

UK Financial Reality Index – Q4 2010

January 2011



The latest research from the Alliance Trust Research Centre shows that the overall financial situation facing UK households improved slightly during Q4 2010, increasing from 76.9 to 80.9, but remains significantly below the critical level of 100. The improvement during Q4 was largely due to a better economic background, which more than compensated for worsening conditions in terms of both household budgets and net wealth. Financial conditions have been supported by the recovery in GDP growth recorded during 2010, and a lower level of insolvencies. Real disposable income improved slightly, but remains well below its long term average, and stock market performance was also positive. Of our three main sub-indices, only the economic background reflects conditions which are better than the long run average, whereas both household budget conditions, and net wealth, remain below their long run averages. Household spending growth has improved in recent quarters, but our results suggest that this could come back under pressure in the early months of this year.

UK Financial Reality Index



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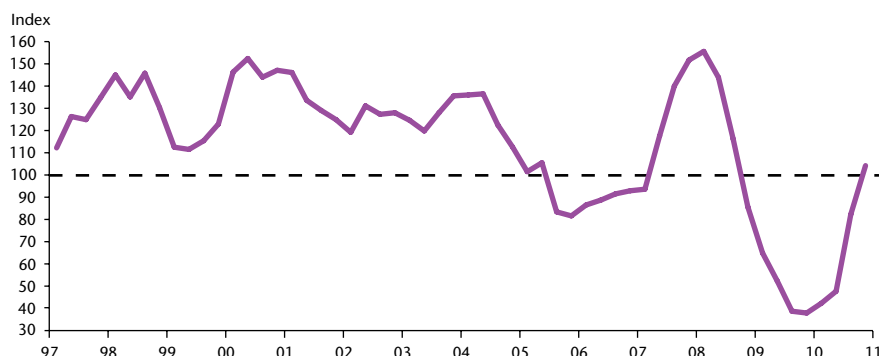
Financial Reality Index

The Alliance Trust Financial Reality Index improved from 76.9 in Q3 (10) to 80.9 in Q4 (10). Although the index increased, it remains below the critical level of 100.

Economic Background – Increased from 82.3 to 104.2

The economic background component of the Alliance Trust Financial Reality Index has increased to a level of 104.2 in Q4 (10), from a level of 82.3 in Q3

Economic Background



(10). This sharp improvement has taken the index into positive territory for the first time since Q3 (08). Two of the components of the economic background index have increased over the quarter. Economic activity, as measured by GDP, registered its first positive reading in our index since Q1 (08) and there was further improvement regarding personal insolvencies. However, unemployment has increased and continues to exert a negative influence on this index.

Household Budget – Decreased from 60.6 to 59.0

The household budget index has deteriorated for the second consecutive quarter, falling from 60.6 to 59.0, making this the weakest of the three main components of our Financial Reality Index. Household budget conditions remain well below their long run average. The deterioration during Q4 (10) was driven largely by sharp increases in the costs of basic goods and services, such as food and energy, and very muted levels of real earnings growth.

Net Wealth – Fell from 98.6 to 94.3

The net wealth index has declined for the third successive quarter, falling from 98.6 to 94.3. This index has moved even further below the critical level of 100, suggesting that conditions remain worse than the long run average. The deterioration in this index during Q4 (10) was largely driven by a renewed bout of weakness in the housing market, as a drop in buyer confidence hit demand, and the fact that household debt levels remain high.

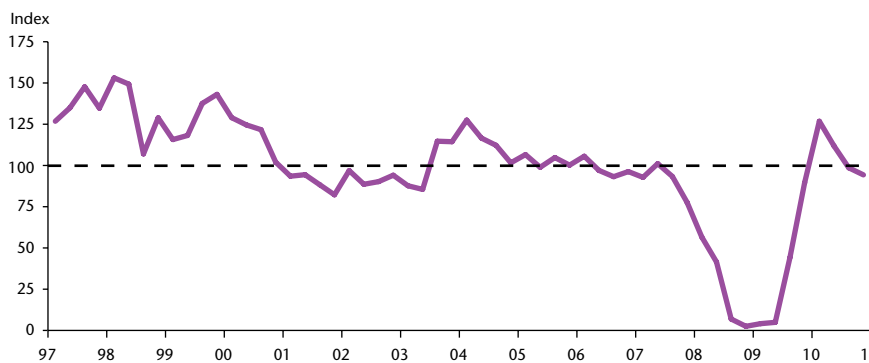
Summary and conclusions

Our Financial Reality Index has increased during Q4 (10), reaching its highest level since Q4 (09). However, the index remains below the critical level of 100, highlighting the fact that conditions are still below the long term average. The improvement in the index in this particular quarter has been largely due to an improvement in general economic activity in the third quarter of the year, and the fact that stock market performance improved. On the negative side, we have seen an increase

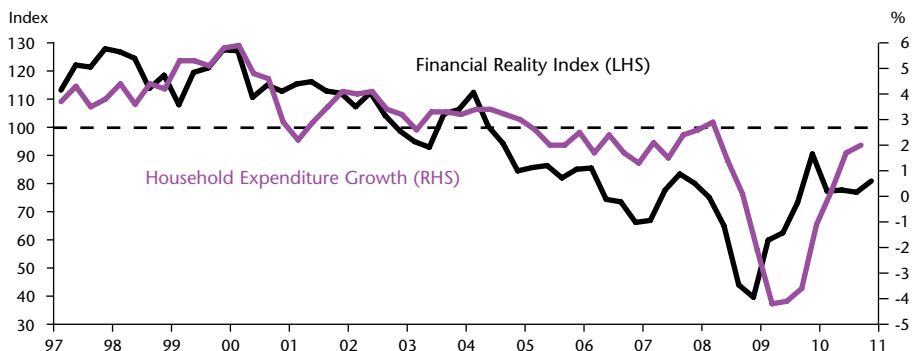
Household Budget



Net Wealth



Financial Reality Index v Household Expenditure



in unemployment, and no improvement in real earnings growth at the very time when households are having to cope with a sharp rise in the cost of basic goods and services.

Over the course of our 13 year study there has been a very close relationship between our Financial Reality Index and actual consumer spending growth as can be seen in the chart above. Consumer spending growth recently turned positive once more and is currently running at close to 2%, but our results suggest that this rate of growth could start to

fall towards a much lower level. The proposed cuts in public sector spending are expected to add even further to the downward risks to consumer confidence and spending.

Sources: ONS, DCLG, BoE, Reuters EcoWin and In-house Analysis