

**THOMAS
MILLER**
INVESTMENT

QUARTERLY REVIEW

October 2009

Tradition with Innovation

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Market Movements

Year to 30th September 2009

FX	30/09/09	30/09/08	% Change	52wk High	52wk Low
GBP/USD	1.602	1.780	-10.03	1.779	1.351
EUR/USD	1.464	1.407	4.11	1.484	1.233
USD/JPY	89.680	106.190	-15.55	106.29	87.120
USD/CNY	6.826	6.846	-0.29	6.895	6.804
EUR/GBP	0.914	0.790	15.71	0.98	0.769

BONDS	10 Year			5 Year			2 Year		
	30/09/09	30/09/08	CHANGE	30/09/09	30/09/08	CHANGE	30/09/09	30/09/08	CHANGE
US	3.305	3.823	-0.52	2.312	2.979	-0.67	0.945	1.960	-1.02
UK	3.592	4.449	-0.86	2.635	4.201	-1.57	0.882	4.012	-3.13
Germany	3.220	4.015	-0.79	2.401	3.768	-1.37	1.265	3.476	-2.21
Japan	1.301	1.472	-0.17	0.601	1.054	-0.45	0.250	0.764	-0.51

EQUITIES	30/09/09	30/09/08	% Change	52wk High	52wk Low
Dow Jones	9,712	10,851	-10.49	10,883	6,470
S&P 500	1,057	1,166	-9.37	1,167	667
NASDAQ	2,122	2,092	1.46	2,168	1,266
FTSE - ALL SHARE	2,635	2,484	6.08	2,665	1,756
FTSE 100	5,134	4,902	4.72	5,190	3,461
DAX	5,675	5,831	-2.67	5,877	3,589
NIKKEI	10,133	11,260	-10.01	11,457	6,995
Hang Seng	20,955	18,016	16.31	21,930	10,676

COMMODITIES	30/09/09	30/09/08	% Change	52wk High	52wk Low
Gold	1007.65	875.54	15.09	1024.28	682.41
Oil	70.61	100.64	-29.84	102.84	32.40
S&P GS AIG Soft	552.81	694.81	-20.44	694.81	475.37
S&P GS Ind Metals	1467.50	1644.58	-10.77	1644.58	853.25

CASH	12 Months LIBID			6 Months LIBID			3 Months LIBID			1 Month LIBID		
	30/09/09	30/09/08	CHANGE	30/09/09	30/09/08	CHANGE	30/09/09	30/09/08	CHANGE	30/09/09	30/09/08	CHANGE
US	1.265	4.325	-3.06	0.625	5.000	-4.38	0.475	5.125	-4.65	0.335	4.900	-4.57
UK	0.975	6.425	-5.45	0.625	6.325	-5.70	0.600	6.225	-5.63	0.445	5.975	-5.53
EURO	1.200	5.550	-4.35	1.000	5.355	-4.36	0.695	5.250	-4.56	0.410	5.000	-4.59

MPC
0.50

Fed
0.25

ECB
1.00

Source: Bloomberg

THOMAS MILLER INVESTMENT APPOINT NEW CHIEF INVESTMENT OFFICER



Mike Balfour

Thomas Miller Investment (TMI) has appointed Mike Balfour as Chief Investment Officer.

TMI, which has a total of 50 staff across offices in London, the Isle of Man and Edinburgh, originally served only the mutual insurance and captive insurance companies managed by the Thomas Miller Group, but in the last five years TMI has provided innovative independent investment solutions for businesses from outside the Thomas Miller Group.

Paul Neagle, TMI's Chief Executive, said: "Mike's appointment is key as we continue to move towards being seen as an established participant in the mainstream asset management sector, rather than simply as an in-house operation.

"We were already earning a reputation for success in the institutional investment marketplace, and our acquisition of the business of Singer & Friedlander Investment Management (IOM) Ltd last year enabled us to establish a firm foothold in the private wealth sector. We currently have approximately US\$3.8bn of assets under management, of which around half is generated from external clients and half from the in-house businesses, and it is our intention to become a leading player in the sector.

"Our investment management business has grown significantly over the last five years and Mike's experience adds to an already well established management team and investment process. His arrival will help us take the business to the next level."

Mr Balfour was Chief Investment Officer at Edinburgh Fund Managers until 2001, and then Chief Executive of Glasgow Investment Managers, and became a high-profile member of the industry.

He said: "I am very excited about joining Thomas Miller Investment. I did not want to return to the industry until I had found the right job, and this is it. TMI is a firm with an excellent reputation. The organisation has grown over the past 30 years as a firm devoted to working side by side with clients, and there is enormous potential for continuing to take that out into the wider marketplace."

Mr Balfour replaces Brian Sheppard who is due to retire from the Thomas Miller Group in 2010 after more than 30 years' service in London, Bermuda and the Isle of Man.

THOMAS MILLER INVESTMENT (ISLE OF MAN) LIMITED MAKE KEY SENIOR APPOINTMENTS



Rosie Rowlands
Business Manager



Mark Moran
Operations Manager

Mark Moran and Rosie Rowlands have been appointed to senior positions within Thomas Miller Investment (Isle of Man) Limited (“TMI”).

Both join from HSBC Securities Services (Isle of Man) Limited and bring with them a wealth of experience. Mark was Vice President - Global Process Champion and was involved in the research and implementation of controls and procedures to achieve efficient processes, whilst Rosie was Financial Controller and previously Senior Business Analyst.

The appointments are new strategic roles for TMI and demonstrate the company’s strong commitment to and ongoing confidence in, the Isle of Man and its economy.

Mark, commenting on his role as Operations Manager said, ‘TMI has grown significantly over the past few years and is now a major player in the Investment Industry. However, there is still an enormous potential for expansion and I believe that my experience and skills will help to ensure that this potential is fulfilled.’

Mark holds an HND in Business Administration from the Isle of Man College and is a member of the Securities Institute.

Rosie will undertake the role of Business Manager and stated, ‘I am extremely pleased to be joining a firm like Thomas Miller Investment with its established reputation for integrity & tradition but most importantly it’s emphasis on providing a peerless investment service. To join the company at such an exciting time is a fantastic opportunity and a challenge that I am greatly looking

forward to.’

Rosie has over 20 years experience in the Banking and Accountancy industry and is currently studying to become a member of the Association of Chartered Certified Accountants.

John Greenwood, Chief Executive Officer of the Isle of Man office commented: ‘We are delighted to welcome such high calibre staff to the team. The last year has been a challenging but successful one for us. The experience that Rosie and Mark bring in developing and managing internal control and reporting systems, as well as team management, will assist TMI in further enhancing our level of client service and relationship management.’ He added, ‘we have a long standing reputation in the institutional marketplace and our acquisition of part of the Investment Business Book of Singer & Friedlander Investment Management (IOM) Ltd in October last year enabled us to successfully enter into the Private Wealth sector. These two appointments will assist the team in continuing to ensure that our client focused reputation is carried forward in all aspects of our service.’

ECONOMIC REVIEW

Global Equities – A ‘Sugar High’ or the ‘Real Deal?’



David Thomas
Senior Portfolio Manager

‘If past history was all there was to the game, the richest people would be librarians’

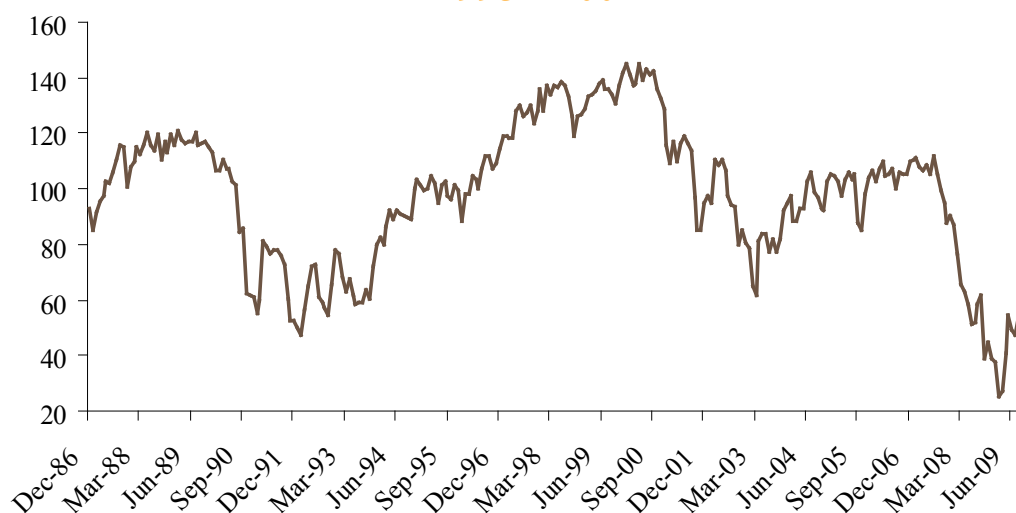
Warren Buffet.

The third quarter has seen further impressive gains for equity markets, spurred on by continued encouraging signs that global economies have bottomed and that a meaningful turn-around is imminent. Such is the extent of the rebound, that the S&P 500, for example, has achieved its best back-to-back quarterly performance since 1975, whilst the FTSE 100 Index had its largest quarterly gain ever (since its inception in 1984). Hence, most major developed equity markets are now up, on average, around 16% in local currency terms, since the beginning of 2009, whilst many Far Eastern and Emerging markets have recorded gains in excess of 50% over the same period. On the Fixed Income front, demand for the continued flow of new corporate bonds remained intact, helping prices to rise, whilst Government issues also saw some capital appreciation, albeit at a more pedestrian rate.

Whilst some of the equity rally can rationally be explained away as a rebound from over-pessimistic levels, it cannot be denied that the extent and power of the rebound has been breathtaking. The euphoria which has driven some stocks up by well in excess of 100% has been compared with a ‘sugar high’ which must inevitably come to an end. However, with cash returns currently close to zero, investors have been forced to seek better returns as risk aversion has faded, thereby forcing more money into equities. In that sense, the ‘wall of money’ has supported equities to such an extent that any pull-back, albeit modest, has been seen as an opportunity to buy. The fear of losing money in equities has been replaced by the fear of missing out on the rally, which has created conditions for the development of a ‘virtuous circle’ whereby rising prices force in more investors, which, in turn, pushes prices yet higher. This cannot continue indefinitely however, and surging asset prices will need to be supported by a meaningful (and sustained) recovery in economic activity. Should this fail to materialise, then the foundations currently being established may still prove to be built on sand.

Conference Board Consumer Confidence

1995 = 100



Source: Bloomberg

Economies –Blue Skies Ahead or Potential Headwinds on the Horizon?

Given the above therefore, at what point are we in the economic cycle and what are the potential headwinds that could blow the current optimism off course?

In the second quarter review, we alluded to the 'economic alphabet', which contains various possible shapes, including 'U', 'V' and 'W' formations. At that time, leading indicators were already pointing to a more positive sentiment, but it was still unclear as to how strong and lasting these would turn out to be. Since then, the improvement has continued and there are increasing signs that GDP growth in the US may already have resumed in the third quarter. Indeed, in Germany and France, GDP came in at 0.1% in the second quarter, which, although meagre in absolute terms, was still a positive surprise and reflects a significant rebound from the first quarter of 2009.

The extent of the turnaround in economic fortunes have led some economists to predict that developed countries may be in the process of establishing a 'V' shaped economic formation, which would go some way to supporting the rise in equity values in the last 6 months. However, consumer confidence, whilst better than it was, remains fragile, as indicated by the graph above.

The graph above shows that, whilst there has undoubtedly been a recovery in the last few months, it is still well below average levels and therefore, if final demand does not follow through, then either a 'double-dip' or 'U' shaped economic outcome cannot yet finally be ruled out. In particular, there are a number of challenges likely to emerge in 2010 which make the outcome still far from certain.

One of the major risks to the current improvement is a premature withdrawal of the massive stimulus that various Central Banks have provided since the financial near-meltdown which began in October 2008. It is estimated that about \$2.5 trillion of the \$5 trillion pledged by G-20 countries has been spent and it is clear that some of the more 'hawkish' members would like to see this stimulus removed sooner rather than later. The problem is that it is not known what will happen should such support be withdrawn too soon. History would suggest that if the timing is wrong, then economies could rapidly turn downward again, as experienced in the 1930s and in Japan in the 1990s. In addition, incentives such as the scheme to encourage new car buying by providing attractive trade-ins for old vehicles (known as 'cash for clunkers' in the US) have helped new car sales, especially in Germany and the US but these schemes are now coming to an end, and it is yet to be seen whether or not the rebound in sales will continue.

Another potential headwind is corporate profitability going forward. On an earnings front, the Q2 reports generally were encouraging with close to 70% of companies beating market expectations, which was above the figure for recent quarters. In general, a number of companies disappointed on top line growth, but beat estimates for the bottom line' suggesting that many companies managed their businesses far better during the current downturn by controlling costs and slashing inventories. In addition, analysts expectations were pushed down to extremely low levels and therefore, companies have been able to match, or beat, estimates that were perhaps unduly pessimistic.

The real question however, is whether this situation can be maintained. Cost cutting can produce beneficial results for companies, but this tends to be a relatively

short term effect and needs to be supported by genuine growth in demand. Companies seem to be rebuilding inventories on anticipation of demand returning and if this fails to materialise, then another bout of de-stocking may occur. In essence therefore, the short term benefits of cost cutting and inventory rebuilding need to be replaced by an upturn in consumer spending. Currently many companies continue to warn of 'tough' conditions and the most frequently used word to describe economic conditions seems to be that they are 'stabilising.' Markets will need more than this to sustain a rally from these levels.

The risk of premature withdrawal of economic stimulus measures and the sustainability of corporate profits are probably the two most prominent potential headwinds for 2010, but they are not necessarily the only ones. Over-regulation of the banking sector, whilst an easy and politically popular measure, could also prevent a return to the free flow of capital necessary to get economies back on an even keel. In addition, there is still a lingering worry that inflation has not been beaten and that it will re-emerge as economies recover. Inflationary proponents point to 'core' inflation, which remains relatively stubborn in the US, the UK and Europe, despite the downturn and any pick up in commodity prices could see 'headline' inflation also begin to recover. This, in turn, would require higher interest rates which might stifle the recovery and lead to sluggish growth thereafter. On the other hand, there are still a number of economists who still see deflation as the more potent threat. In many ways, this would be a worse outcome and so Central banks will be wary of letting it take firm hold.

Highlights of the Third Quarter:

Geo-political:

President Obama has attempted to court the Iranians, but, to date, there have been little outward positive signs of a thaw in relations. Indeed, it is predicted that Iran may be capable of making nuclear weapons within 12 to 18 months and so the risk of nuclear proliferation is increasing, with its inherent de-stabilising effects.

The risk of creeping protectionism on a global scale still remains, as highlighted by recent disputes between China and the US involving a range of products from tyres to poultry. If the economic backdrop again begins to deteriorate, then pressure may mount on politicians to protect 'local' jobs, which could lead to further trade disputes emerging.

Global Economics:

Central Banks have maintained loose fiscal and monetary policy but, behind the façade, there are disagreements over how long such stimulus measures should remain in force. The recent G-20 meeting provided some form of unified communiqué, but it has had no real effect on market sentiment. Both the US and the UK continue to believe that stimulus should continue until all risks of a relapse have passed. However, the Europeans seem more intent on looking at ways to regulate banks more stringently, to prevent such excesses occurring again. In reality, 'quantitative easing' is likely to be withdrawn first, whilst interest rates will be kept at current levels, at least for the time being. The announcement on 6th October that Australia was raising its cash rate from 3% to 3.25% does not detract from this view, since they were always perceived as the first of the G-20 countries likely to begin tightening due to the relatively mild nature of their recession. The surprise therefore lay in the timing rather than the direction, but the other major Central Banks will undoubtedly be interested in seeing how this move is perceived by investors and how it impacts on their economic performance in the coming months.

Unemployment remains a concern and it is not likely that peak levels will be seen until at least the middle of 2010. In the latest downturn, the US has lost over 7 million jobs and this could swell to 9 million before the tide turns, and this will be mirrored in other developed economies.

Equities:

As mentioned earlier, equities continued their strong upward momentum in the third quarter. In local terms, gains have generally ranged from 20% to 25%, with many Far Eastern and Emerging Markets achieving similar gains despite their huge surge in the second quarter. Notable exceptions were China, with the Shanghai Composite edging 6% lower after rumours that the Authorities were seeking to curb excessive speculation in the asset markets. Japan also lagged, with the TOPIX ending 2% lower on the quarter due to political concerns and a rising Yen negatively impacting on export stocks.

On the corporate front, earnings often beat analyst estimates, albeit from a low base. In general terms, financial stocks led the market higher as earnings rebounded from extremely depressed levels. Resource stocks also rose on a weakening Dollar and hopes that demand would pick up, led by China, whilst technology and early cyclicals were included in the list of outperforming sectors. Not surprisingly, 'defensive' sectors tended to under perform as investors switched into the more geared economic plays.

There has continued to be a steady stream of corporate cash raising, either through 'rights' issues or bond issues. To date, markets have been able to absorb this flow and 'rights' issues in general, have been close to fully subscribed. The demand for corporate debt has also continued and many companies have tapped the market in recent months. Again, this has been well supported, with many issues being several times oversubscribed.

Fixed Income:

Despite surging equities, fixed income markets remained relatively resilient during the quarter. The strongest demand remained in the corporate arena, with an estimated \$775 billion of new issuance coming in the third quarter. For the year to date, the figure stands at approximately \$2.75 trillion, which matches the total for 2008. Interestingly, in absolute terms, many corporations are managing to issue debt at rates below what they could have achieved before the crisis began. Hence, with attractive credit alternatives hard to come by, corporations are continuing to seek finance via the Eurobond market. Government issues however, still managed to provide some capital gain, with the yield at the 10-year end of the spectrum declining from 3.5% to 3.4% in the US, whilst in the UK the 10 year yield declined from just under 3.7% to 3.6% over the same period. In Europe, the 10 year yield in Germany, for example, ended the quarter at 3.3%, versus 3.4% as at the end of the second quarter.

The resilience of the fixed income markets in the face of rising equities may be seen as somewhat perverse, as signs of a recovery in economic activity might be perceived as a precursor to a rise in interest rates and/or potentially inflationary pressures. However, this has not been a 'normal' recession and much of the action taken by Central Banks can almost be seen as one gigantic economic experiment. It is still far from clear what the final outcome will be and therefore, with a 'double-

dip' still possible, it is perhaps not so illogical for fixed income yields to remain at low levels. The effects of 'quantitative easing' have also created an almost artificial market in some Governmental issues, despite rising debt levels and it will be interesting to see what happens once Governmental support begins to be withdrawn.

Commodities:

Oil settled down into a tighter trading range during the quarter, ending the review period at around \$70 per barrel, similar to the closing level seen at the end of June. Copper saw some firmer demand and rose from an opening level of just under \$5,000 per tonne to close at just under \$6,000 per tonne, having hit a high of \$6,475 on 28 August.

Gold saw a renewal of interest, especially towards the end of the quarter, and finally regained the \$1,000 per ounce on 11 September (a level last seen in February). Some of the gain was due to a weakening of the US Dollar, but there was also some real demand on the back of concerns over the medium term fate of the US Dollar as the reserve currency.

Currencies:

The burgeoning US Budget deficit put the US Dollar under some pressure during the quarter. The US deficit has now reached \$1.27 trillion and is expected to rise to \$1.6 trillion in Fiscal 2010 before easing down to \$1.4 trillion the following year. There are increasing concerns over the status of the US Dollar as the world's 'reserve currency' and this is likely to keep it under pressure in the medium term. However, in reality, there is no real alternative to the American currency immediately on the horizon and so any transition is likely to be slow. Over the quarter, the trade weighted index fell from just over 77 to just over 74, but still remains above the 70.7 level recorded in May 2008.



Of the other currencies, Sterling has been losing ground due to its Government debt level, which is forecast to exceed £175 billion in 2009. On the other hand, the Euro and the Yen have remained firm, whilst there has been an increasing focus on Far Eastern and commodity based currencies, which are perceived as having appreciation potential over the medium term.

Outlook:

As we commence the final quarter of 2009, financial markets have gone some way to repairing confidence, but investors remain nervous, especially given the extent of the equity rally seen since the dark days of early March 2009. In itself, this nervousness is not anything to be unduly worried about, as it suggests that we have not yet reached the level of euphoria that is common in the closing phases of a bull run. The old adage that a bull market climbs a ‘wall of worry’ seems to be holding as worldwide bourses continue to move higher.

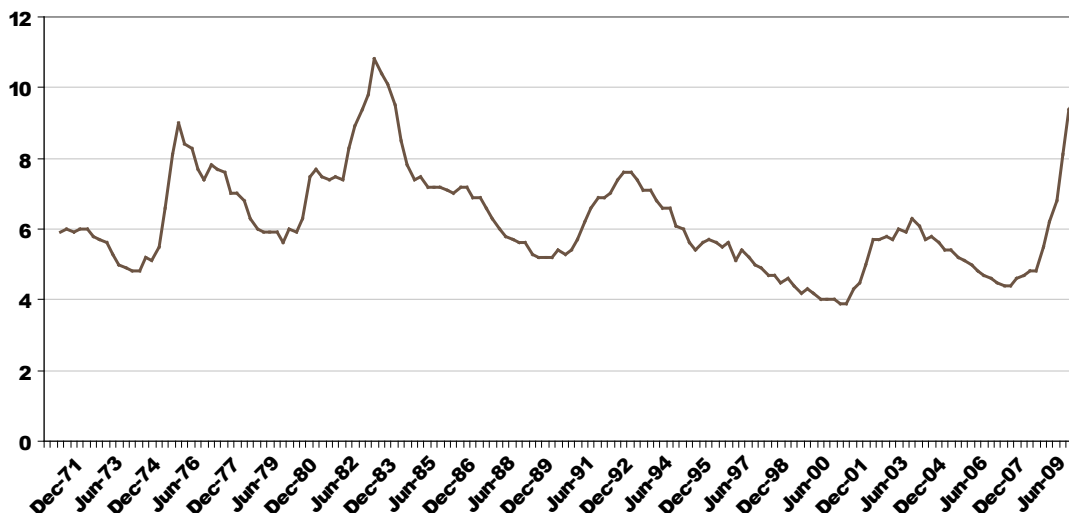
At the current time, equities seem to be in a ‘sweet spot’ due to the fact that monetary and fiscal policy remains accommodative. Corporate earnings are also likely to see a rebound in the fourth quarter of 2009 as the year-on-year comparisons begin to become more favourable, especially in the financial sector. This partially explains why the Standard and Poors Composite Index is currently trading at around 20 times 2009 earnings, a level which has not been seen since 2004, but it still leaves the market vulnerable to a short, sharp correction should economic data deteriorate, even for a brief period.

Looking beyond the fourth quarter, there are some potential headwinds still to be overcome in 2010,

which suggests that equity markets may find the going increasingly tough from here. The most worrying of these is what might happen once the stimulus provided by Governments begins to be withdrawn. The worry is that demand has been artificially held up by these packages and that, once support is withdrawn, there will be no follow through which would result in a further downward lurch in economic activity. For example, the ‘cash for clunkers’ scheme has provided a much needed boost to the beleaguered motor industry, but what is not known is just how much of this has merely pushed demand forward. If this is the case then there is the risk that, once the scheme ends, sales will again tail off dramatically. The recently announced extension of the scheme in the UK suggests that the Government remains unconvinced that the consumer is yet ready to spend more aggressively without incentives.

At present, financial markets are anticipating a resumption of economic growth worldwide from the fourth quarter of 2009 onwards. Even if this proves to be relatively modest, or even insipid, if it can be maintained, then there could be the beginning of a withdrawal of Government stimulus packages from about the second quarter of 2010. This has led the futures markets to the conclusion that interest rates will be higher in 12 months (by, on average, 1.25% to 1.50%), which has led some analysts to worry about the direction of bonds in 2010. However, higher rates are by no means a foregone conclusion, since unemployment rates continue to climb in the US and Europe and this could yet have a dampening effect on consumer demand well into 2010. History also suggests that the Federal Reserve traditionally waits about 3 months after unemployment has peaked before commencing tightening. The graph below shows the current trend in unemployment in the

US Unemployment Rate Since 1970 (%)



US and, whilst the pace of the rise appears to be slowing, it seems likely that the actual peak may not be seen until well into 2010. If this is the case, then, provided the Fed acts as it has done in the past, rates could be left on 'hold' for longer than currently anticipated.

Of course, interest rates are only one part of the current economic equation. Both the US and the UK continue to be wary of the sustainability of the economic recovery and therefore are likely to err on the side of caution in respect of stimulus withdrawal. Europe is less likely to be so cautious and therefore could be the first of the major blocs to begin the process of withdrawal in 2010. The core economies of Europe, however, have the relative luxury of not being saddled with huge debt levels, as is the case with the US and the UK, which could, conceivably, take a generation to repair. This leaves the UK and the US with the problem of having to move towards a period of more fiscal austerity, involving public spending cuts and higher taxes, just at the time when their economies remain relatively fragile. In the UK, spending cuts will be inevitable whether there is a Labour or Conservative administration after the General Election. The only difference will be the extent and thrust of such cuts, but whichever way they go, there is the increasing potential for a clash with the public service unions from late 2010 onwards.

Conclusion:

In conclusion, equity markets have been more resilient than many had expected, and current monetary and fiscal conditions provide support, at least in the short term. This still does not preclude the possibility of a meaningful set-back in equities, especially if economic data shows signs of tailing off. Valuations are looking towards the upper end of fully valued, even assuming a modest recovery in 2010, but the fact is that cash has moved from being a 'safe haven' to a potential liability in rising equity markets. This has created an almost virtuous circle whereby equities rise, creating momentum which spurs markets higher. This, in turn, forces more investors to seek higher returns via the equity market, thereby maintaining the rally. However, even if there is a setback, it seems clear that investor psychology has shifted decisively from 'selling on rallies' to 'buying on dips' and this should provide a series of relatively firm supporting levels on the downside.

On the Fixed Income side, we believe that the uncertainty over the timing of higher interest rates is likely to keep yields relatively range-bound in the short term. Government yields remain extremely low by historical standards and could be vulnerable if there is a more robust recovery than anticipated and/or the inflationary threat re-emerges. However, the situation

remains sufficiently unclear at present to suggest that the risk of rapidly rising yields is still a little way off. Furthermore, the appetite for corporate bonds remains strong, which implies that investors remain happy to own fixed income, but are looking for more attractive yields to compensate. As mentioned in the previous review however, the long bull market in Government and Government Guaranteed Bonds may finally be coming to a close, as the emphasis continues to shift towards the corporate bond sector where there are more attractive yields. On that basis, we continue to favour keeping Government maturities relatively short given their lower volatility, but we will also maintain our search for selective high quality Corporate Bonds given their attractive yield spreads.

MONETARY EXPANSION, ASSET RETURNS & BANK LENDING



Mike Balfour
Chief Investment Officer



Abi Oladimeji
Senior Economist

As the credit crisis deepened in the third quarter of 2008, the major central banks became increasingly proactive in their attempt to stabilise the financial system and kick-start the money markets. Central banks responded to the credit crisis through measures including coordinated rate cuts, injection of capital into banks, direct buying of commercial paper and bank guarantees. In the first quarter of 2009, with official interest rates close to zero, the major central banks shifted the focus of monetary policy towards increasing the quantity of money.

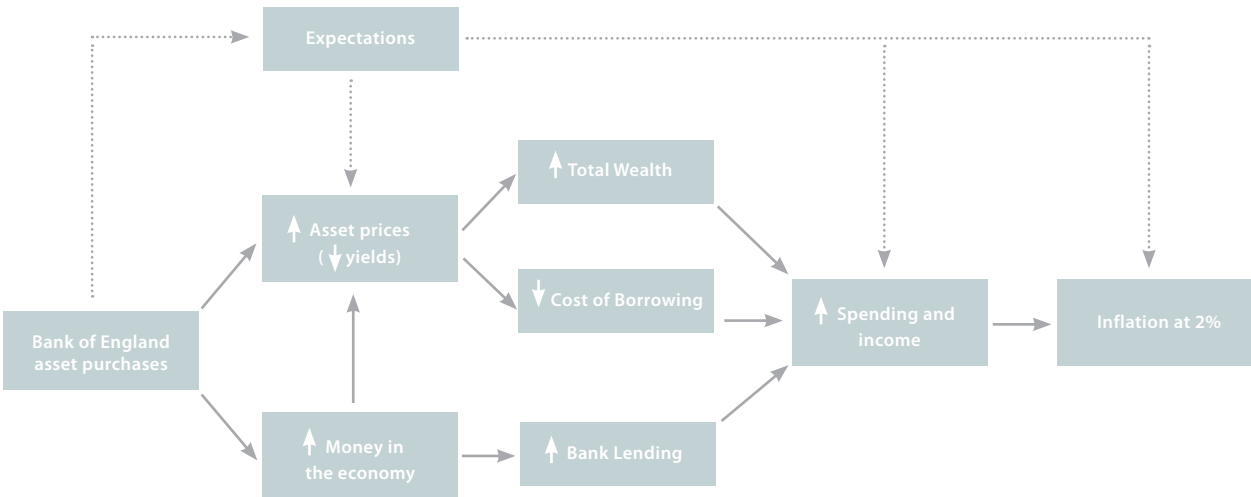
On 5 March 2009, the Bank of England announced that the Chancellor of the Exchequer had authorised the MPC to use the Asset Purchase Facility (APF), which had been set up to buy high-quality assets in an effort to improve liquidity in the credit markets, to extend monetary policy—specifically, quantitative easing. The table below shows the outstanding stock holdings (on a settled basis, net of any redemptions) for each facility as at the end of 17 September 2009.

Commercial Paper	£861m
Corporate Bonds	£1,024m
Gilts	£147,574m
Secured Commercial Paper	£0m

Source: Bank of England

The increase in money supply was expected to result in an increase in spending through a transmission mechanism described in the process diagram below.:

Chart 1: Stylised Transmission Mechanism for Asset Purchases



Source: Bank of England

As depicted in the stylised transmission mechanism (Chart 1), it is clear that the ultimate aim of the central banks' decision to expand the money supply through large-scale asset purchases is to provide further stimulus to nominal spending and to reflate the economy (in the case of the Bank of England, in order to bring inflation back to target in the medium term). However, while the increase in liquidity has fuelled strong movements in asset prices, bank lending has remained anaemic. This is illustrated in Chart 2 to the right:

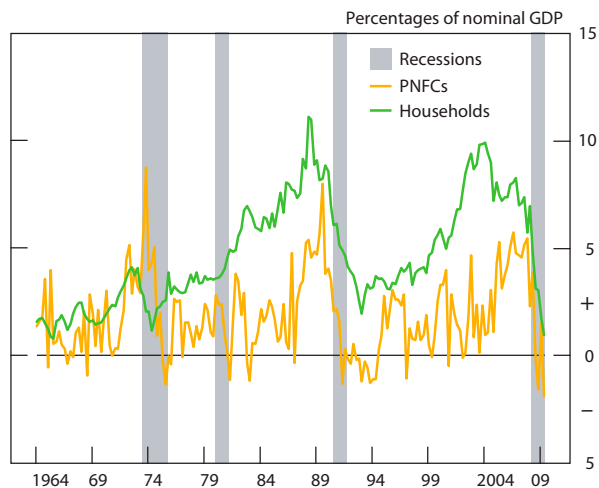
The issue that arises therefore is whether there can be a meaningful recovery while lending remains weak. Empirical analysis shows that economies can recover even if bank lending to the private sector was contracting. The pace of bank lending tends to lag the upturn in leading indicators during recoveries from recessions that are associated with financial crisis. Moreover, as illustrated in the charts below, recent evidence shows that companies are increasingly favouring other sources of financing over bank lending with corporate debt issuance and equity issuance filling some of the void created by the contraction in bank lending (Chart 3).

Additionally, the overall level of demand for lending has fallen as the trend of deleveraging continued across both private non-financial corporations and households (Chart 4).

Overall, we anticipate that bank lending will pick up as the macroeconomic backdrop improves so long as central banks maintain expansionary monetary policies.

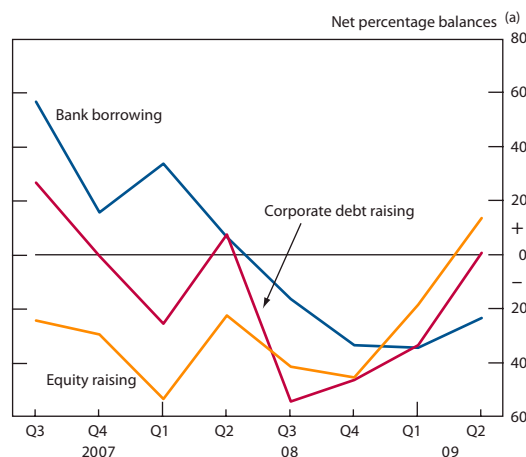
An interesting aspect to the stylised transmission flow chart presented above is the middle path. BOE asset purchases are expected to lead to rising asset prices and falling yields, increasing wealth and reducing borrowing costs. Given this is the BOE's explicit intention, it is hardly surprising that the gilt market and, in particular, the equity market have performed so strongly. The property market has also shown signs of stability. Given that the bottom path is not yet working well (as discussed above), the result of the asset purchases is being reflected mainly in asset price rises and lower borrowing costs. It would therefore seem logical that when banks begin to lend more there would be less emphasis on the requirement for yields to fall and asset prices to rise. In other words, an increase in bank lending, when it eventually materialises, will be undoubtedly beneficial to the economy but not necessarily so for the equity, gilt or property markets.

Chart 2: Net Bank Lending to Private Non-Financial Corporations (PNFCs) and Households



Source: Bank of England

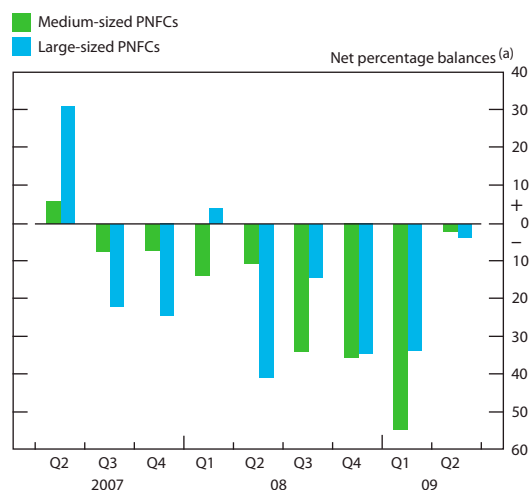
Chart 3: Survey Measures of Attractiveness of Different Sources of Finance



Source: The Deloitte CFO Survey 2009 Q2 (Taken from Bank of England)

(a) Net percentage balances are calculated as the percentage of respondents who thought that each source of funding was attractive less the percentage who thought it was unattractive

Chart 4: Credit Conditions Survey: Demand for Lending



Source: The Bank of England

(a) Weighted responses of lenders. A positive balance indicates an increase in demand for lending

WHAT'S BEEN GOING ON AT THOMAS MILLER INVESTMENT...

Thomas Miller Investment Annual Golf Day



Archerfield Golf Links

Thomas Miller Investment (Isle of Man) Limited recently held their Annual Golf event in typical “glorious Scottish Weather” at Archerfield Golf Links Course near Edinburgh.

Albeit that the weather increased the challenge of the course over the early few holes the day itself was excellent. With Mike Balfour (Chief Investment Officer of Thomas Miller Investment Limited in London) winning “nearest the pin” and John Greenwood (Chief Executive Officer, Thomas Miller Investment (Isle of

Man) Limited; winning the longest drive, the Thomas Miller team did themselves proud.

Senior staff and Directors from Thomas Miller Group based in Edinburgh and London also attended and combined with the Isle of Man representatives and their guests there were 20 enthusiastic golfers, for those who haven't had the pleasure of playing we can certainly recommend it; it had an “entertaining” mix of woodland and links holes!





Paul Neagle
Chief Executive Officer



EDINBURGH OFFICE RECEPTION

A superb time was had by all at the recent Thomas Miller Edinburgh office Reception at the Bourne Fine Art Gallery; where over 100 guests were in attendance, including TMI staff and Directors from London, Isle of Man and Edinburgh.

demonstrates the importance of business generated north of the border and will provide a significant boost to the specific areas of Cash Management and the Private Wealth Service.

The recent Appointments of Sandi Bomphray as Office Manager, Angus Chapman as Relationship Manager and Neil Dunmore as Senior Relationship Manager

TMI (Isle of Man) Move Office -Over the road!

Since the acquisition of part of the Investment business book of Singer & Friedlander Investment Management (Isle of Man) Limited in October 2008, Thomas Miller Investment (Isle of Man) Limited has gone from strength to strength.

With assets now over \$3.8bn and over 30 employees (up from 13 this time last year) the business is expanding at a remarkable rate..... so much so that the company outgrew it's office space in its Douglas office in Mount Havelock and relocated 'over the road' to the top floor of the Bank of Ireland building in September.

The modern, open plan layout that has been created has enabled the team to come together on one floor increasing both efficiency and morale.

The second phase of the project will include the creation of several more meeting rooms in the Mount Havelock offices where the rest of the Isle of Man companies remain.

Speaking about the new office, John Greenwood said 'It looks fantastic, it is a great space to work in and it certainly seems to have lifted the team's spirits. It is a big step forward from where we were in Mount Havelock and I must congratulate all involved in helping the project go so smoothly.'



CONGRATULATIONS...

Castletown Golf Club Scratch League Champions

Thomas Miller Private Wealth would like to congratulate the Castletown Scratch League Team who took the coveted IOMGU Scratch League title by the slimmest of margins, half a point from close rivals Douglas GC. Ironically it was this score that Castletown lost the league to Douglas GC by last year.

With all to play for in the last game of the season at a rain soaked Douglas, Castletown went into the match two and half points ahead. Undeclared all season they

suffered their first defeat, although the result of 4-2 gave the southerners the vital two points required for the title. Team Captain Donald Beggs - "Thank you to Thomas Miller Private Wealth for their generous sponsorship this year, our Galvin Green waterproofs served us well all season, we look forward to defending our title next year!"

Well done to the whole team and we look forward to following you again next year!

READER FAQ's

Why should I consider ETF's?

The Benefits of ETF's

Exchange Traded Funds (ETFs) have become popular and highly successful investment vehicles over the last few years as investors seek to reduce costs, gain greater diversification and demand flexibility from their investments (Figure 1).

This provides an opportunity to explain exactly what an ETF is, the benefits of investing in them and why and how TMI use these within their client portfolios.

be created or reduced (the size of the ETF can increase or decrease). They now cover a whole variety of asset classes (equities, bonds, commodities and currencies) markets and sectors. Some providers buy the physical assets in the underlying index and others enter into derivative swap agreements. TMI prefer to concentrate on the physically backed issues to control counterparty risk; however this may not always be possible in cases such as agriculture or soft commodities etc. where derivatives must be used to gain exposure to the underlying asset.

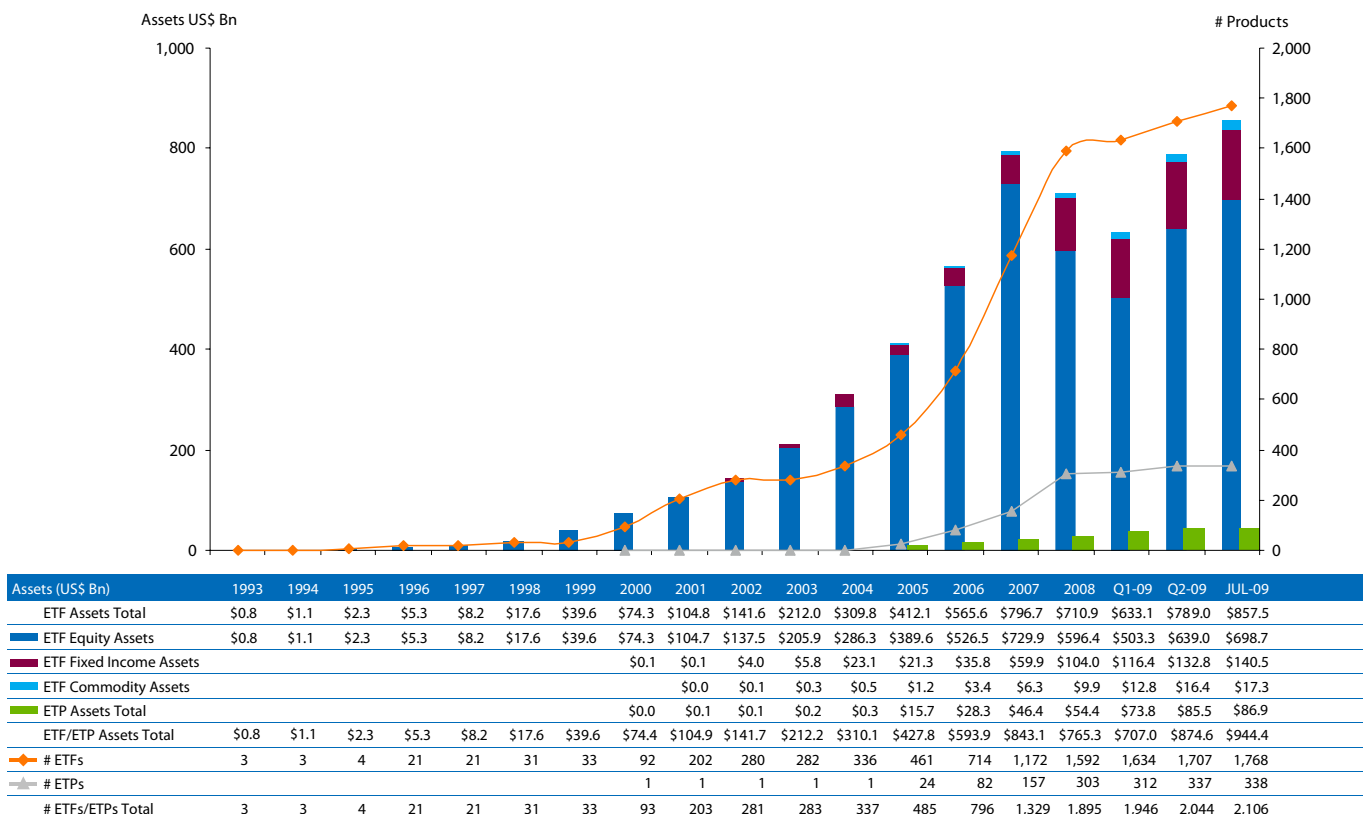
What is an ETF

An ETF can be defined as a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. ETFs experience price changes throughout the day as they are bought and sold and they are normally open ended vehicles, so shares can

Benefits

- ETFs trade during market hours with a two way price, it allows instant flexibility to choose entry and exit points with absolute price transparency.
- Total expense ratios (TER) are significantly lower than actively managed funds, with typical charges

Chart 1: Global ETF and ETP asset growth, as at end July 2009



Source: ETF Research and Implementation Strategy Team, Barclays Global Investors, Bloomberg.

being 0.1% – 0.15% per annum for main indices and 0.4% - 0.6% for specialised sector or asset tracking funds. This compares to an average 1% - 1.5% for most actively managed funds.

- Most issues are highly liquid and actively traded.
- Broad diversification can be achieved with one single fund.

How do TMI use ETFs?

Large liquid ETFs are carefully selected to provide core market/asset class exposure and suitable entry and exit target levels selected. Trade execution is swift and simple and settlement and safe custody is very straightforward.

“Core & Satellite”

We apply this approach to our private client mandates wherever possible – the ETF providing a “core” exposure and allowing flexibility to perfect shorter term trading opportunities and instant asset allocation changes where appropriate. Longer-term “satellite” (carefully researched and selected actively managed collective investment schemes) are used to complement the ETF positions by adding alpha/enhancing performance. This provides a very cost effective approach to portfolio management as longer term positions are held in conjunction with the flexibility of the ETF positions to add to or reduce exposure in accordance with group asset allocation decisions. This strategy allows a true “top down” risk

based portfolio management approach to smooth returns over the medium to longer term.

Summary

In summary, ETFs are becoming an ever more popular method of investing and the industry still continues to grow with more innovative products such as leveraged or short ETFs. Access to asset classes previously not easily accessible also provides an attraction for investors.

However you choose to invest, ETFs should not be overlooked!





TMI LIQUIDITY FUND



TRANSPARENCY ● SAFETY ● PERFORMANCE

For more information on the funds, please visit:

www.tmiliquidity.com



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