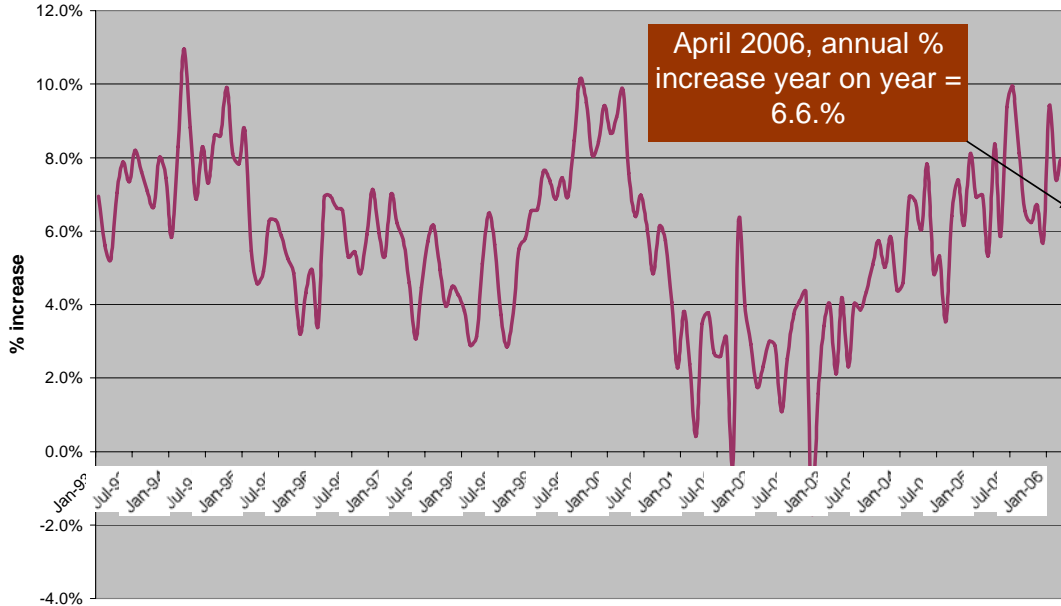


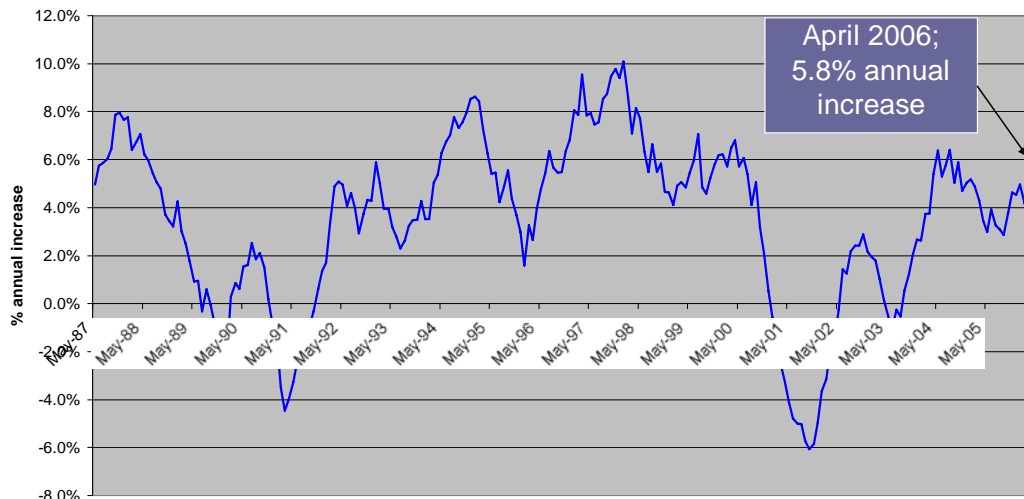
A TAMRIS Perspective – The US Consumer

The US economy grew by a real 4.8% in the first quarter of 2006. US retail sales increased by 6.6% in the year to April capping off a strong run of growth since the 2001 recession and industrial production rose by a healthy 5.8% in the year to April.

US retail sales, annual increase Jan 92 to April 2006

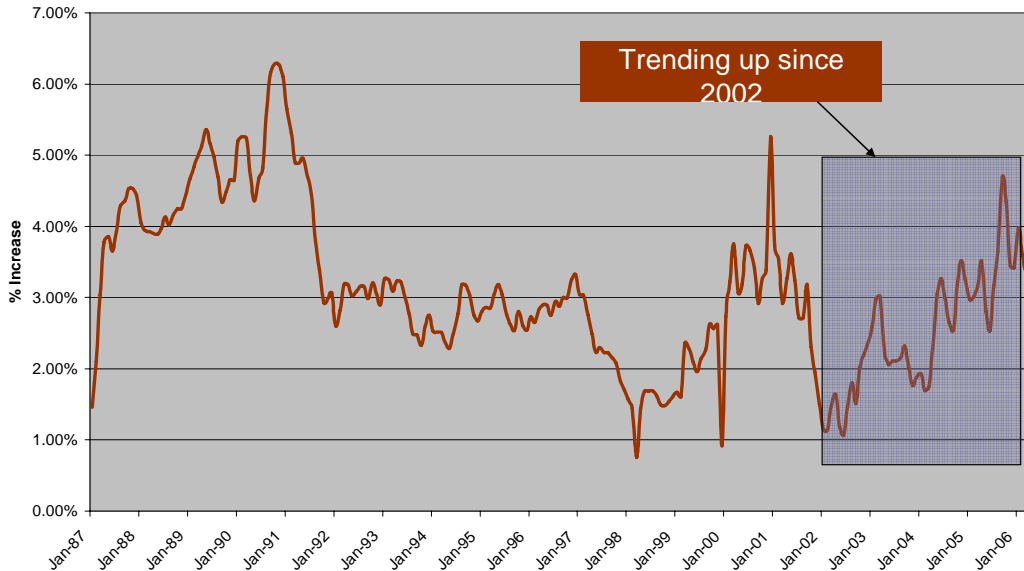


US Industrial Production, May 1987 to April 2006 annual increase

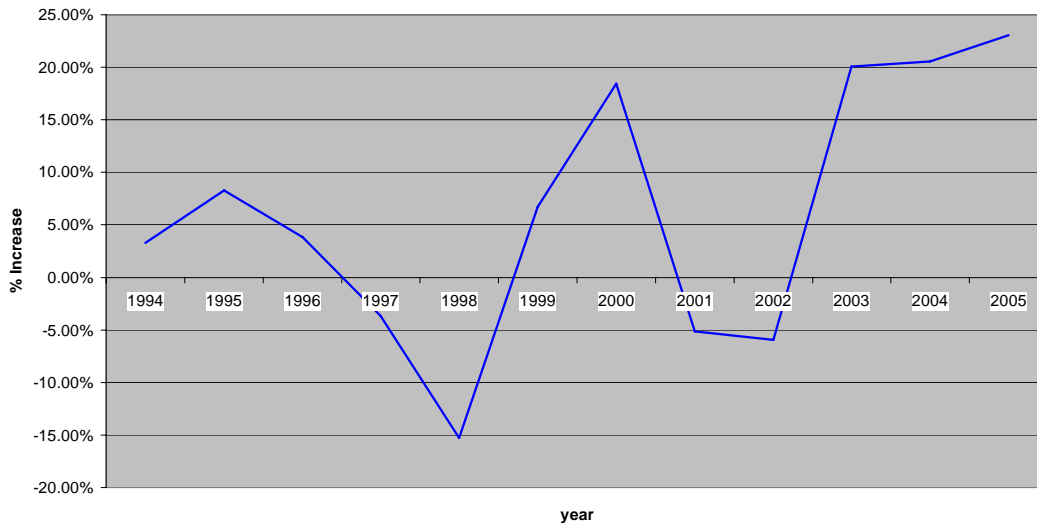


Yet, inflation and interest rates are on the rise. Consumer price inflation rose to 3.55% in the year to April and a falling dollar is also forcing the price of imported goods to rise at a time when commodity price inflation (denominated in dollars) is reportedly rising at its fastest pace in modern economic history.

US Consumer Price Inflation



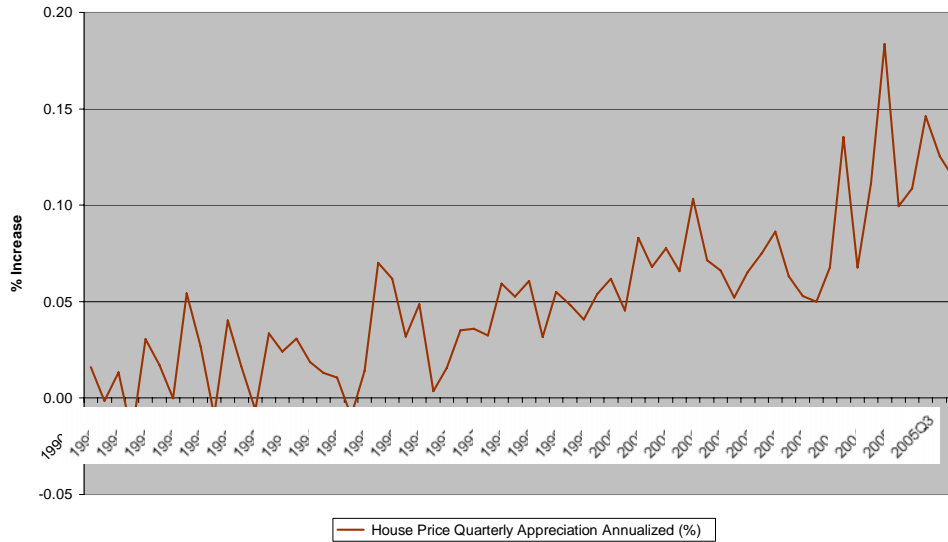
Bank of Canada Commodity Price Index, % annual increase



Interest rates in the US (and, indeed globally) have been on the rise since 2003 and ordinarily rising interest rates would curb economic activity by increasing the cost of borrowing (reducing consumption due to credit) and reducing marginal return and hence the attraction of higher risk investments.

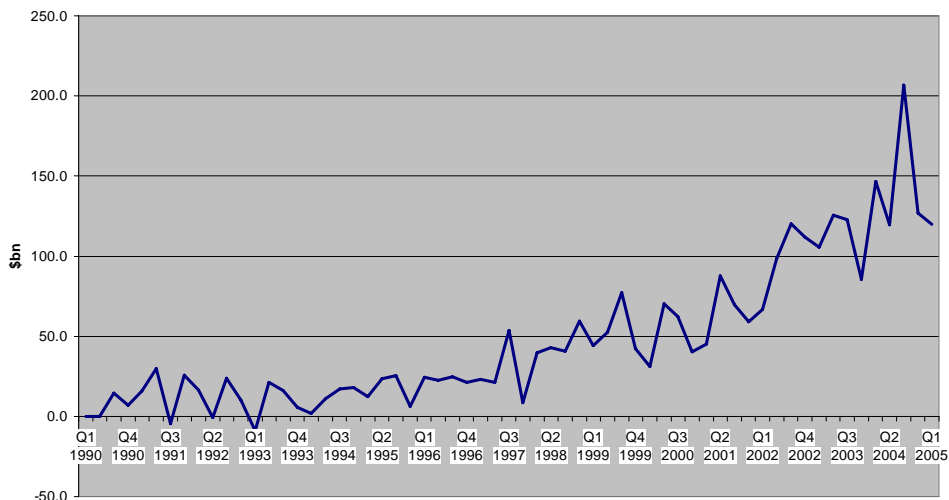
To date this has not happened in the US economy, where it appears that interest rates have been sufficiently low and appreciation in house prices sufficiently high to generate sustained demand from home equity withdrawals. As stated in the January review, US consumers have been withdrawing capital from their homes at a rate equivalent to 7% of income in 2004.

US House price appreciation, annualised quarterly rises



And as house prices rose, so did equity withdrawals from real estate. The following chart shows US net home equity withdrawals from the first quarter of 1991 to the first quarter of 2005, taken from a Federal Reserve research paper. Since home equity withdrawals have been highly correlated with rising house prices, it is plausible to assume that sizeable home equity withdrawals were an important component of consumer demand throughout 2005. We can assume this because earnings have not kept pace with inflation and real growth in credit has been falling.

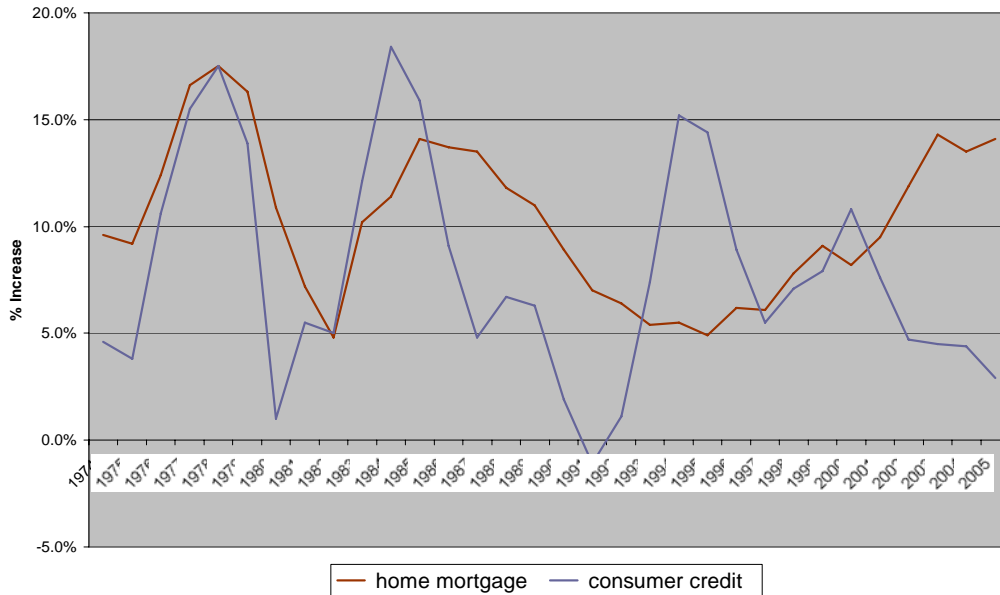
Net Equity Withdrawals, US\$bn per quarter to Q1 2005



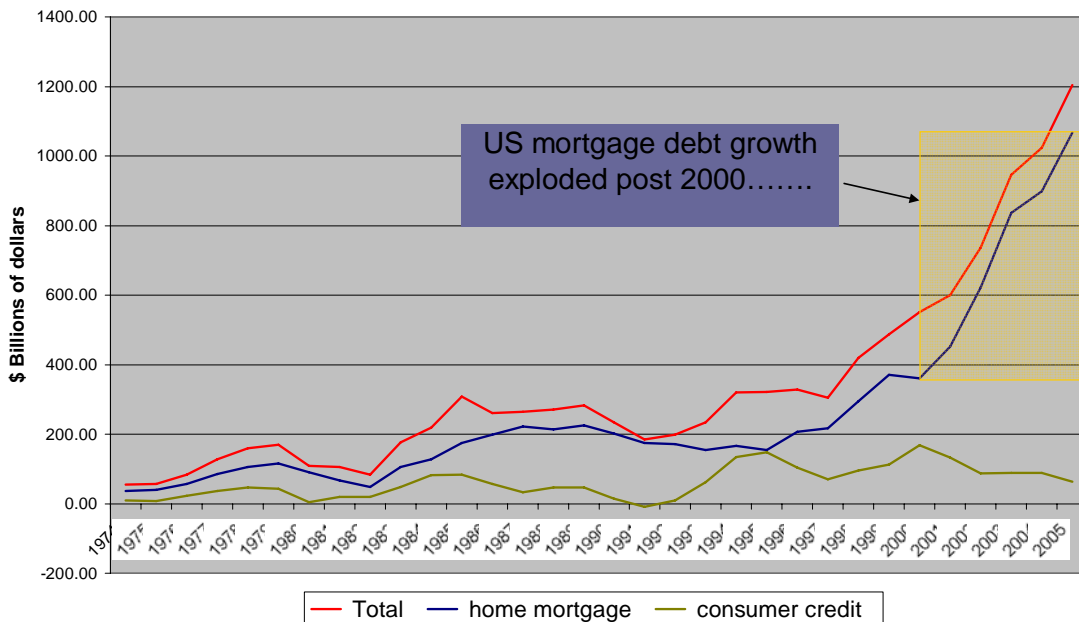
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The cost of this boom in house prices and consumer expenditure, has been rapidly rising debt. Debt which is exposed to rising interest rates and falling property prices.

Consumer debt, mortgage and consumer credit - % annual increase



Total annual new consumer borrowing; credit & mortgage



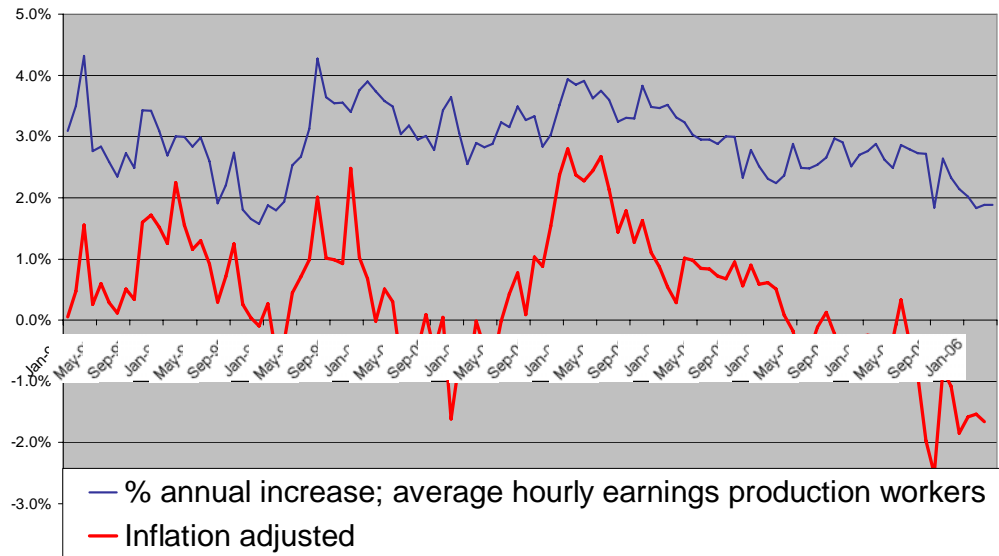
The latest figures on the housing market shows rising inventories and falling prices. The price of the median new home in the US fell by 7.3% from March while the backlog of unsold homes has risen to a new record – it would take almost six months to sell the current inventory of newly built homes. What is clearly interesting is what

Independent, Impartial, Objective

happens to the consumer if the housing market continues to decline. If home equity withdrawals fall, consumer demand will likely be impacted unless wages start to rise.

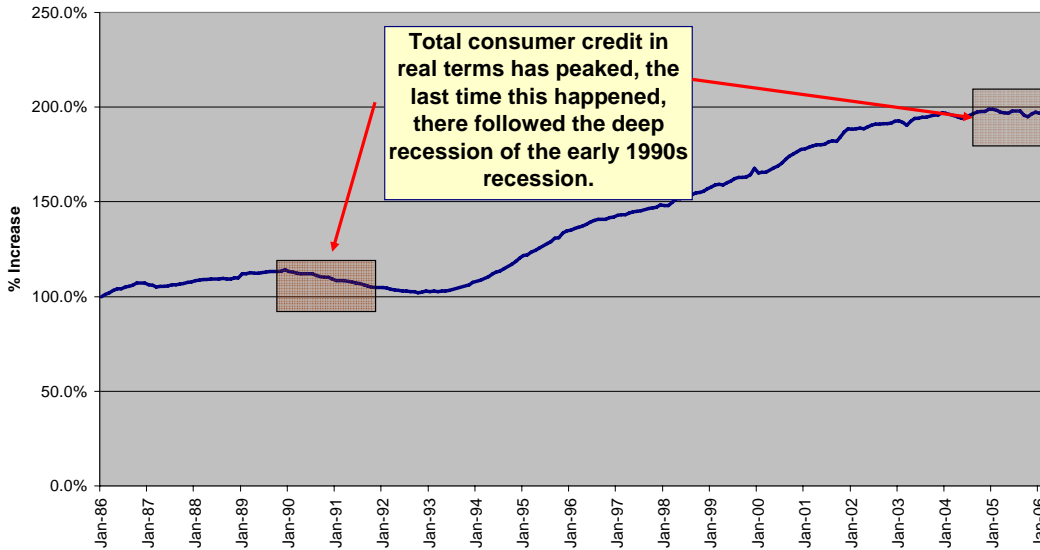
Wage growth is presently insufficient, given high levels of debt to keep consumer demand and hence the US economy growing in its current shape and form. Note the following graph showing hourly earnings growth in manufacturing; real wage increases are negative following the surge in inflation and earnings growth in the US economy are well below the average increases seen in a recovery.

Real & nominal hourly manufacturing earnings, annual increases, 1997 to 2006

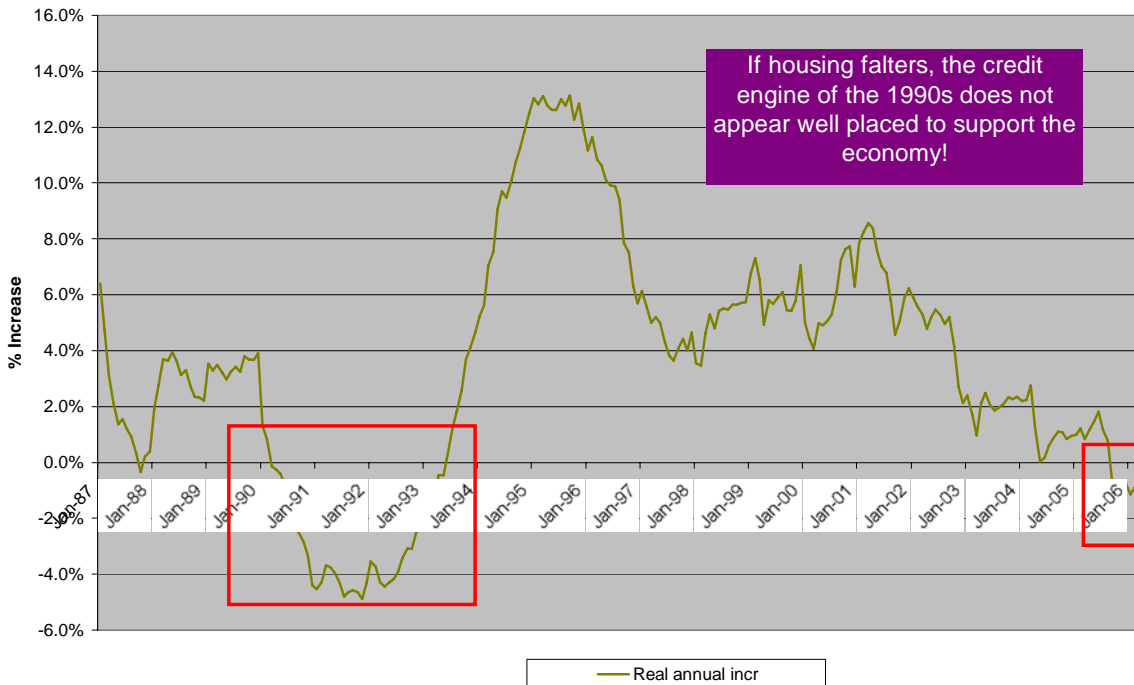


Also, please note that growth in consumer credit, for a long time an engine of growth has stopped expanding. Indeed, the last time real growth in consumer credit turned negative was before and during the last serious recession in the early 1990s.

Total real consumer credit, inflation adjusted, since 1986



Real annual increase in total consumer credit



The omens are not good.

US credit growth and the ability to service credit and debt look as if they have peaked and with a declining housing market, however mild, the ability to both spend and service debt could be significantly impaired. In this context we cannot underestimate the importance of the consumer to economic growth, especially in the US where consumer demand accounts for 70% of GDP growth.

No wonder the Federal Reserve wants to wait and assess the impact of previous interest rate increases before raising them further. As the Fed Chairman has said, it will wait on future data to determine whether or not it should hold rates or raise them. This is not indecision, this is someone clearly weighing very real risks.

But the future of interest rates depends on the future of inflation and the future of inflation may have some roots in the need for significant increases in earnings to finance both debt and final demand if the housing market falters. There is room in the economy to finance higher wages and inflation would help reduce the real debt burden. But, in order for the US economy to adjust to its external trade and internal financial imbalances, consumer demand growth must moderate significantly and global domestic demand in Europe and Asia must replace that provided by the US over the last 15 years. A period of high domestic interest rates, a weak currency and weak domestic demand is therefore needed and the stage may have already been set.

Whatever happens, the US housing market and US consumer debt are clearly one very important counterparty to the events that will unfold from hereon in.

Please note that the above analysis is not intended to provide any recommended course of action. What is of greater importance for investment strategy is the relationship between asset prices and economic risk and this is something over which your portfolio or asset manager should be responsible.

This analysis is also not intended to provide a complete analysis of all the issues. Global inflationary risks and rising interest rates do not just pose problems for the US consumer. They also pose problems for the global economy and the global capital markets that for a long period of time have thrived on the excess liquidity supplied by the US, the Japanese, the European and the Asian central banks. If this liquidity is being withdrawn, as interest rates rise, you are likely to see an increase in volatility and risk. While there is insufficient data on the global derivatives market to do a full analysis, it is likely that the derivatives markets will be exposed to increased volatility as liquidity is withdrawn. It is also possible that global derivatives markets have got ahead of their ability to manage the risks of the current economic and market scenario as the laws of demand and supply reassert themselves. After all, it is not that which we can see that we need to fear, but what is writ between the lines.

As always, a portfolio should be constructed planned and managed to be able to meet financial needs in the face of risk and uncertainty at all times, since risk and uncertainty face us at all times. As such your portfolios should be positioned in advance of and not following a risk event.