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three
thought-
provoking
articles

Fidelity Special
Situations Fund –
Our View

Financial
Independence
Or The Benefits
Culture?

Inheritance Tax –
A Simple Solution

INDIVIDUAL SAVINGS ACCOUNTS LIMITED

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Fidelity Special Situations Fund – Our View

During the past year, investors have progressively been informed of Fidelity's planned changes to their Special Situations Fund. Hitherto, we have refrained from comment but, for several reasons, we firmly believe that now is the time.

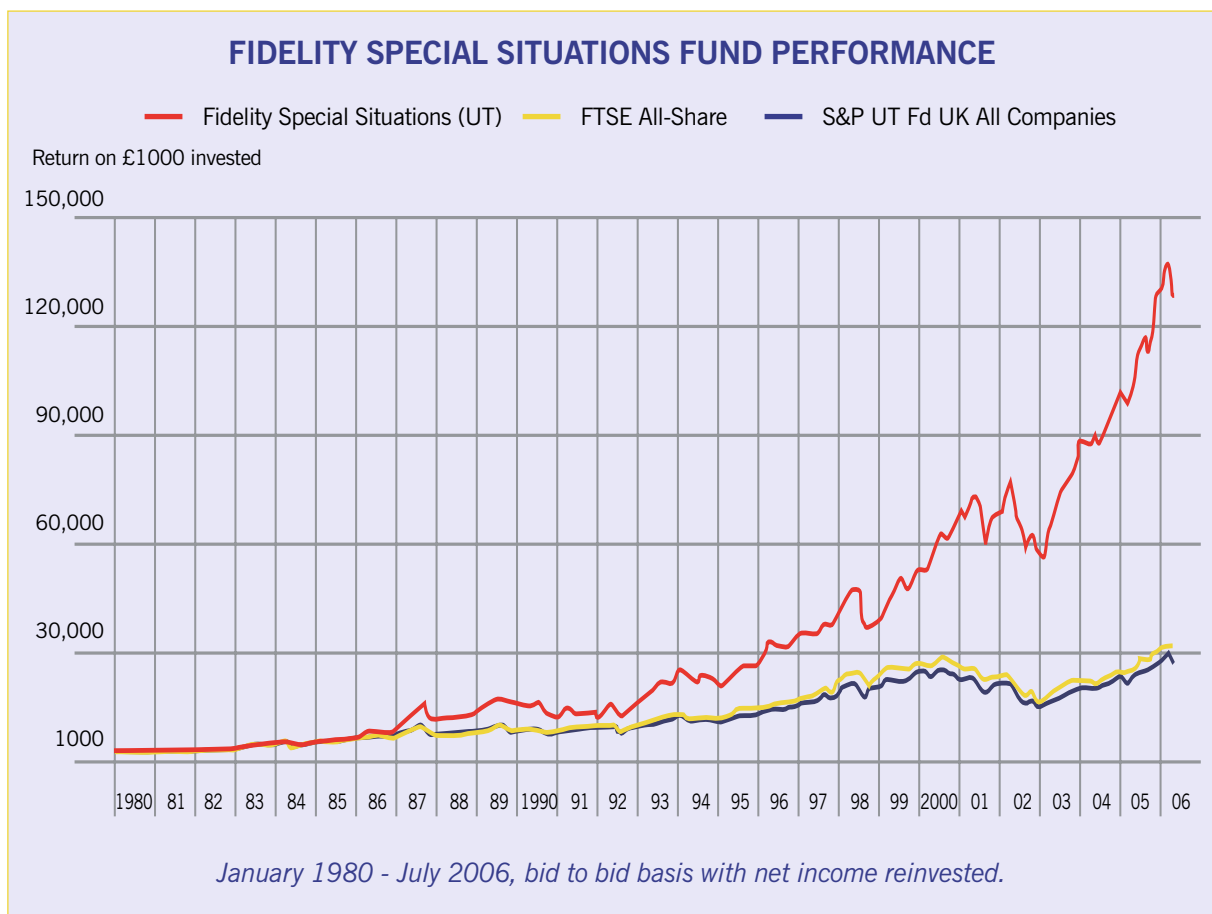
Information And Misinformation

In September of last year Fidelity announced they would be restricting access to this fund. To say the very least, it is unusual for a fund management group to turn away business, but this is precisely what Fidelity did! There followed a plethora of "guides" produced by various independent financial advisors, who (surprise, surprise) concluded that investors should transfer their holdings from Fidelity Special Situations to various other funds which these advisors favoured.

The justification for any course of action always lies in the strength of the argument, and we have not seen one such "guide" which passed muster in this respect.

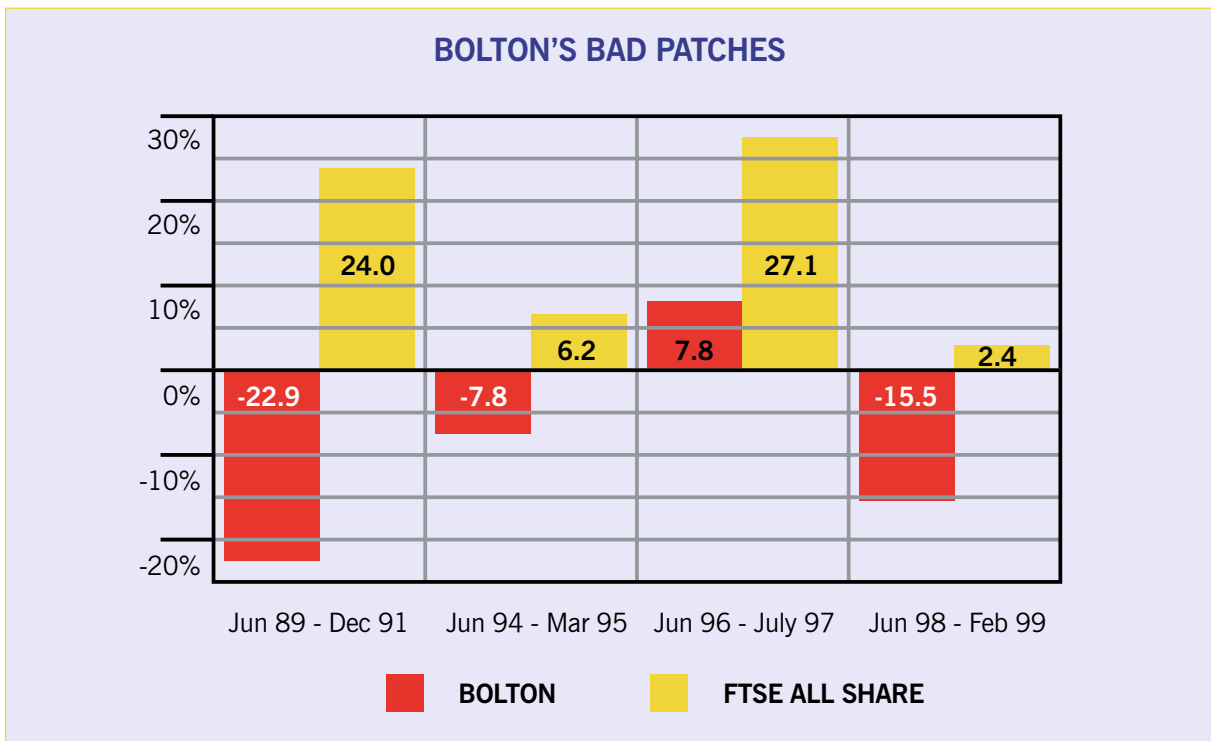
Our View

We have recommended this fund consistently for over twelve years up until the recent Fidelity moratorium, and our faith has been rewarded as the graph below suggests.



(Source: Fidelity)

As with all investment funds, a long-term period of stellar performance will include short-term periods of underperformance, as the chart opposite suggests.



The (Not So Secret) Recipe

Since the fund was launched in 1979, it has remained under the control of Anthony Bolton. His approach to management is based on the recognition that the stockmarket always contains shares which are undervalued. He believes that these anomalies fall into five distinct categories as follows;

- a) Recovery and turnaround stocks.
- b) Businesses whose share prices do not reflect the real value of their assets.
- c) Stocks with unrecognised growth potential.
- d) Stocks which are cheap compared to peers in their sector.
- e) Stocks which can benefit from “merger and acquisition” activity, but whose price does not recognise this reality.

Bolton tends to hold individual shares for an average of 18 months. This is the period he feels is required for a mis-valuation to correct itself.

Our View

Pundits can talk all night about “investment theory” and the way in which money should be managed. At the end of the day, however, the proof of the pudding is in the eating, and Anthony Bolton’s system has delivered substantial capital gains for his investors.

Our strongly held view, therefore, is that investors should continue to maintain their funds with Fidelity. If they do, then their ongoing investment will be split into two funds, with half being reallocated to a new fund called the Global Special Situations Fund. The other half will remain in the original fund, and continue to be managed in the same way.



Lesson Learned?

There are over 490 UK oriented equity funds to invest in, and another 817 spread across various overseas countries. In our view, investors seeking growth should have an internationally diversified spread of funds. This said, is there an argument in favour of extending the aggressive style of investment management personified by Anthony Bolton and the Special Situations Fund? We believe there is, and that this should encourage investors to opt for “special situations” type funds. Almost all of these funds concentrate solely on the UK stockmarket, so we welcome Fidelity’s initiative in extending the concept to stockmarkets overseas.

Those investors who have benefited from the long-term success of Fidelity’s Special Situations Fund should have the faith to extend the philosophy further.

Future Investment

We consider that investors will benefit from maintaining their holdings with Fidelity. This said, for any **additional annual investments** which our clients make we recommend that they diversify into similar types of funds (ie those pursuing a “special situations” investment style) offered elsewhere.

Existing “UK special situations” funds have a remit to invest throughout the UK market. In other words they can select from other small, medium or large capitalisation stocks. There are currently around 2400 quoted shares listed on the UK exchange. Of these 2050 are considered to be “small companies”.

An analysis of the median market capitalisation of five of the leading funds in this area illustrates that there is a considerable difference in their approach to investment. This is particularly true with regard to the market capitalisation of the shares selected for purchase (as the table below suggests).

FUND	FUND SIZE	MEDIAN MARKET CAP
M & G Recovery	£1658m	£2950m
Artemis UK Special Situations	£815m	£1270m
Fidelity Special Situations	£6283m	£3050m
Framlington UK Select Opportunities	£797m	£1660m
Merrill Lynch UK Special Situations	£254m	£820m

(Source: Bloomberg)

The “Aggressive” Approach

In the table above, the median stock in each case is the mid-ranking share. For example, if a fund has (say) 999 different holdings, the one ranked 500th in size is the median. Obviously there are subtle differences in the selection emphasis of each of the above managers. Nevertheless, in each case the overriding philosophy is to remain unconcerned about volatility, and to be prepared to buy shares which most investment managers avoid.



There is a natural tendency for managers of “special situations” type funds to opt for smaller companies simply because this is where most “undiscovered value” lies. Examples of two such companies are as follows.

Firstly, five-a-side soccer centres. This branch of our national game now has more active players than the traditional eleven-a-side game. The soccer centres which cater for this activity typically have ten pitches with artificial hard-wearing grass and facilities for changing rooms and refreshments. Charges are generally £5 per head for each hour. Two companies, Goals Soccer Centres and Powerleague operate in this market. The former was floated in late 2004 with a market capitalisation of £26 million, but whose value has since reached £87 million. Powerleague was floated in 2005 with a £36 million valuation, which has subsequently reached £57 million. Clearly this is a niche market, in a traditional sport, with a fresh slant.

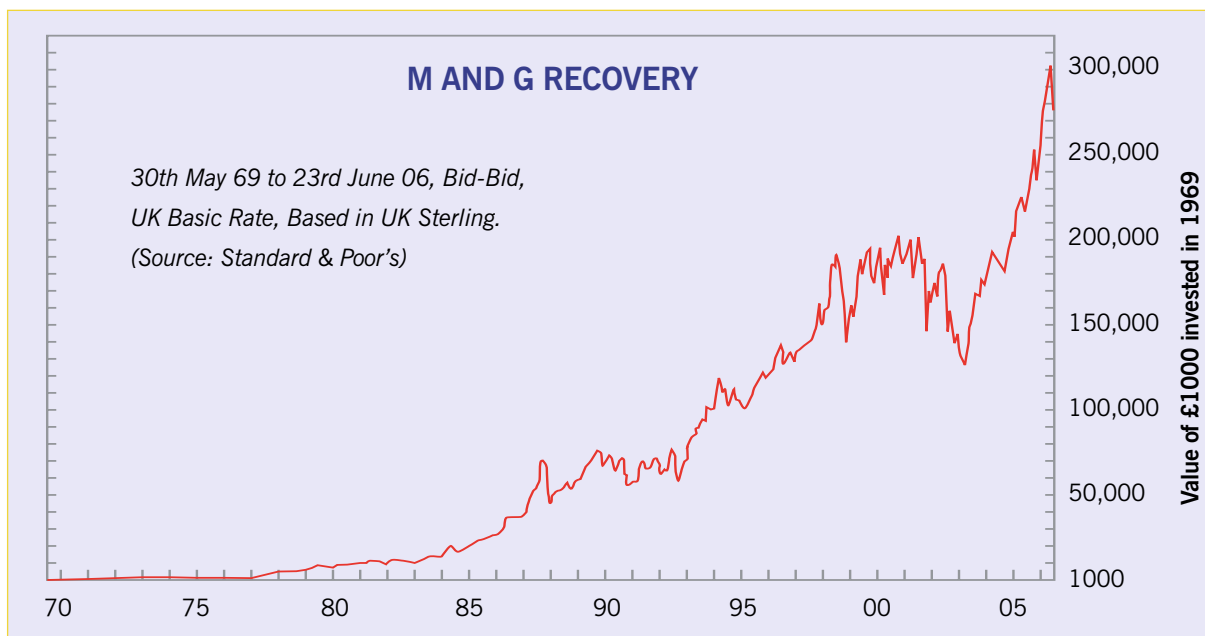
Another rapidly expanding area is debt-management, and the dramatic increase in so-called IVA's (Individual Voluntary Arrangements). Irresponsible behaviour (by both borrowers and lenders) has given birth to this new market. However, this is an “ill wind” which benefits the so-called “IVA-factories”.

The IVA is a legally binding agreement between the debtor and his creditors, which must be set up and administered by a qualified insolvency practitioner. Several companies are in the business, but perhaps the best known is Debt Free Direct. This company floated in 2002 with a value of £9 million and has since achieved a valuation of £176 million. Other competitors growing rapidly are Debtmatters, Accuma and Cleardebt.

Companies running soccer centres and debt consolidation are not alone in their ability to grow rapidly, but investing in such companies is only for those funds which have a remit for a higher level of risk-taking.

Aside from investing in the smaller companies sector, special situations funds will also invest in very large companies, but usually only those which have recently fallen out of favour. Some of these funds are described as “recovery” in preference to “special situations”, the best known of which is the M and G Recovery Fund. This is one of Britain's oldest funds having been launched in 1969. It may be old, but it continues to be agile, with an average annual return of 16.5% since inception. This performance record is dramatically better than the FTSE All-Share Index whose return over the same period has averaged 11.9% per annum.

One additional amazing feature is that the M and G Recovery Fund has been run by only three managers in its 37 year history. Its performance is charted below.



The official employment statistics present a rosy picture of gainful activity in the UK. However, the table below may well reflect a more accurate view of the true size of the labour force.

ECONOMIC ACTIVITY RATES BY AGE AND SEX		
Age	Men	Women
18-24	78.7%	69.7%
25-34	92.0%	75.2%
35-49	91.6%	77.9%
50-64 (M); 50-59 (W)	75.0%	69.1%
65+ (M); 60+ (W)	8.8%	9.8%

(Source: Labour Force Survey estimates from Autumn 2004.)

Official figures from the Department of Work and Pensions reveal that 957,000 people are currently claiming the Job Seeker's Allowance (aka "the dole"). These are joined by 2.7 million on Incapacity Benefit and 777,000 lone parents deemed not to be in "the field of work". Another 314,000 are judged to be in a special disability category, whilst those judged not to be in paid work but instead caring for relatives amounted to 368,000.

Psychological and behavioural reasons are now deemed sufficient to render the sufferers unable to work. This has resulted in a big increase in the numbers on Incapacity Benefit. We now have sub-sectors such as alcoholics (48,620), drug addicts (32,100), and even people categorised under "disorder of scholastic skills" (42,460). The most intriguing ailment, however, appears to be "unspecified mood disorder" (numbering only 5700 at present, but destined to increase in size as it becomes more widely known).

In total the various component groups above amount to 5.29 million people, or 16% of the UK's working age population. This figure is not substantially different from the combined total of 5.8 million reached in 1993 under John Major's government at the height of the Exchange Rate Mechanism crisis. The present government has a stated priority to reduce the number on Incapacity Benefit by one million over the next ten years. Will it happen?

All in all, therefore, it seems inevitable that increasing numbers of people (some of whom will also be investors) will face unwaged periods in the future.

The table on the opposite page indicates the benefit rates payable in various circumstances. It is hard to look at these without forming the conclusion that a much better alternative is the aspiration of financial independence, funded by personal savings. Everyone is vulnerable at some time in their life. When that time arrives it helps to have a financial cushion!

KEY SOCIAL SECURITY BENEFIT RATES

The following benefit rates are effective from April 2006. All amounts shown are weekly benefits.

• The single person's State pension	(£4,381 per annum)	£84.25
• The additional State pension for a spouse	(£2,626 per annum)	£50.50
• Jobseeker's allowance age under 18		£34.60
• Jobseeker's allowance age 18-24		£45.50
• Jobseeker's allowance age 25 and over		£57.45
• Statutory maternity / paternity pay – standard rate		£108.85
• Statutory sick pay – standard rate		£70.05
• Bereavement payment – single lump sum * and **		£2000.00
• Widow's pension / bereavement allowance – standard rate, age 55 and over **		£84.25
• Age-related widow's pension / age-related bereavement allowance age 54 reducing to £25.28 at age 45 **		£78.35
• Widowed parent's allowance		£84.25
• Child benefit for a couple – only, elder or eldest child *		£17.45
• Child benefit – second and each subsequent child *		£11.70
• Long-term incapacity benefit ***		£78.50
• Short-term lower rate incapacity benefit under pension age *		£59.20
• Short-term higher rate incapacity benefit under pension age		£70.05

* *These benefits are tax free.*

** *Bereavement payment / bereavement allowance is available to a man or woman whose spouse dies on or after 9 April 2001.*

*** *Long-term incapacity benefit may be tax free if it replaced invalidity benefit.*

8 Inheritance Tax – A Solution

Recent research has indicated that, on average, people begin their Inheritance Tax planning at age 70. However, for anyone keen to reduce their liability a simple approach exists – one which can dramatically reduce your liability providing it is maintained as a discipline for a long period of time. The additional attraction is that whilst the approach involves diverting income to beneficiaries, the income tax savings they could enjoy may well be double or more the net income which you have forsaken. This is the only arrangement we know of which can deliver three tax savings (IHT, capital gains tax and income tax) simultaneously.

The Big Mistake

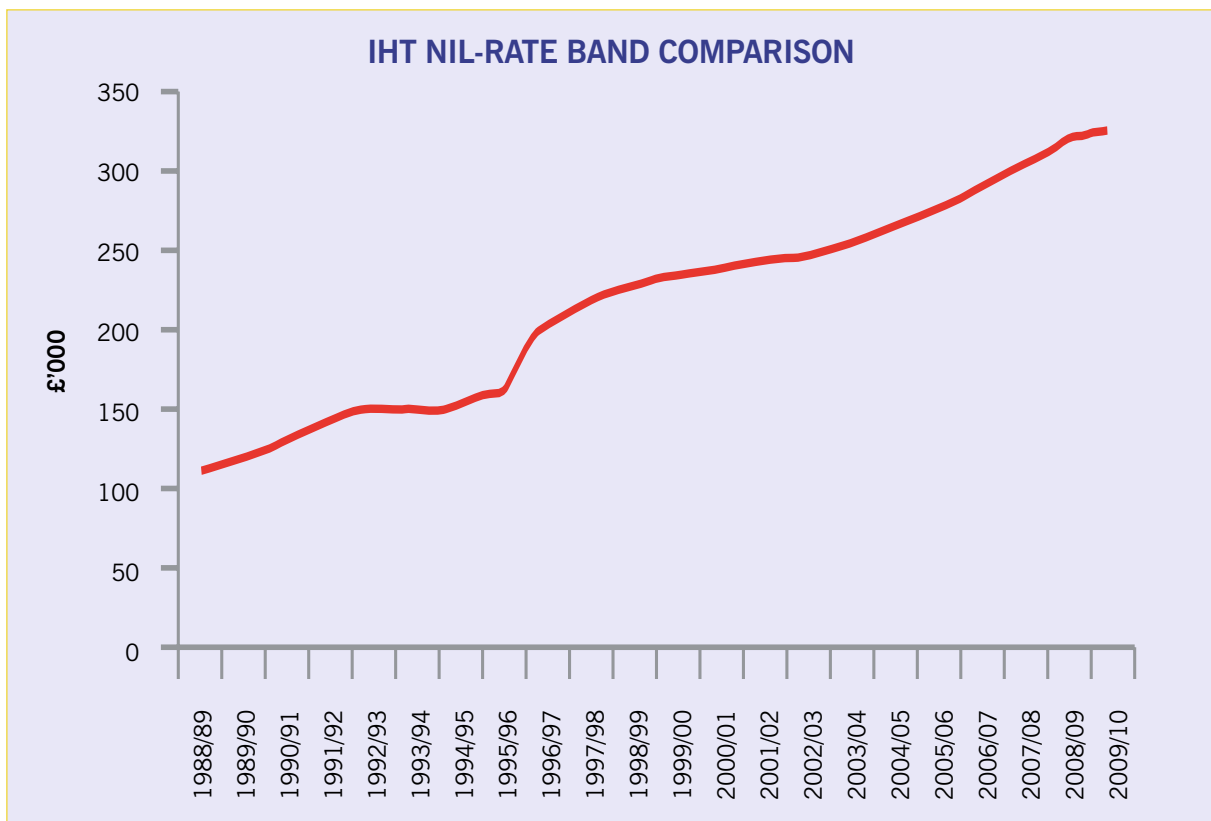
The overwhelming majority of people make one big mistake when planning for Inheritance Tax. They believe that the solutions inevitably require a major personal sacrifice in order to be effective. The equivalent medical analogy is to compare someone taking tablets over (say) ten years to deal with an ailment, whilst another person does nothing and eventually requires drastic surgery. Obviously the former approach is better, but since most people are lethargic the latter solution is more common.

The ISA-Loan Route

Many people assume that they have to reduce the size of their estate in order to eliminate inheritance tax. This requires making gifts, and since people are almost always uncomfortable with this solution they usually resolve to do nothing. If instead they were to concentrate on making loans, (and utilising repayments as tax-free income), their IHT reduction would be painless. Crucially, however, they would retain control.

What makes this strategy even more effective is that if they can prevent their estate growing larger, rising thresholds will reduce their tax liability.

The graph below illustrates the extent to which the IHT “nil rate band” has increased since April 5th 1988. The current level is £285,000 and with effect from April 2009 the starting level will be £325,000.



(Source: Grant Thornton)

Quite simply, if you can pursue a course of action to ensure that your **taxable estate** does not increase then much or all of your problem will disappear over the years. This is most easily achieved by loaning money to your beneficiaries. If the loans are then invested in a tax advantageous way your beneficiaries can create more capital for themselves whilst generating even more spendable proceeds for you yourself to enjoy. The process is as follows.

1. You loan (say) £7000 to each of your beneficiaries. This is supported by a simple written declaration which states that the loans are:
 - a) Interest-free
and
 - b) Repayable on demand
2. Your beneficiary(ies) then invests the funds in an “equity-income” ISA and may elect to take the dividend income each year.
3. You may ask for the loan to be repaid progressively over the years. Under this option the income (ie dividends) from the ISA (which should approximate to 3.5% in the first year and rise thereafter) will gradually, if required, be paid back to you.

Over (say) ten years, with increasing dividends, around half of your original loan will probably have been repaid. However, by that time, if the ISA were to increase by 7.25% a year, the original £7000 investment would be worth £14,000 (ie allowing for the fact that all dividends have been paid out annually).

The overall effect therefore in the above example is as follows.

- a) You will probably have received **more income** (ie net spendable proceeds) than is the case if the investments were made in your own name.
- b) The repayments of the loan are tax-free (ie they are deemed to be the repayment of your capital. As such they are not taxable.)
- c) Your beneficiaries would have a sum of £14,000, of which £10,500 would be their own capital whilst the balance of £3500 remained in your estate.

There are several variations on this theme. For example you could partially and progressively gift some of the loan each year. Again all you need do is write-off an amount and designate that it constituted part of your annual £3000 gift exemption.

Summary

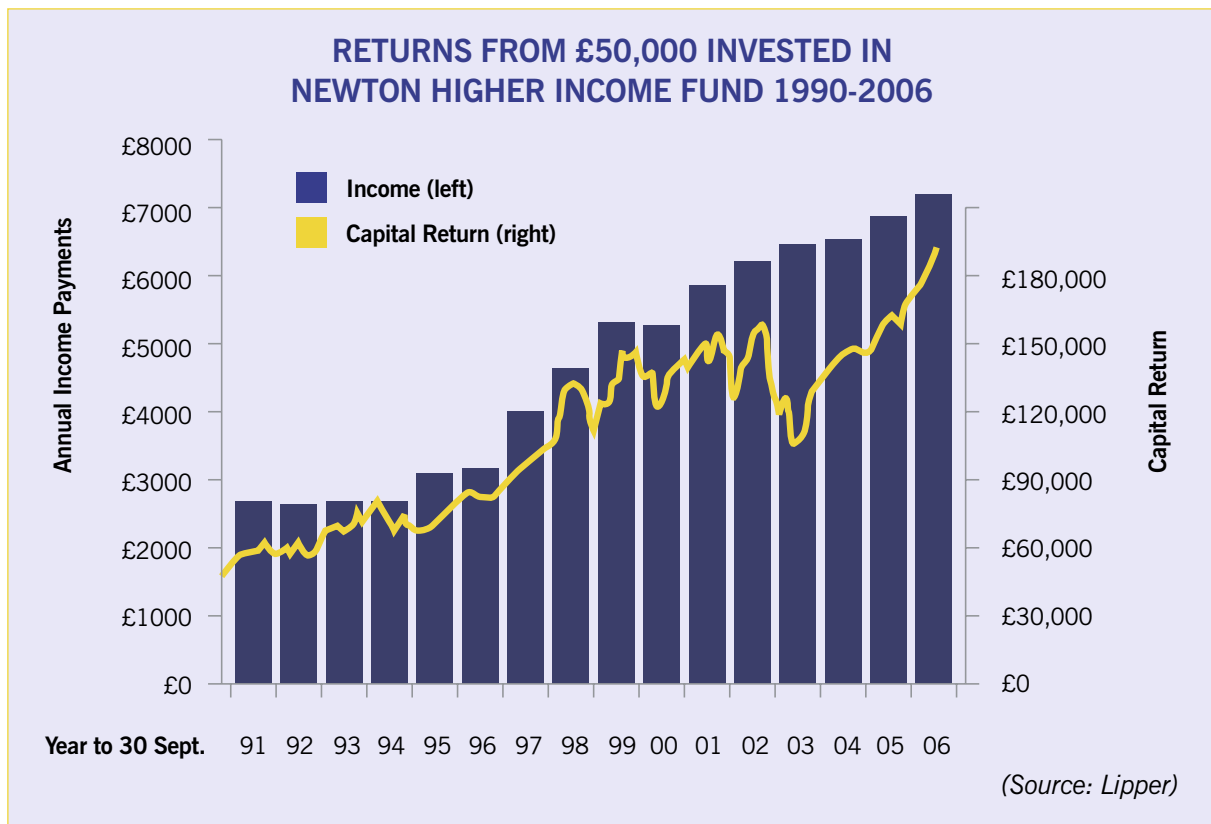
This is a simple scheme which works devastatingly well. Moreover, it is painless and leaves **you** in control. It works particularly well if the donor has a need for extra income.

If you wish to make such an arrangement we can draft the specific loan documentation (but please avoid the busy March period). Call Ian King or Mark Betts for further assistance.

January 1st 2007 sees the dawning of a new era for income-seekers. From this date a radically different investment vehicle (known as the Real Estate Investment Trust) will become available to UK investors. The aim of these arrangements is to deliver a higher income than is available from dividends on shares (ie the equity-income approach). In addition these funds will offer the prospect of long-term capital gains (ie from the various properties they invest in).

Comparing Income Streams

The argument in favour of providing a long-term retirement income based on the dividends of equity-income funds is irrefutable. It is also catching on fast. In 2005 the equity-income sector proved to be the UK's most popular category. The effect of rising dividends can only be fully appreciated in the long-term. There are currently a total of 82 funds in the equity-income sector, each of which is characterised by steadily rising dividends and long-term capital growth. One such fund is the Newton High Income Fund, which has consistently ranked amongst the top 20.

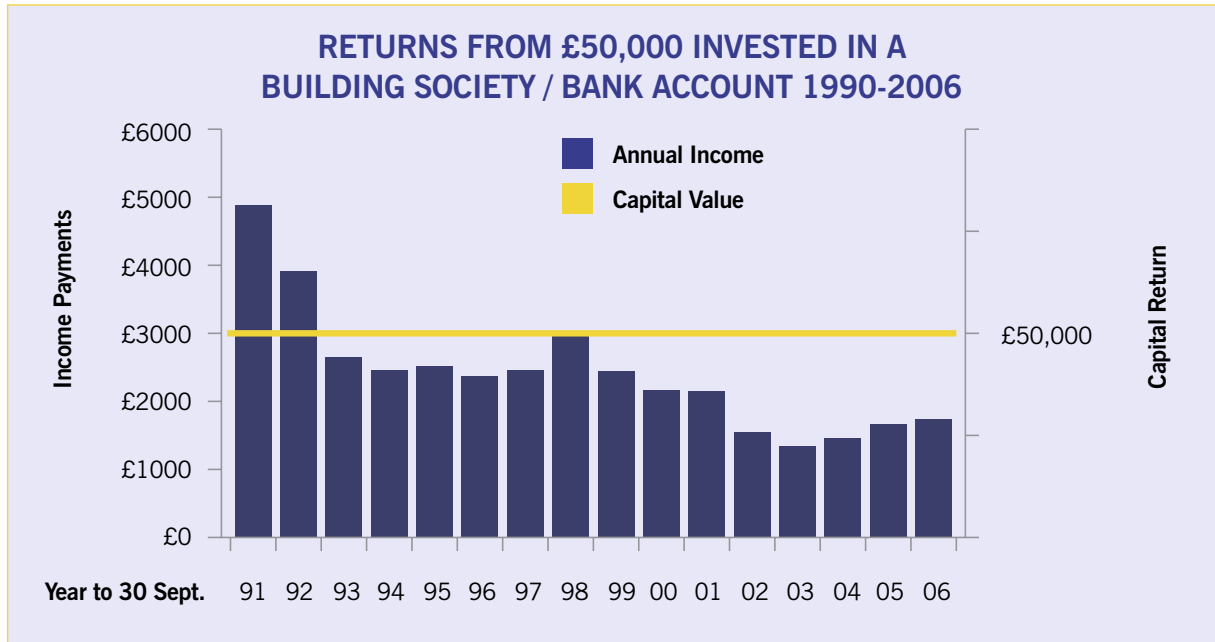


Investors electing to receive an annual income should be aware that the dividends are not guaranteed. This income, and the capital on which it is based, are both likely to fluctuate and may fall in value. This investment therefore contrasts with a Bank/Building Society account where the capital is guaranteed.

(NB. The above capital return assumes non-aggregation of dividends, ie dividends are paid out twice a year to the investor and not therefore reinvested.)

The Newton Higher Income Fund is a good barometer of performance in the equity-income sector. As the statistics illustrate, the annual dividend income from this fund would have (temporarily) fallen in only three years. Over the 15 year period as a whole this income (ie dividends) would have increased almost fourfold. Meanwhile, even if an investor had withdrawn all of this income, his capital would have risen over threefold during the period.

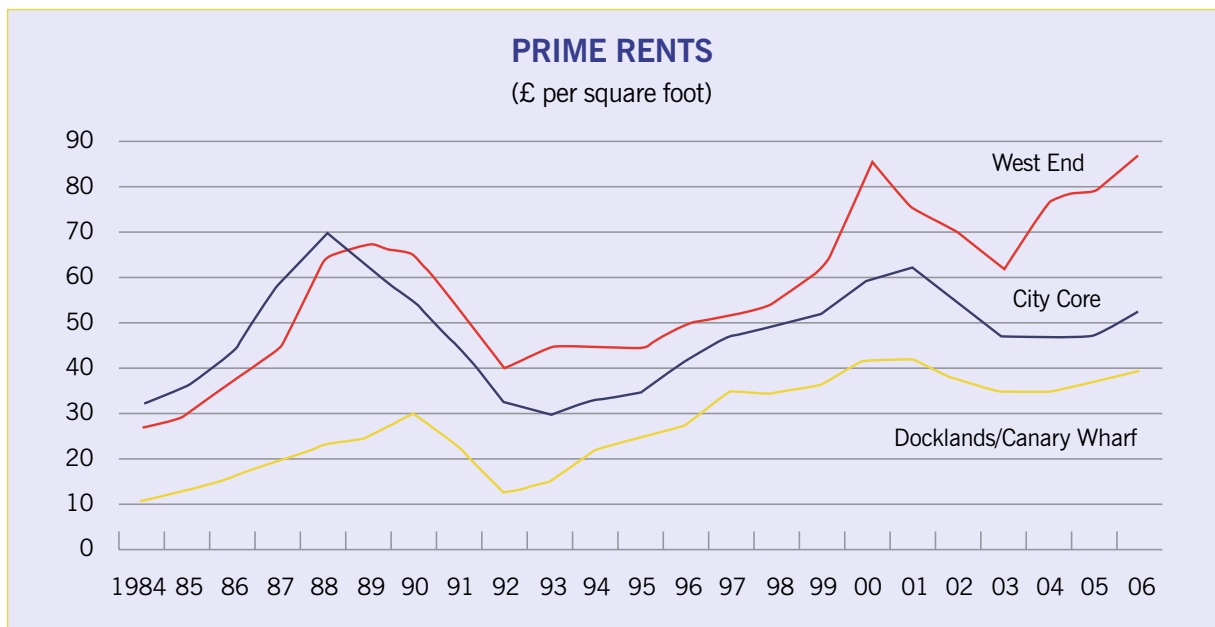
Steadily increasing income and long-term capital growth – this sums up the rationale of the equity-income approach. In comparison, a bank deposit would have provided a much poorer return as the table below illustrates.



(Source: Lipper)

The Rental Alternative

Rental income from commercial property has evidenced a substantial and consistent increase over many decades. However, this increase has not been as great as we have witnessed with equity dividends. This said, the initial yield (ie percentage income) available from such property is likely to be higher.



(Source: Colliers CRE)

Many investors will welcome the arrival of an alternative form of investment. We believe that the Real Estate Investment Trust (REIT) will prove to be an immensely popular arrangement.



Since the ending of fixed exchange rates there have been some unusual changes in the relationship of the World's leading currencies. Obviously the Sterling-Dollar exchange rate is the one of most interest to UK investors, closely followed by the Sterling-Euro rate.

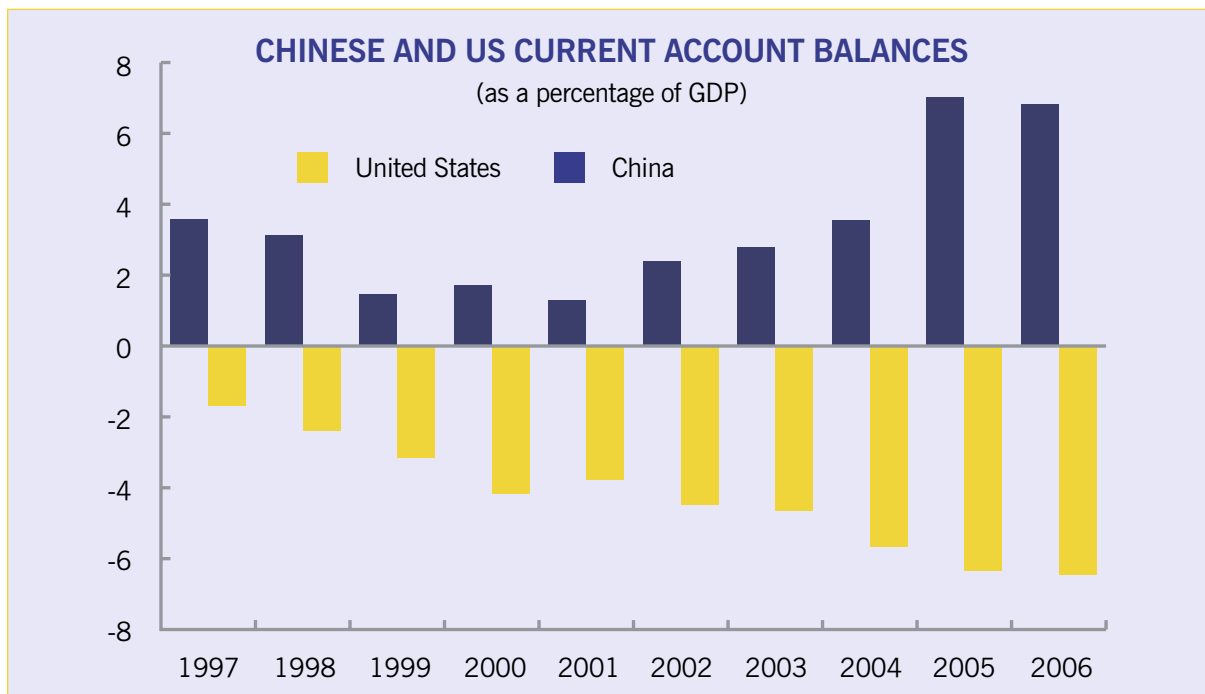
A falling currency usually signifies a weak economy, but some of the changes are so dramatic that it becomes hard to rationalise them. In February 1985 the exchange rate came within 3% of a Pound-Dollar parity. By August 1992 the position was so much different, when the rate exceeded two Dollars to the Pound. Today we are in a similar situation, and investors may wonder what effect a two Dollar-Sterling rate might have.

The Dollar plays a unique role not simply as the currency of the United States but also as the established international reserve currency. The US economy is 6.7 times the size of Britain's, and around the same size as that of the EU. Everyone is aware of the massive budget and trade deficits of the US economy. In the world economy, of course, the books have to balance, so for every excess spender there must be a matching saver. For this reason the USA is currently absorbing 80% of the world's excess savings to fund its deficit (which was 320 billion Dollars in 2005, and will be a similar amount this year).

If a rich man has a large overdraft does this really matter? Only if he cannot pay it back of course. For investors, however, what message does history tell us? The following returns (to Sterling investors) from UK and Overseas equities shows what happened in the aftermath of the previous exchange rate extremes (ie 1985 and 1992).

1985 – 1 POUND = 1.03 US DOLLARS		
	UK Equities	Overseas Equities
1985	20.3%	10.8%
1986	27.5%	37.2%
1987	8.0%	(-8.7%)
1988	11.6%	31.0%
1992 – 1 POUND = 2.01 US DOLLARS		
	UK Equities	Overseas Equities
1992	20.5%	16.8%
1993	28.3%	25.3%
1994	(-5.9%)	1.4%
1995	23.8%	20.1%

One of the main issues continues to be the enormous balance of payments deficit which America has with China. However, these two countries are now so dependant on each other that there is little serious risk of diplomatic conflict, or punitive remedial action.

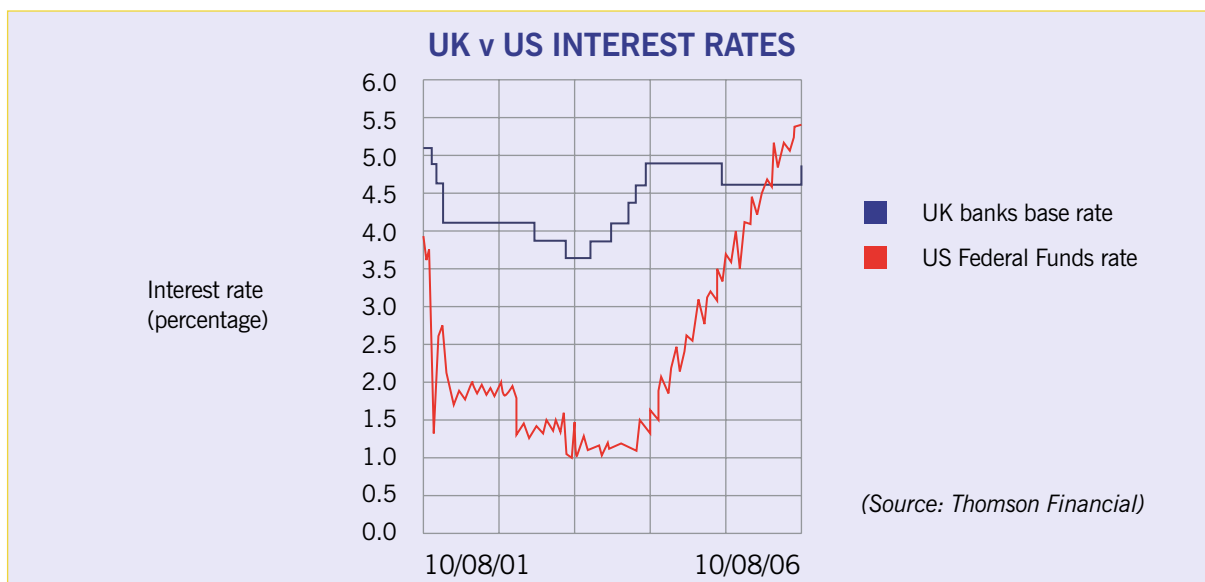


(Source: International Monetary Fund, World Economic Outlook Database, April 2006.)

Big Country – Big Questions

The ability of the US Dollar to withstand the threat to its exchange rate level must, to a certain extent, be governed by the strength of its own economy. The table below suggests that the recent ongoing increases in interest rates have not been sufficient to halt the decline in the Dollar’s value.

During the last ten years, inflation in the United States has amounted to 30% (ie on average 2.66% compound per year), whilst the US economy has grown by 64% (ie an average annual compound rate of 5.1%). Over the past ten years the US stockmarket has returned approximately three times the rate of its inflation.



(Source: Thomson Financial)

Without doubt the expansion of world trade has been the biggest driver of stockmarkets during the last two years. Moreover this phenomenon shows little sign of abating as the table below suggests.

LEADING EXPORTERS AND IMPORTERS IN WORLD MERCHANDISE TRADE 2004

Rank	EXPORTERS	Value	Percentage Share	Percentage Increase Over 2003
1	Germany	912.3	10.0	21
2	United States	818.8	8.9	13
3	China	593.3	6.5	35
4	Japan	565.8	6.2	20
5	France	448.7	4.9	14
6	Netherlands	358.2	3.9	21
7	Italy	349.2	3.8	17
8	United Kingdom	346.9	3.8	13
9	Canada	316.5	3.5	16
10	Belgium	306.5	3.3	20

Rank	IMPORTERS	Value	Percentage Share	Percentage Increase Over 2003
1	United States	1525.5	16.1	17
2	Germany	716.9	7.6	19
3	China	561.2	5.9	36
4	France	465.5	4.9	17
5	United Kingdom	463.5	4.9	18
6	Japan	454.5	4.8	19
7	Italy	351.0	3.7	18
8	Netherlands	319.3	3.4	21
9	Belgium	285.5	3.0	22
10	Canada	279.8	2.9	14

(Source: World Trade Organisation)

NB: The above table illustrates the value of trade in billions of US Dollars. The percentage share refers to the proportion of World exports and imports attributable to individual countries (latest year's statistics – 2004), and the annual increase shows each individual country's increase in trade over the previous year.

The Gradual Transformation

Trade figures tell us much but not everything. Many of the countries listed on the previous page will, in time, be overtaken by the rise in emerging market economies. The tables below provide a snapshot of the key elements in these anticipated changes

THE WORLD'S LARGEST ECONOMIES

2000

USA
China
Germany
UK
France
Italy

2050 (Forecast)

China
USA
India
Japan
Brazil
Russia

(Source: OECD)

The transformation of emerging market economies will not be without problems. India is a good barometer. Today only 28% of its population lives in urban areas, but this percentage is projected to double over the next 25 years. This would mean that today's urban population of 285 million is expected to reach 575 million by the year 2030.

There will be many social problems. The last census (2001) suggested that only 49.7% of India's population had tap-water, and 57.4% sanitation facilities. Cities will grow larger. In 1901 only Calcutta had a population exceeding 1 million. Today there are 35 such cities. Of these Mumbai (Bombay) will reach a 25 million populace within 10 years.

Alongside the social problems, however, will emerge economic solutions. India's projected economic growth is likely to act as a catalyst to the development of many other countries worldwide, including those of the Western World.

The decades ahead promise to be exciting!

The oft-expressed phrase of the national lottery promoters, “you’ve got to be in it to win it”, could just as easily be part of stockmarket folklore. The chart below illustrates the importance of being in the stockmarket (and remaining in it) at all times. In the ten year period to June 28th 2006, the FTSE 100 Total Return Index returned 113%. However, if the ten best trading days were eliminated this return would have fallen to only 35%.



(FTSE 100 Total Return Index. Source: Datastream from 28 June 1996 to 30 June 2006)

The Insignificance Of Volatility

Volatility has always been a feature of the stockmarket. In certain stockmarkets (such as those of the emerging markets) this volatility is experienced in the extreme. However, even in mature and established markets, such as the UK, it is to be expected. This was confirmed during the most recent major fall in share prices, which took place between May 9th and June 13th of this year. During this period emerging market shares fell by 23% whilst global equities in general fell by 9.8% (Sterling terms).

Volatility is the price we must pay in order to obtain a better return on our savings. No-one can be harmed by falling share prices, unless of course they choose to sell when stockmarkets are down.

The Simplest Conclusion

The simplest of all simple questions therefore is whether you are best served with an investment which never (ever) falls in value. Or, alternatively, are you better off opting for an investment which (despite such frequent falls) should deliver a dramatically better return over any decade?

Many investors try to resolve the problem of temporarily falling markets by “timing” their investments. Theoretically, this sounds plausible. In practice, however, it is impossible to predict when, or by how much, share prices will fall. Also, by being outside of the stockmarket for a period of time, these investors are dependant on their ability to be able to return to the market in time to catch the next “upward swing”. The best investment solution is to purchase funds each year. This also works well from a taxation standpoint since the £7000 ISA allowances are made available annually, on a “use it or lose it” basis.

The simplest approach – it is usually the best!



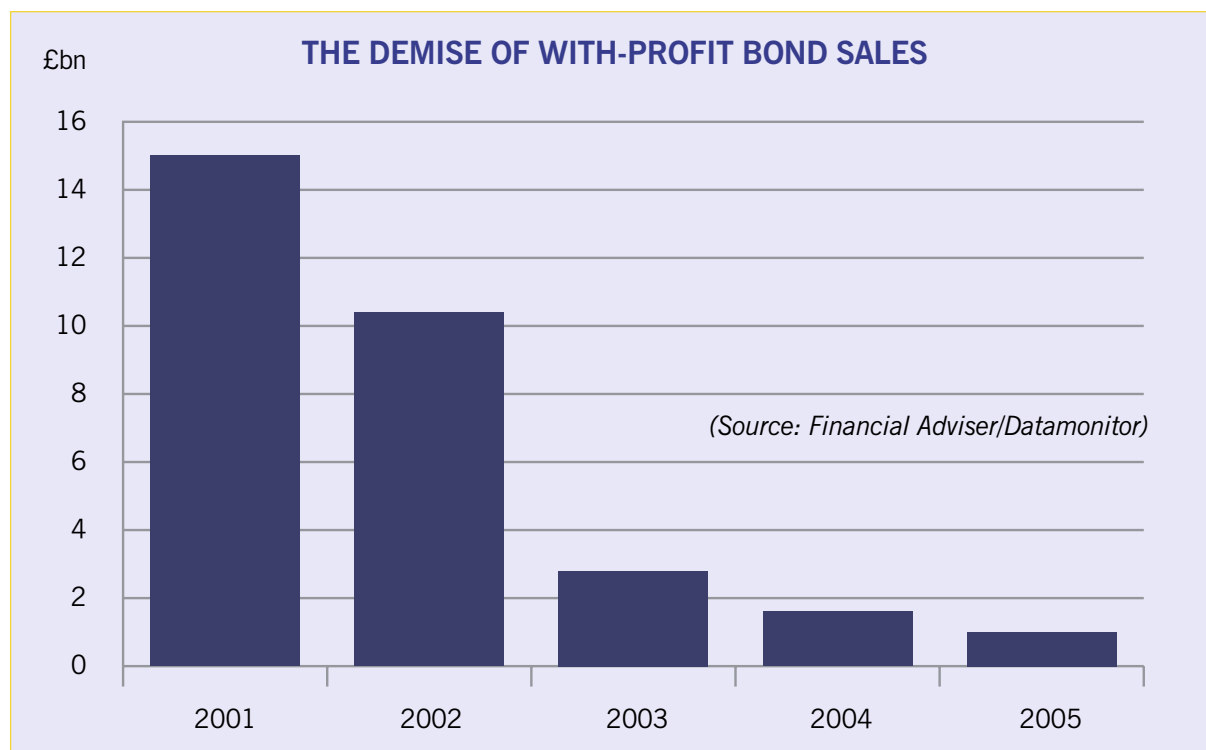
We have always believed that it is our duty as advisors to remain committed to the strategies and arrangements we believe are the best – irrespective of whether or not these are popular. Sometimes holding such views means we decline to accept business. However we would rather lose business than promote a product or strategy we could not endorse.

One such product was the “with-profits bond”. These were sold by the bucketful from the late Nineties to the beginning of the current decade. It is not hard to understand why these products were so popular since, superficially, they had much to offer. Many people came to believe that somehow this was an investment which could not fall in value, yet despite this fact was capable of delivering the kind of returns expected from the stockmarket.

In reality the entire with-profits concept was opaque. Once its mystique started to unravel, following the endowment-mortgage problem, the faultlines became too great to paper over. This will inevitably happen, sooner or later, with any investment which is based on irrational fundamentals. The sad fact is that there are many people who believe that if a product is “easy to sell” then why not sell it?

The extent of this irrationality can be gauged from the fact that by 2001 total sales of with-profits bonds exceeded those of equity-linked ISAs. This made no sense from any standpoint. In particular, the internal tax treatment of bonds was particularly disadvantageous compared to ISAs (and PEPs). This meant that, all things being equal, they could never perform as well as ISAs. In addition, the management charges and commissions were usually much higher. Such technical analysis, however, did not stop these bonds from being sold.

Thankfully today this sad episode has virtually ended, as the table below illustrates.



The simplest of basic realities suggests that the best financial products are those which combine three factors. Firstly, the underlying investment argument must be sound. Secondly, the tax advantages need to be substantial. Thirdly, management charges should be fair, spread annually, and without penalties for early encashment.

When assessed on the above criteria there is no investment product which can approach the ISA (or PEP).

If we turn the clock back 20 years who would have believed that a Russian oil and gas company would become one of the ten largest companies in the world? On the other hand, who would have believed that Ford and General Motors would fail to rank amongst the world's top 500 companies?

The world changes and investors who seek capital growth need to place a greater emphasis on two investment areas; namely the Asian markets and the emerging economies worldwide. The tables below indicate the extent to which large companies in both the Far East and the "emergers" have risen.



Conclusions

The rise of companies in the Far East and "emergers" has been dramatic. Not only do these countries now have 64 companies listed amongst the world's top 500, but when this year's rankings are compared with those of 2005, the growth of these companies can be seen to be frenetic. The same statistical source confirms that there are now 32 British companies represented in the World's top 500. Arguably therefore an investor could restrict himself to a UK "blue chip" portfolio and still enjoy a measure of diversification.

Taking a balanced view of the two arguments set out above, our opinion is that in less than five years time the number of Far East and emerging markets companies will have exceeded 100. We also believe that over the same period the number of British companies featuring on the list will be much reduced.

As to the future prospect of emerging markets, our view is that drivers such as globalisation, strong commodity demand, outsourcing and cheaper manufacturing capacity all remain in abundance. Anyone who is a long-term growth investor should be making a substantial commitment to these growth areas.

LEADING UK / LEADING EMERGING MARKET COMPANIES

	Company	Country	Market Value (bn\$)	World Ranking	
				2006	2005
1.	BP	UK	233.259	5	5
	Gazprom	Russia	196.338	10	58
2.	Royal Dutch Shell	UK	211.279	7	7
	Saudi Basic Industries	Saudi Arabia	175.665	15	22
3.	HSBC	UK	190.316	11	11
	Samsung Electronics	South Korea	107.197	35	52
4.	GlaxoSmithKline	UK	151.854	19	19
	China Mobile Hong Kong	Hong Kong	104.203	38	64
5.	Royal Bank of Scotland	UK	103.450	39	32
	Al Rahji Banking & Investment	Saudi Arabia	91.468	47	191
6.	Rio Tinto	Australia/UK	79.423	61	117
	Petrobras	Brazil	91.217	48	113
7.	Unilever	Netherlands/UK	69.118	79	59
	Saudi Telecom	Saudi Arabia	86.953	55	87
8.	Lloyds TSB	UK	53.497	123	98
	Lukoil	Russia	70.766	76	186
9.	British American Tobacco	UK	50.553	131	140
	Surgutneftegas	Russia	62.778	94	180
10.	Tesco	UK	44.977	146	112
	Vale do Rio Doce	Brazil	54.394	117	155
11.	Diageo	UK	44.630	147	128
	Taiwan Semiconductor Mfg.	Taiwan	48.925	136	139
12.	BG	UK	43.951	149	197
	America Movil	Mexico	43.070	155	167
13.	Carnival	USA/UK	40.613	162	121
	Oil & Natural Gas	India	41.899	158	192
14.	Aviva	UK	33.230	206	200
	Hutchison Whampoa	Hong Kong	39.090	170	151
15.	Standard Chartered	UK	32.405	211	241
	Bradesco	Brazil	33.294	205	475
16.	BT Group	UK	32.150	215	161
	Samba Financial	Saudi Arabia	32.637	209	160

	Company	Country	Market Value (bn\$)	World Ranking	
				2006	2005
17.	SABMiller	UK	29.508	230	345
	Teva Pharmaceutical Industries	Israel	31.956	216	301
18.	Prudential	UK	28.043	247	251
	CNOOC	Hong Kong	31.743	217	254
19.	National Grid Transco	UK	26.954	259	188
	Banco Itau	Brazil	31.031	222	324
20.	Reckitt Benckiser	UK	25.300	279	247
	Saudi Electricity	Saudi Arabia	30.885	223	223
21.	BAE Systems	UK	23.500	312	388
	Sberbank Of Russia	Russia	29.237	232	
22.	Reed Elsevier	Netherlands/UK	22.774	320	230
	Unified Energy System	Russia	29.173	234	
23.	Imperial Tobacco	UK	20.688	365	309
	Kookmin Bank	South Korea	29.045	236	412
24.	Cadbury Schweppes	UK	20.675	366	277
	Singapore Telecommunications	Singapore	27.353	255	218
25.	Xstrata	UK	20.439	373	
	Korea Electric Power	South Korea	26.939	260	366
26.	Old Mutual	UK	19.147	399	
	Ambev	Brazil	26.459	266	313
27.	Scottish Power	UK	18.874	402	433
	Sasol	South Africa	25.746	273	391
28.	Centrica	UK	17.655	439	377
	Hon Hai Precision Industry	Taiwan	25.392	277	436
29.	British Sky Broadcasting	UK	16.934	458	278
	Etisalat	UAE	25.320	278	138
30.	Scottish & Southern Energy	UK	16.890	461	437
	Reliance Industries	India	24.898	284	341
31.	GUS	UK	16.059	490	348
	National Thermal Power	India	24.792	286	382
32.	Legal & General	UK	16.024	492	447
	Cheung Kong	Hong Kong	24.550	291	283

	Company	Country	Market Value (bn\$)	World Ranking	
				2006	2005
33.	Cemex	Mexico	24.432	294	491
34.	Sun Hung Kai Properties	Kong Kong	24.388	297	259
35.	Wal-Mart de Mexico	Mexico	22.762	321	401
36.	POSCO	South Korea	22.477	326	344
37.	Saudi British Bank	Saudi Arabia	21.778	339	477
38.	Boc Hong Kong	Hong Kong	21.255	351	299
39.	Riyad Bank	Saudi Arabia	20.931	359	422
40.	Tenaris	Argentina	20.881	360	
41.	Banco Brasil	Brazil	20.726	362	
42.	Tata Consultancy Services	India	20.621	367	406
43.	CEZ	Czech Republic	20.583	368	
44.	MMC Norilsk Nickel	Russia	20.171	376	
45.	Amtel	Mexico	20.169	377	
46.	Anglo Platinum	South Africa	19.836	387	
47.	Hyundai Motor	South Korea	19.763	389	
48.	Standard Bank	South Africa	18.611	407	464

	Company	Country	Market Value (bn\$)	World Ranking	
				2006	2005
49.	Infosys Technologies	India	18.362	414	476
50.	Firststrand	South Africa	18.217	418	
51.	Chunghwa Telecom	Taiwan	18.193	419	294
52.	Banque Saudi Fransi	Saudi Arabia	18.088	422	
53.	Wipro	India	17.868	430	
54.	Bharti Tele-Ventures	India	17.544	443	
55.	PTT	Thailand	16.828	463	454
56.	MTN Group	South Africa	16.622	469	
57.	ITC	India	16.427	472	
58.	Turkiye Is Bank	Turkey	16.389	474	
59.	Etihad Etisalat	Saudi Arabia	16.372	475	485
60.	SK Telecom	South Korea	16.300	476	450
61.	Formosa Petrochemical	Taiwan	16.130	482	350
62.	LG Philips LCD	South Korea	16.129	483	439
63.	Shinhan Financial	South Korea	16.081	488	
64.	Woori Finance Holdings	South Korea	16.010	494	

Emerging Or Submerging?

Cynics will always have their say and inevitably it was not long before the expression “submerging markets” entered the investment lexicon. No serious observer of the emerging markets sector would ever doubt that such investments can fall dramatically. However, as we have always emphasised, **this is only a problem for those who choose to sell when the market is down.**

Education Meets Opportunity

When education meets opportunity the effect can be dramatic. India, for example, has the largest middle class in the entire world – 250 million of so people who are educated, entrepreneurial and energetic. On top of all this, they also form the potential market for many of the consumer goods India is beginning to produce.

In Russia, the drama is somewhat different. During the last seven years the average income of Russians has increased more than fivefold (in Sterling terms). Investors can ignore the evidence if they wish, but the message (to us) is crystal clear. Cynics might state that this is simply the government exercising a “wage explosion” policy. During the same period however Russia’s foreign debt has halved, whilst its GDP increased fivefold. These wage increases are based on solid economic progress and represent real wealth.

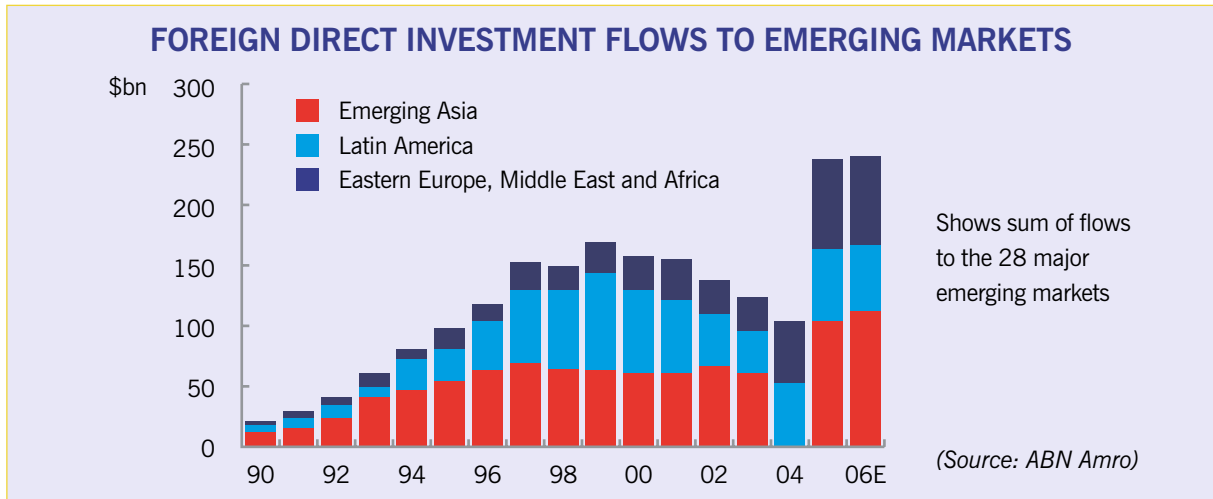
You cannot look anywhere without seeing clear evidence of the rise of emerging markets. In our opinion, investing in emerging markets will deliver long-term returns which are greater than those of the alternatives.



Prospects

Extreme volatility has always been a feature of emerging markets. However, since the sharp correction in May and June, we have witnessed considerable resilience in share prices.

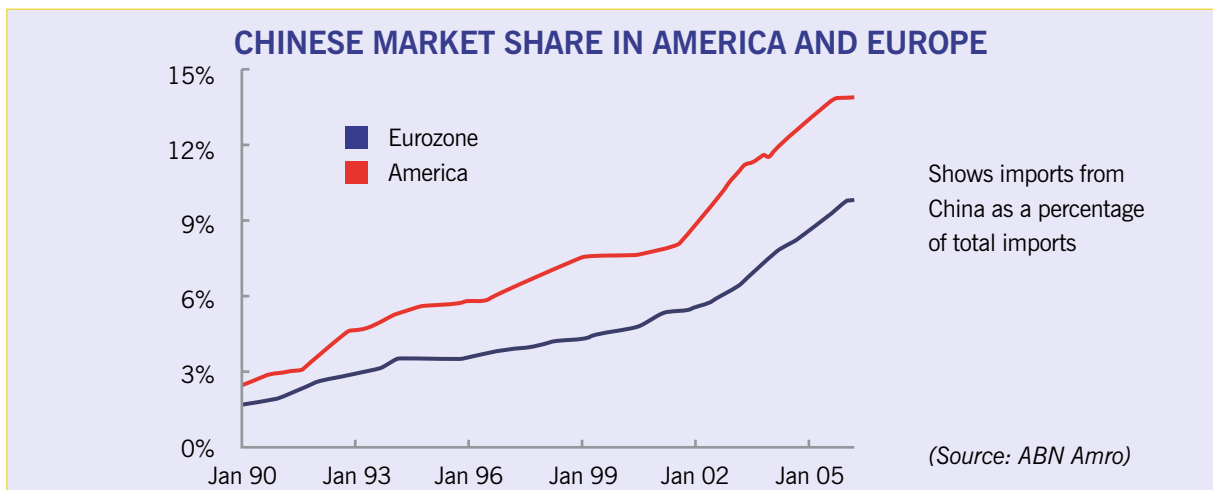
When comparing emerging markets with western stockmarkets since 1998 we have seen an average outperformance of 12% per annum. Our firm belief is that this outperformance will continue. In the final analysis however, it is the weight of money which determines whether share prices rise or fall. In this connection the bar chart below illustrates the dramatic increase in money flowing into emerging markets over recent years.



What adds impetus to globalisation is the outsourcing approach of American and European companies. This has had the effect of reducing costs, raising margins and increasing returns for investors.

Globalisation will probably remain the main source of economic growth in the emerging world. New realities are reinforcing the argument. For example China has now surpassed the USA as the largest export market of the majority of other Asian countries. Separately, for commodity-exporting economies (such as most Latin American countries) China's appetite for raw materials has provided an opportunity to develop exports and improve their balance of payments. Brazil has been a major beneficiary of this process, with its current account in surplus, domestic interest rates down and foreign investment substantially up.

The flow of funds into emerging markets has never been greater, and it has not been negatively influenced by the recent set-backs. Clearly however, much depends on China, but with its import growth set to continue at this year's level of 20%, commodity exporting countries and the open Asian economies should continue to thrive.



Globalisation, global liquidity and China's insatiable demands should together help emerging markets weather the anticipated reduction in global economic growth. With the economies of the G7 nations projected to hit a cyclical low point next summer, emerging markets could well begin to rise again in 2007.

We are all open to influence. In most respects this is not a bad thing since, at the very least, it suggests we are open-minded. But what about sub-conscious influence? This is harder to deal with, principally because, by definition, we are often unaware that it exists.

During the last tax year, investments into ISAs reached the highest level of their seven years existence. The total amount invested exceeded £31 billion, representing in total 12 million ISA accounts.

Half A Loaf?

The above statistics suggest that investors have fully received the message, but on closer examination it might be more accurate to presume that they have listened to only half of it. Quite simply, people appear to fully appreciate that, all things being equal, saving taxation is a worthwhile planning pursuit. What they appear to be less confident about is the investment argument in favour of equities.

A breakdown of the statistics suggests a clear pattern of investor-psychology. Out of £31 billion invested in ISAs during the last year, £21.8 billion (ie over 70% of the total) was invested in “cash-only ISAs”. Only 3 million people invested in “stocks and shares ISAs”, and of these around half elected the mini-ISA route (which probably indicates that they also arranged a cash-ISA allocation in tandem).

Personal Experience v. Irrefutable Statistics

So, why do the majority of these investors avoid the stockmarket? Who knows, but the majority would probably say that they have insufficient confidence in this system to commit themselves fully to this form of investment. It is intriguing to speculate why this view is so widely held.

The simplest conclusion is that people place a greater reliance on personal experiences than irrefutable statistics. Is this logical? Supposing you had a personal friend who crossed the road and got knocked over by a bus. Having thought about this, you might well form one of two conclusions. Firstly, you could take the view that what happened to your friend should influence your own willingness to cross the road. Alternatively, you could take the view that statistically your chance of coming to harm when crossing the road was proven to be infinitesimal.

So it is with investments. Statistics are far more reliable than the personal experience of any single individual. Looked at another way, historical returns are the sum total of every investor’s personal experience, averaged out.

Decades Of Success

The Eighties decade was indeed a golden one for unit trust investors. So were the Nineties. However, the first decade of the new Millennium has witnessed considerable mayhem for equity investors. Without doubt, many people have had their confidence shaken, and some may even be wondering if it is now worth investing in the stockmarket.

However, despite the fact that the first three calendar years saw falls in the stockmarket, the returns over this decade exceed those of a bank deposit investor. It seems that even when times are bad, investors who commit themselves to the stockmarket continue to be rewarded.

We would always encourage our clients to make use of independent sources of investment statistics. For many people the most easily accessible and “user-friendly” of these is to be found in the various consumer finance magazines such as Bloomberg Money, Money Management and Money Observer. Looking at these statistics is the best antidote for periods of falling prices.



We live in the (so-called) age of information. Without doubt the speed of readily accessible information can be beneficial.

Some clients now download individual fund reports. For the minority of investors who do this, it can be a rewarding experience. Unfortunately, many people experience difficulty in comprehending the jargon which the investment professionals use in these publications. For those clients who do use the reports a summary and definition of the most frequently used terms is set out below.

GLOSSARY OF TECHNICAL TERMINOLOGY

ALPHA

A measure of the portfolio's expected return when the benchmark produces no movement.

ANNUAL VOLATILITY

Volatility is one measure used to assess the risk of a portfolio as it helps to describe the likely range of returns achieved by the fund. In statistical terms it is the standard deviation of the return distribution. Greater volatility of monthly Net Asset Value returns means that there is a wider range of likely returns in the future, or greater uncertainty regarding the fund return. Most investors would equate this greater uncertainty with greater risk. Gearing will have an impact on the volatility of an Investment Trust.

BENCHMARK COMPARISON

Comparison of the investment performance is made with the benchmark. The benchmark is a recognised index of stocks which should not be taken as wholly representative of the fund's investment universe. The fund investment strategy does not follow or track this index and therefore there may be a degree of diversity in the performance from the main index stated.

BETA

The amount the fund is expected to gain or lose when the benchmark moves by one unit. (It takes account of the relative risk of the Fund as well as the correlation of movements between the Fund and the benchmark.)

CORRELATION

Measures the coincidence of movement that occurs between the Fund and the benchmark. (Correlation coefficients can take values from +1 to -1. Correlation of +1 would indicate that the two portfolios move in perfect unison. A correlation of zero would indicate no relationship between the two. A negative correlation would indicate that they move in opposite directions.)

EQUITY GEARING

Total portfolio less non-risk securities and liquidity stocks divided by net assets and excluding any effects of performance fee and revenue reserve accruals where applicable.

GEARING RANGE

Indication of the maximum and minimum percentage by which a trust may be geared.

INFORMATION RATIO

The information ratio is calculated by dividing the excess average annualised return of the fund by its tracking error and measures the relationship between excess risk and relative return. The higher the ratio, the better, as it shows that the risk taken by the fund manager relative to the benchmark has been rewarded. Gearing will have an impact on the information ratio.

MAXIMUM DRAWDOWN

The greatest loss that could have been experienced by an investor over the entire review period.

MEAN ANNUAL RETURN

An arithmetic average (mean) of the monthly returns during the review period, multiplied by 12.

R SQUARED

Measures the degree of explanation that can be made about movement in the Fund by a movement in the benchmark. A value of 100 equals 100% explanation.

REDEMPTION YIELD

Annual percentage return on the current share price (from Capital and Income) from now until the wind up date assuming growth rates in total assets and dividends are those shown.

RELATIVE RISK

The risk of the Fund measured in relation to the benchmark's risk which has a value of 1.00. (Calculated by dividing the volatility of the Fund by that of the benchmark.)

RISK ADJUSTED PERFORMANCE

The difference between the Fund and the benchmark return where the benchmark's return has been adjusted to the level of risk of the Fund. It is thought of as a measure of "value-added" by a manager.

SHARPE RATIO

A measure of the annual excess return divided by the annualised standard deviation of returns of the benchmark. (Excess returns are those in excess of the risk-free rate of return.)

TOTAL EXPENSE RATIO

Management fees and all other operating expenses (including tax relief, where allowable, but excluding interest payments and commissions which are treated as a separate capital item) expressed as a percentage of average net assets over the year. This calculation is based on the financial year end data and is updated annually.

Overview

In all of this, there is of course a real danger that investors could lose sight of what should be their priority – effective financial planning. When knowledge becomes so precise that its range is analogous to the circumference of a pinhead, then its relevance has to be questioned.

We take care to ensure that our literature is designed to impart the right amount of knowledge in the most consumer-friendly way. We know from experience that when people encounter difficulties in understanding something the typical response is to ignore it.

Financial planning at its best focuses on an overview of an individual's affairs. An exercise of this nature, by definition, will necessitate the interaction of many different facets of that individual's affairs (principally those of taxation and investment).

Knowledge is power, but relevant knowledge is the aspiration of a wise investor.

All opinions expressed are those of Individual Savings Accounts Limited (the promoters and publishers of this booklet).

Remuneration Declaration

In our capacity as independent financial advisors we are entitled to receive commissions on investments entered into through this publication. However, in line with our usual practice we have waived all initial commissions on investments made via this promotion. This enables you to receive a discount on each fund purchased.

We are also entitled to receive the standard annual commission of 0.5% on the value of each of the funds quoted in this publication. This is paid out of the annual management charge of the unit trust/OEIC, and does not therefore constitute an extra charge to the investor. If you elect to make an investment via either Cofunds or Fidelity Funds Network, our sole remuneration will, therefore, be 0.5% p.a.

Restrictions and Regulations

The information contained in this publication is intended to enable investors to make their own decisions. If you require further information in respect of any of the products mentioned then please telephone us. Please be aware, however, that we cannot offer personal advice and if you are uncertain as to the suitability of any product offered, it may be advisable for you to obtain independent advice (elsewhere) on a "face to face" basis. Cancellation rights are not applicable to applications made via this promotion. Individual savings accounts are long-term investments, and if you withdraw your investment in the early years you may suffer a loss. The value of shares, and the income from them, may fluctuate or fall. Past performance is not necessarily a guide to the future. The value of any tax relief conferred by ISAs and PEPs is dependant on the investor's tax position. Levels, bases of and relief from taxation are all subject to legislative change. The 10% dividend tax credit ceased to be available in April 2004 (but not the freedom from taxation on capital gains or gross interest). Yields are variable and neither capital values nor income are guaranteed. This publication has been issued by Individual Savings Accounts Limited. Our FSA authorisation references are 125686 and 188474.

Where companies have adopted the OEIC system, during the last eight years, any performance statistics quoted represent the unit trust return (up to the date when the funds ceased to be operated as unit trusts) and the OEIC return thereafter. Unit trust statistics are in all cases quoted in accordance with the guidelines of the FSA, and the OEIC returns are quoted to reflect a similar position.

Group Structure and Approach

Individual Savings Accounts Limited is an "information and discount broker" specialising in ISA investments. The company operates in association with The PEP Shop Limited, which pioneered the discount-marketing of PEPs in 1992. Both companies are appointed representatives of Expatriate Advisory Services Plc who are regulated by the Financial Services Authority. The group structure therefore includes three financial services companies each dedicated to a particular market. All companies are registered at, and operate from 16 High Street, Kegworth, Derby DE74 2DA.

We are independent financial advisors, and as such our advice is required to be uncompromised and impartial. However our approach is to provide information on products rather than advice to individuals. In this way we eliminate both the time and expense associated with "personalised" advice. This service is governed by the direct offer advertisement rule (where clients purchase an investment which we have promoted in our literature). Alternatively, if a client requests us to arrange the execution of an investment which he himself has independently researched and selected, this is deemed to be "execution-only".

