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Press Release

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Luis eyes “once in a lifetime” yield opportunities in 2009

After a torrid year for credit markets, marked by severe illiquidity and record levels of volatility, Fatima Luis, manager of the F&C Strategic Bond Fund, remains cautious over the medium term while anticipating a turning point during the latter part of 2009.

Ms. Luis said: “Our macro outlook for 2009 is cautious, based primarily on our expectation that the economic backdrop will continue to deteriorate. Although the rate cuts are beginning to be passed through to mortgages and fiscal recovery packages are imminent, the mechanism for passing those to the consumer and businesses is not solid and won’t be until the banks have resolved their issues. Until stability in the financial sector is finally evident, it is difficult to envisage any improvement in the current operating environment. Further co-ordinated responses from governments during 2009 will be necessary to encourage economic activity and their actions will be main the driver for asset prices this year.”

However she argues that “credit markets are presently taking the most pessimistic view and factoring in significant defaults of around 20% in the high yield market. This situation assumes a worse economic downturn than the 1930s, but the world is now very different. In our view the reality for 2009 is unlikely to be

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as bad as spreads currently suggest. As such, we believe that many of these projected defaults are unlikely to occur and there are very attractive opportunities for investors to lock into some 'once in a lifetime' yields."

In terms of valuations, Luis states that she feels more positive now than in recent months, particularly for the high quality end of the market such as investment grade, with the spread of the average BBB credit over 600 basis points. "With these types of yields there is no need to go much lower on the credit ladder even though spreads are over 2000bps on high yield," said Luis. "Indeed, high yield is the cheapest it's ever been but liquidity is still very poor and companies needing to refinance will effectively have a very tough task ahead."

Luis believes that the UK gilt market is underpinned by the prospect of further cuts in interest rates in 2009 as the Bank of England looks to bolster the ailing domestic economy. "The attraction of bonds versus other asset classes can rise further if inflation turns into deflation and if the prospect of a huge increase in government issuance - as they borrow to fund the economic recovery programme - becomes a reality. US government bonds are in a similar situation as the UK but, while US Treasury supply is expected to soar to record levels in 2009 to raise capital, it's likely that yields will fall whilst investors focus on the possibility of a long and protracted global recession".

Luis cautions that risk aversion will likely remain elevated for most of 2009. This should be mitigated by policy efforts and a more controlled de-leveraging of the financial system, meaning risk appetite may slowly start to improve.

"As 2008 drew to a close, there was an increase in investment grade new issues which came to the market at attractive levels and were well received. This has to be a good sign but not yet enough to encourage more investors back into the asset class. Once the forced selling and redemptions end and volatility comes down, the market will start to see improvement," said Luis.

Luis believes that sizeable interest rate cuts during 2008 will have hit savers, particularly those who are dependant upon high interest rates as a means of income.

"The corporate bond market has previously been an obvious place to generate income, particularly when spreads are wide and yields are high by comparison. It's possible that these types of client may be one of the first to come back to the bond market but this may not occur until the end of 2009, perhaps even 2010," she said.

"When the markets eventually turn, the opportunity to add significant returns should be huge. Valuations will eventually represent an excellent buying opportunity for bond investors, but caution certainly still needs to be exercised for at least the next 6 months, possibly longer, as it's likely that the situation will worsen before the recovery period begins."

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Notes to Editors

F&C Investments

- F&C Asset Management (F&C) is a London Stock Exchange listed asset management group which traces its origins back to 1868 with the launch of the Foreign & Colonial Investment Trust, the first ever publicly listed investment fund. Foreign & Colonial Investment Trust remains a client of F&C.
- F&C is an active fund manager with a multi-specialist investment model where individual teams have strong accountability for their products and processes. The group is also an active shareholder with a leading franchise in governance and sustainable investment.
- F&C now manages £93.3 billion (€118.4 billion) of assets* for a diverse range of institutional, insurance and retail clients across all major asset classes – equities, bonds, cash and property – as well as alternative and specialist product classes such as Socially Responsible Investment funds, hedge funds, funds of hedge funds, private equity funds, Global Tactical Asset Allocation products and Liability Driven Investments. F&C invests globally and has been a longstanding investor in emerging markets.
- F&C manages assets principally from three investment centres: London, Amsterdam and Edinburgh. The group has an office network spanning ten countries: China (Hong Kong), France (Paris), Germany (Frankfurt), Ireland (Dublin), The Netherlands (Amsterdam), Portugal (Lisbon), Sweden (Stockholm), Switzerland (Geneva), UK (London, Edinburgh, Dorking) and the United States (Boston).

* As at 30 September 2008.

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