



Welcome to the latest edition of our newsletter, our update on developments in the world of financial services.

If you have any questions about the issues raised in this issue, please do not hesitate to contact us.

How to build a portfolio

The word 'portfolio' is the shorthand term for the collection of investments you own across all your accounts - from pensions to bank deposits. Ideally, this will be spread across a variety of assets - equities, bonds, property and cash - and the mix will have been determined by your specific objectives and attitude to risk.

Ultimately, a portfolio's success is dependant on its performance – but one investor's idea is never the same as the next. Your needs are highly personal and your portfolio needs to reflect that. Risk is key to helping determine which asset classes you select and in what proportion. For example, cash provides security of capital and the interest it earns provides you with a regular income. However, those income payments are generally quite low and change in line with interest rates. There is also no opportunity for capital growth.

At the other end of the risk scale are equities – that is, shares in a company that allow you to participate in its growth and profits. Equities generally offer greater long-term opportunities as a successful company will increase its dividends and capital value as it increases its profits. However, unlike cash, equity prices are volatile and vulnerable to both short-term changes in market sentiment and consumer downturns. Ultimately, if things go very wrong for a company, you may end up getting back less than you originally invested - or nothing at all if that company goes bust.

Deciding how much of your portfolio goes into each asset class is known as asset allocation. Perhaps surprisingly, different asset classes tend to perform in different ways, even when the background conditions are constant - but this lack of correlation can be used to your advantage. Rather than choose just one asset for all your money and take your chances on it being the right one, you can instead put a little bit into each. In this way, at least some of your money will be performing the best it can all the time - and this diversification helps to smooth out those bits which are not performing quite so well.

Investment is a long-term decision but, given these caveats and knowing the short-term risks, a good portfolio should generate the maximum possible return for your attitude to risk. To ensure you get that risk decision right, and don't get taken by surprise in a downturn, it's a good idea to talk over your options with an expert.

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Inflationary pressures rise

UK interest rates have remained at their all-time low of 0.5% for an entire year. The UK has crept tentatively out of recession and the Government and monetary policymakers are anxious to do nothing to derail the economy's fragile recovery.

However, the rate of inflation reached 3.5% during January, compelling Governor of the Bank of England (BoE) Mervyn King to write an open letter of explanation to the Chancellor of the Exchequer. King believes the rise is a "temporary deviation" and expects inflation to fall below its Government-set target level of 2% in the second half of 2010.

Even taking King's explanation for the sudden rise in prices into consideration, it is worth remembering the rate of inflation has almost doubled in two months, running at 1.9% during November and rising to 2.9% during December. Only a few months ago, deflation seemed a more credible risk. In normal circumstances, the BoE would increase the cost of borrowing in order to cool inflation. However, rates are unlikely to rise in the short term because policymakers fear higher interest rates could endanger the UK's economic recovery.

Low interest rates are generally good news for borrowers, but are bad news for savers, who have already endured a year of exceptionally low interest rates. Returns on cash are meagre and high inflation is eroding the real value of cash. Looking ahead, Britons face the combined problems of high inflation and rising taxes, both of which will put additional – and unwelcome – pressure on disposable income.



Reaching your goals

Investors are generally either income-seekers or growth-seekers but, whatever your aims, it is important to set them out and understand your attitude to risk as these decisions will form the basis of the investments you make. There is a relationship between the amount of risk taken and the amount of potential return but, to ride out short-term ups and downs, you need to take a long-term view. So the decisions you make about a pension – which might have a 35-year lifespan – will be different to those of, say, an inheritance which you want to spend in less than five years. Put the latter in the wrong place and you risk losing a lot of what you have been given.

Taking a chance

The first Premium bond draw was held in 1957 and the top prize was then £1,000. Today, over £40 billion is held by investors – and prizes range from just £25 to a monthly jackpot of £1 million, making them an attractive option for those who like the idea of no loss* gambling. Premium bonds cost £1 each, and investors can buy as few as 100 or as many as 30,000. The prize fund is then calculated by using the current interest rate on the entire fund and allocating this proportionally across the different prize levels.

*Because the draw is then based on chance, whilst your capital is always safe, there is no guarantee you will receive any income. However, if you do win, the full value of any prize you receive is tax free.

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