Throughout December 2010, when we distributed our last newsletter, the FTSE100 index ranged between a low of 5600 and a high of 6000. During 2012 (up to early December when I'm writing this), apart from a four week period in the summer when the market dropped to the 5300s, the market has ranged between 5600 and 6000.

This highlights how little movement in investment terms there has been in the last two years. Before 2008, it made little difference what politicians did, markets moved independently, now they wait on politicians' actions on quantitative easing or Eurozone action.

The next bull market is just around the corner..... but how far is the corner? While the US fiscal cliff and China hard landing is leading to short term caution, the main driver of future returns depends on the Euro crisis.

The general assumption is that if only Germany were to agree to pooled debt then the euro crisis will go away - it won't. The only way a monetary union is going to work is via a political and fiscal union in which Germany sets the rules. There isn't the appetite amongst the eurozone countries to embark on this.

All this creates uncertainty which is awful for financial markets. Nuriel Roubini, in his excellent book Crisis Economics uses an excellent analogy to explain the difference between risk and uncertainty. If someone is given a revolver with one bullet in the chamber of six and then spins the magazine before firing it he knows there is a one in six chance he is going to get hurt: this is risk!

However, if he is given a gun not knowing if it has none, one or six bullets he has no idea what the risk is - that's uncertainty. That's where we are with the European crisis and until uncertainty can be turned into risk that can be measured, or at any rate estimated, then the economic and investment environment will not improve.

The key factor in investment markets for the foreseeable future is the de-leveraging of the excess debt which built up in the 15 years to 2008. What this means is that households, companies and governments are tightening their belts and spending less.

Ernest Hemingway was known for many good quotes: one that is apposite today is "How do you go bankrupt? Two ways, first gradually and then suddenly."

If countries can't afford to pay back the debt they have built up, there will no alternative to default either through inflation or non-payment of loans.

What are our predictions for the future?

We believe that the euro will not survive and countries will decide to leave. However, having thought it would happen in 2012, we and many others misjudged how European politicians could find creative solutions to 'save' the euro.

The only question to us is will it be six months, six or sixty years before a country decides to leave. All of history dictates that you can't maintain a monetary union without a close political one.

Investors are therefore potentially sitting on a time bomb with the possibility of a disaster at any moment and the certainty of increased volatility over time.

How are investors to respond?

In years gone by a strategy of buy and forget was often considered to be best but it is our view that funds which are focused purely on bonds or equities are going to be vulnerable to nasty shocks.

The core of any portfolio should be a range of multi asset funds and investment trusts which are looking to provide positive returns over the economic cycle.

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We are delegating to proven winners 50-60% of your portfolio to preserve and grow your capital in today's uncertain world.

They in turn are making strategic judgements on the allocation of funds and tactical decisions as to where to invest on a day to day basis. What sets them apart is that their focus is on generating returns which match inflation and cash returns so they don't have an incentive to promote their own sector.

You won't find a UK equity fund manager saying that equities don't offer good value because no one would invest in their fund. Multi asset managers can be more impartial.

Diversification

The key to investment success is diversification so we look at funds which deliver good results from taking different strategies. This is important since there has been a tendency for risk-off and risk-on to limit the benefits of diversification in traditional funds.

Around this core, we look for further funds which generate their returns from stock selection. As we move into 2013 what sectors do we like?

UK small and mid-cap equity income: blue chip equities such as Diageo and Glaxo have been very popular but much of their dividend income has come from large cash piles which they have not been able to put to better use. There are plenty of smaller companies which deliver good dividends.

The same can be true of the US economy where the development of shale gas is having a dramatic and positive effect. It is predicted that the US will be energy self-sufficient by 2017.

Gold producing companies have not benefitted from the climb in the spot price and everything points to gold being the ultimate store of value. The expansion of the monetary base through quantitative easing means that currencies are being de-based. The best insurance policy is gold and the companies that produce it.

Emerging market bonds: while sovereign debt in Europe and the rest of the developed world looks decidedly risky, countries such as Korea and Brazil offer higher yields and greater security. A good global bond fund targeting this area should deliver income with lower volatility than equities.

Retail Distribution Review

Or RDR as the financial services industry has referred to it.

RDR, which comes into force on January 1st 2013 brings the most far reaching changes to the provision of financial advice for 25 years or more.

Essentially there are three changes. Advisers must have a higher level of qualifications and cannot be paid by commissions. Firms must also decide whether they will be independent meaning they advise from the ***whole range*** of products and funds, ***restricted*** to just a few or ***tied*** to one.

Martec has been operating within this structure for a number of years and will remain independent. We see it as a core part of our service to research funds from the whole universe, not just a limited range.

Estate Administration

It is never the right time to talk about Wills and Probate but it is important to make sure your finances are in the right order.

It starts off with Lasting Powers of Attorney and Wills. You should take a moment to think about what would happen if you were incapacitated and not able to manage your finances?

Another major factor is the availability of cash to cover the initial Inheritance Tax that has to be paid before probate is granted. We will be happy to discuss with you strategies to ensure funds are available from your existing investments if possible.

With best wishes for Christmas and a prosperous 2013 from Alistair, Juli and Roger

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