuation and earnings growth forecasts for the small cap sector. Figure 4 shows the dividend yields of US small versus to large cap stocks which suggest that small cap stocks still offer fair relative valuation based on the dividends they have paid. The sector looks well positioned, therefore, to do quite well if robust relative earnings projections are anywhere close to right.

We expect US small caps to outperform over the medium term. Given that this sector has historically proved to be a rich source of "alpha" (i.e. individual stock outperformance), we would advise looking at the best active managers aiming to beat the Russell 2000 index.

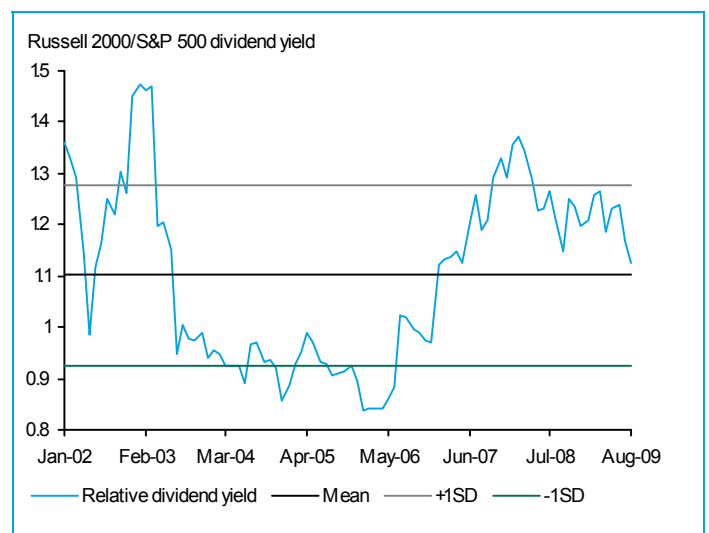
A case for active management

Figure 3 – US small caps haven't seen a noticeable outperformance this year



Source: MSCI Indexes via Bloomberg

Figure 4 – US small caps look attractively valued



Source: Datastream, Barclays Wealth Strategy

Brian Nick
Investment Strategist



Global recovery will be
commodity intensive...

...but the commodity price
recovery has yet to come...

...with inflation worries...

...and USD invoiced prices
providing further reasons to buy

Commodities

Buy a diversified portfolio of commodities

Commodities have provided a reasonably effective hedge against dollar depreciation and inflation, which could be important in the current market environment. More importantly, commodity prices performed worse through the recent recession than they usually do during economic downturns, giving more scope for an upturn. Finally, the fact that the rapidly-growing Asian economies happen to be particularly heavy commodities consumers should also benefit prices. We recommend that most investors hold exposure to commodities in their guided portfolios. This exposure could come in the form of a long-only basket of commodities, an allocation to a single commodity, a combination of long and short positions in different commodities, or even a net-short position in certain circumstances. At this time, we recommend clients hold a broadly diversified long-only basket of commodities.

We are recommending clients hold a broad basket of commodities for a number of reasons. First, we expect commodity-intensive economies like China to continue to serve as the engine of global growth, and we therefore expect the global economic recovery to be commodity-intensive (Figure 1). Recent manufacturing and urban investment growth data in China came in stronger than expected, providing a boost to commodity prices broadly.

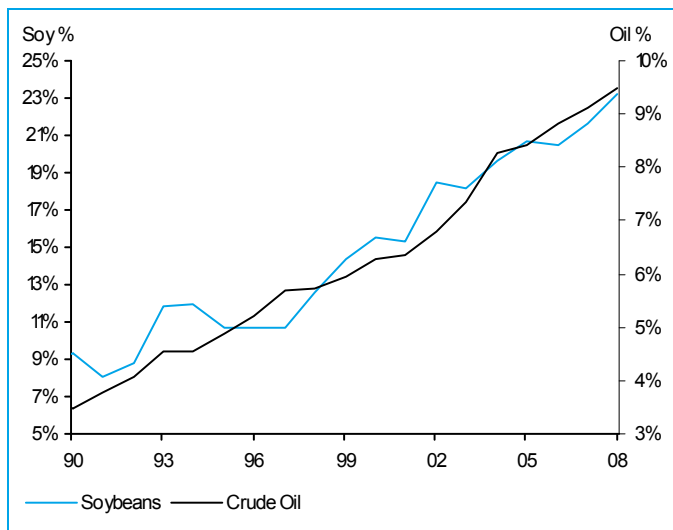
Commodity price recovery has proved tepid so far

Second, the commodity price recovery has thus far has been tepid relative to previous recoveries (Figure 2), indicating that there is still ample opportunity for prices to track higher. In addition, there is evidence that inventories are close to bottoming out in many sectors, and commodity prices should receive a boost from increased economic activity in the US and Europe.

Third, although we are not particularly concerned about the risk of high inflation, in the event that we are wrong a basket of commodities should perform reasonably well as a hedge.

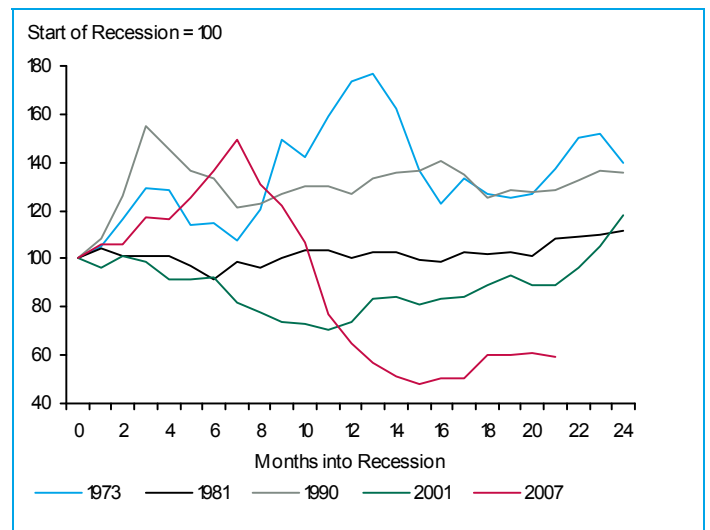
Fourth, since commodities are invoiced in US dollars, quoted prices tend to rise in general when the dollar depreciates in general. We expect the dollar to

Figure 1 – Chinese soy and crude oil consumption as % of world consumption



Source: Bloomberg

Figure 2 – Commodities' recovery has been relatively weak thus far



Source: Barclays Capital Commodity Research, Bloomberg

Regulatory changes could hit ETPs' trading liquidity

Non exchange-traded structured notes are an alternative

depreciate on a trade-weighted basis over time, but are hard pressed to identify which specific other major currencies we favour. In this environment, a long position in commodities can serve as a “generic” short position on the USD. Lastly, the correlation between returns on commodities and US equities over the past year was the highest it has been since the early 1980s. We view this trend as unlikely to persist, and we expect volatility across markets to decrease as market conditions continue to normalise. This decrease will likely be accompanied by a decline in cross-asset correlation generally, and equity-commodity correlation specifically. Going forward, commodities should regain their place as useful portfolio diversifiers.

Implementation issues

Implementation has become more challenging for commodities investors, particularly given the increased risk of regulatory reforms affecting commodities futures trading in the US. US regulators have recently taken a larger role in setting position limits in commodity futures markets to curb speculation, which has caused some of the larger commodity-linked Exchange Traded Products (ETPs) to cease issuing new shares. This could have a serious impact on the liquidity with which these ETPs trade, particularly if regulatory risk becomes serious enough to force these funds to liquidate. This has already happened in at least one case. Even in the absence of full liquidation, the performance of these vehicles may no longer reliably track returns on commodities futures.

This is problematic because a number of ETPs are currently trading at prices well above their net asset value (NAV), meaning that in the event of liquidation, investors could incur a loss on the funds' payouts. Premiums on some ETPs have risen substantially as the market's perception of increased regulatory risk has increased.

Look at smaller vehicles less susceptible to regulatory risk

We are recommending that clients invest in commodities through smaller vehicles that are not as susceptible to regulatory risk. There are several varieties including many actively managed funds and partnerships, which are not required to concentrate their holdings in single individual futures contracts. Smaller issues of non exchange-traded structured notes offering returns linked to the performance of a diversified commodities index can also serve this purpose.



Guided portfolio Opportunities in short rates

Yield relationships among short-term fixed-income securities reflect an expectation that central banks will start raising short-term interest rates as soon as early next year along with considerable uncertainty regarding the direction of central bank policy over the next several quarters. We, by contrast, are reasonably confident in our view that the Federal Reserve, the Bank of England, and the European Central Bank will keep policy rates low for a very long period of time. Investors, in our view, should, therefore, buy structures that will do well if short-rates remain lower for longer than current market prices imply. In particular, inverse floating-rate notes and capped floating rate notes express exactly this view.

Monetary policy will be tightened more slowly than markets imply

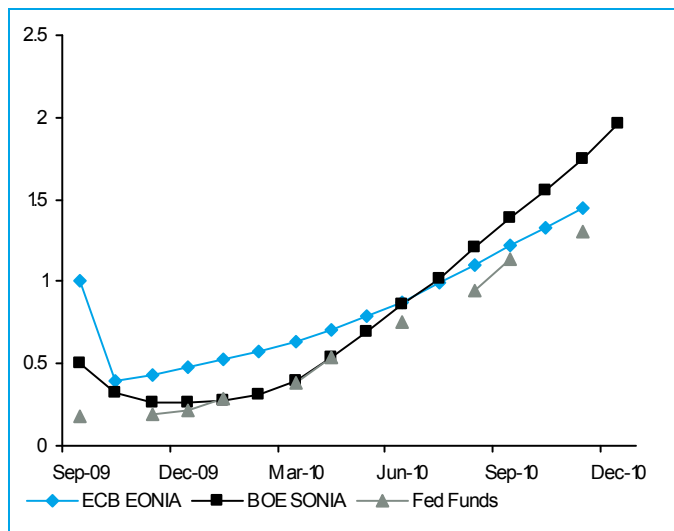
One of our investment themes has been that rates are going to remain low. With the major economies now back in growth mode, markets are pricing in a significant tightening in monetary policy as early as next quarter (Figure 1).

We believe that the markets are pricing in tightening in monetary policy too early. Policymakers will have to be careful as they steer their economies out of the recession. Output gaps are still large, and inflation fears remain overdone according to our colleagues on the Barclays Wealth economics team, who expect rates to remain low for the major economies. Their forecasts imply that no major changes in short rates should be expected until late in 2010 at the earliest (see the forthcoming October edition of our companion publication *Signpost* for more details).

Investors can benefit in terms of higher yields from low and stable short-term interest rates by buying two- to three-year *inverse floating rate notes*. The coupon payment on an inverse floating rate note increases if short-term interest rates decline, and vice versa. Specifically, the bond effectively pays a coupon equal to a fixed-rate *minus* the value of a benchmark short-term rate such as LIBOR. To the extent that short-rates stay lower for longer than markets anticipated when the note was priced, the investor earns a higher return than would have been paid on a fixed-rate bond of the same maturity.

Inverse floating rate notes offer a way to benefit from this

Figure 1 – Market is pricing in rate rises too early



Source: Barclays Capital

Note: EONIA and SONIA are European and Sterling Overnight Index Averages. These reflect the effect overnight rates prevalent in these regions.

Figure 2 – High implied volatility reflects uncertainty



Source: Barclays Capital

Capped floaters offer an enhanced premium over LIBOR

If rates rise for all maturities, the market value loss of an inverse floater will be about twice as large as would have been the case for a fixed-rate note of the same maturity. In the current market, we believe that higher returns are much more likely than greater losses.

“Exit policy” uncertainty makes short-term rates more volatile

Market prices also reflect uncertainty about policymakers’ “exit strategy” from current levels of monetary and fiscal support, as indicated by the volatility of short-term interest rates (Figure 2). This means that market participants, especially those who have issued substantial volumes of short-term and floating-rate debt, are willing to pay much more than usual for protection against the risk of tighter central bank policy. Such protection usually takes the form of an interest rate cap, a contract that will pay off for the buyer to the extent that short-term interest rates rise above the cap level of, for example, 5%. We believe that the market price of such caps is too high because we are reasonably confident that the path of short rates will remain low and fairly steady in the foreseeable future. We therefore recommend that investors look for opportunities to *sell* interest rate caps by investing in capped floating-rate notes.

Capped floaters implement this view by offering investors an enhanced spread over the floating rate note by embedding an interest-rate cap feature. Suppose, for example, a corporation would ordinarily offer a three-year floating rate note at USD LIBOR + 100 bps (1.00%). Instead, such an issuer might offer a floating rate note paying USD LIBOR+120 bps up to a maximum rate of 5%. In EUR , a five year note would pay EUR LIBOR + 100 bps (1%) instead of EUR LIBOR + 30 bps for a cap of 4%. The premium for the cap – the difference between the LIBOR spread on the straight and capped floating rate notes – depends on the volatility of short rates, and is likely to be higher in a high interest-rate volatility environment. The risk of the capped floater is that of rates rising faster than expected so that they reach the cap well before the note matures; as explained above, we think this is less likely than the market expects and prices in.



Guided Portfolio Buy “First to tighten” currencies

The global recovery has almost certainly begun, but not all countries appear to be moving out of recession at the same pace, and we think the dispersion in the timing and magnitude of central bank rate tightening will present opportunities in currency markets over the next several quarters. In particular, we expect the Australian and Norwegian central banks to be among the first in developed countries to start tightening monetary policy. Perhaps soon, and perhaps by more than markets expect. We recommend that investors take positions that are long these currencies and short the US dollar, the euro, the yen, or a combination of the three.

The effects of the global recession are still very evident, notably in high levels of unemployment in the US and euro area. But not all developed economies have experienced as acute a contraction in growth or employment (Figure 1). Norway, for example, had a relatively shallow recession lasting only two quarters, and Australia avoided a recession altogether. This resilience has provided a boost to both countries’ currencies as risk appetite has returned, and should continue to do so as their central banks become among the first to begin raising interest rates.

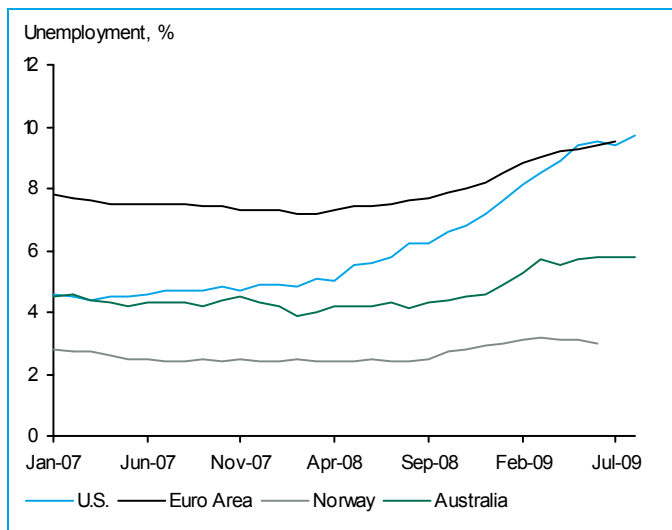
We recommend gaining exposure to AUD and NOK for three reasons:

- Both Norway’s and Australia’s economies are dependent on commodity exports and their currencies, the Aussie dollar (AUD) and Norwegian krone (NOK), have exhibited high correlations with commodity price indexes in the past. We therefore expect a commodity-intensive global recovery to be supportive of them.
- Both economies have outperformed their peers this year, as discussed above, and their respective central banks appear ready to begin raising interest rates after sharp cuts over the past 12 months (Figure 2).
- Australia and Norway already have some of the highest nominal and real interest rates in the developed world, making both AUD and NOK attractive as carry trades versus the euro, the dollar, or the yen.

An increasing interest rate environment should be supportive for both currencies, and it seems clear that both countries’ central banks will be starting their tightening cycles well ahead of their counterparts at the Fed, the European Central Bank, or the Bank of Japan. A “first to tighten” currency trade is, in our view, a risk worth taking.

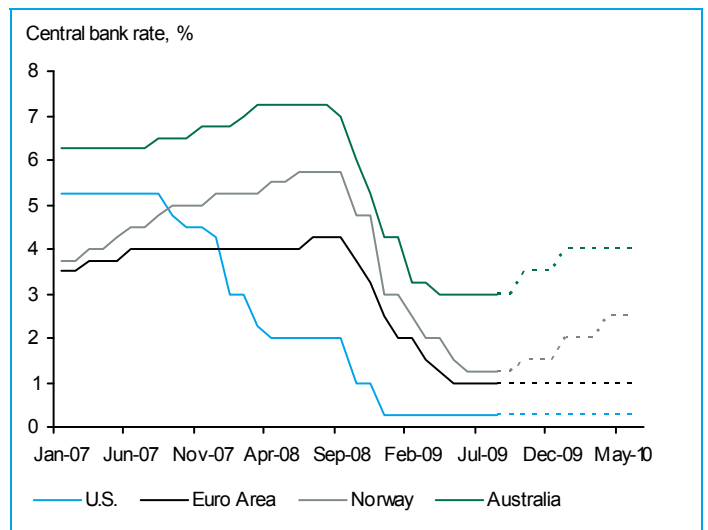
Interest rate outlook is reinforced by commodities

Figure 1 - Unemployment in Select G10 Countries: Norway and Australia fare better



Source: Bloomberg

Figure 2 – Norway and Australia are expected to tighten policy rates soon



Source: Barclays Capital Research, Bloomberg

Glossary

Absolute performance. Any gain or loss in the amount invested. Relative performance is performance relative to a chosen benchmark such as the FTSE 100.

Alpha. A manager's contribution to return performance that cannot be attributed to market performance. How the manager performed if the market has no gain or loss.

Asset Allocation Process. Our asset allocation process starts by using a model to deliver an optimum strategic (i.e. long-term) division of investments between asset classes (our strategic asset allocation). We then have a formalised discussion process, within Barclays Wealth and elsewhere in the Barclays Group, to decide what tactical (i.e. short-term) "tilts" should be applied to this strategic view to maximise returns over the next three months. These "tilts" are given on page 12. So, for example, we would recommend that an investor's allocation to corporate bonds is 2.5 percentage points higher (i.e. overweight) than that suggested by the model-driven strategic asset allocation alone. Please note that we are showing a hypothetical portfolio, which is meant to be a means of communicating our general views across broad asset classes and is not necessarily what we would recommend for any particular investor's actual investments.

Asset classes. The main asset classes are equities, bonds and cash (and equivalents). Other asset classes include hedge funds, commodities, real estate, and private equity.

Beta. The 'beta' of a stock or a market index is the percentage by which the price of that stock or index changes if the general price level of the market as a whole changes by 1%. For example, Asian markets' betas have been greater than 1, indicating that for a given 1% change in global equities, these Asian indices gained (or lost) more than 1%.

Basis points (bps). One hundredth of one per cent (so 50 basis points = 0.5%).

Carry trade. Using the funds from selling a currency with a relatively low interest rate to buy a currency with a higher interest rate. If the exchange rates do not change, the investor earns the difference between the two interest rates (i.e. positive carry).

Inflation: headline vs. core. Headline inflation is the broad measure of inflation as reported by CPI. Core inflation is a measure of inflation that excludes certain items such as food and energy

Deflation, disinflation. Deflation is a sustained period of falling prices. Disinflation is a fall in the rate of inflation.

Duration. Measures the "true maturity" of a bond taking into account coupons that are paid during its life as well as the final repayment. In addition, it is a measure of sensitivity to changes in interest rates.

Fair value. An estimate of the potential market price of an asset.

Fixed income. A debt instrument paying a regular fixed or variable coupon until its maturity date, at which date it pays principal.

GDP and Real GDP. Gross domestic product is the total market value of all final goods and services produced in a country in a given year. It is equal to consumer investment, government spending, and the difference between exports minus imports. Real GDP is adjusted for changes in inflation.

Global macro fund. Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets.

Market Capitalisation ("Market Cap"): The value of a company calculated by multiplying the number of outstanding shares by the stock price of a single share. Small Cap stocks have a market cap between \$250 million and \$1 billion; mid cap stocks between \$1 billion and \$5 billion; large cap between \$5 billion and \$250 billion.

Overweight, underweight. The relative importance of a single asset class in a portfolio compared to a pre-specified benchmark. To be overweight in bonds and underweight in equities implies that you believe bonds will outperform equities.

Risk appetite. The willingness of investors to take on financial risk, e.g. by investing in riskier assets.

RPI. Retail prices index. A measure of inflation used in the UK, which also includes items such as rent and mortgage interest payments.

Systemic risk. The risk that an entire market, or the whole financial system, will collapse.

Yield spread. The yield differential between two bonds, often a risky bond and a similar maturity benchmark security.

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