Scottish Friendly Assurance

ISA UPDATE

September 2009

The past year has been a difficult one for investors with interest rates tumbling and widespread turbulence on stock markets around the world.

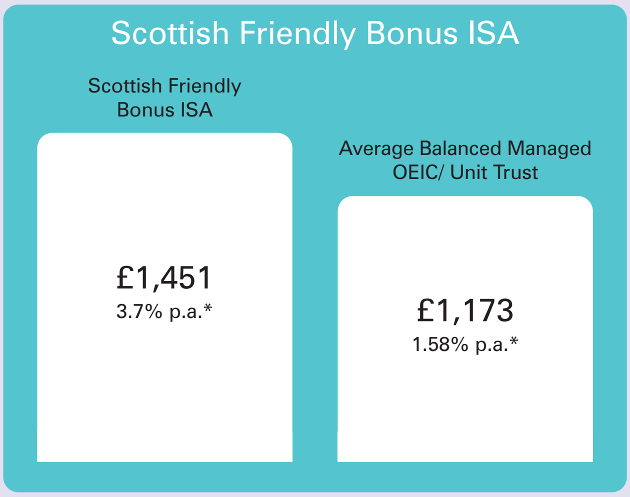
Is the worst now over? Colin McLean of SVM Asset Management provides some insight on this on the next page in his market and portfolio commentary.

Exciting news for ISA investors is that ISA annual investment limits are being raised to £10,200 (of which up to £5,100 can be in cash) from 5 April 2010. And the even better news if you're over 50 is that you can take advantage of these new limits from 6 October 2009.

The Friendly Bonus ISA

The Friendly Bonus ISA is a Scottish Friendly tax-free savings plan that is invested in the ISA With-Profits fund, which invests in stocks and shares, fixed interest funds and cash. As the past performance chart below demonstrates, Scottish Friendly Bonus ISA investors have continued to see their investment grow. Someone who invested £1000 when the Bonus ISA was launched in May 1999, would have seen his or her investment grow to £1,451 ten years later. That's a growth rate of 3.7% per annum.

Past performance is not a guide to future performance. The value of the with-profits bonuses is not guaranteed. A Market Value Reduction (MVR) may apply in certain circumstances to cash-ins. No MVR will apply if you cash in on the 10th anniversary of your original investment. A balanced managed unit trust invests directly in the stock market and its value can go down as well as up and the original investment is not guaranteed.



*Source: Scottish Friendly and Morningstar. Performance of £1,000 invested on 1.6.99 to 1.8.09. IMA Balanced Managed Sector average fund median performance. Offer to bid.

ISA Fund Past Performance

Please bear in mind that past performance is not a guide to future performance. The value of shares and the income from them can go down as well as up, and you're not guaranteed to get back the amount originally invested.

Value of £1,000 invested at various dates to 1st August 2009.

Managed Growth Fund

	Since launch 31/5/99 to 1/8/09	1/8/04 to 1/8/09	1/8/06 to 1/8/09	1/8/08 to 1/8/09
Managed Growth	£1,369	£1,181	£779	£785
Sector[1] median	£1,213	£1,251	£930	£923

UK Growth Fund

	Since launch 21/5/01 to 1/8/09	1/8/04 to 1/8/09	1/8/06 to 1/8/09	1/8/08 to 1/8/09
UK Growth	£1,248	£1,313	£921	£930
Sector[2] median	£1,011	£1,218	£855	£889

Standardised Managed Growth Fund rolling 12 month performance % growth

1/7/04 to 1/7/05	1/7/05 to 1/7/06	1/7/06 to 1/7/07	1/7/07 to 1/7/08	1/7/08 to 1/7/09
20.7%	21.5%	15.4%	-6.0%	-31.7%

Standardised UK Growth Fund rolling 12 month performance % growth

1/7/04 to 1/7/05	1/7/05 to 1/7/06	1/7/06 to 1/7/07	1/7/07 to 1/7/08	1/7/08 to 1/7/09
14.0%	21.3%	25.9%	-15.3%	-20.6%

Source: Morningstar. Performance figures are on a bid-bid basis, inclusive of net reinvested income and tax credit if applicable. This basis does not take into account the initial charge. Standardised past performance figures are on a bid-bid basis, inclusive of net reinvested income. These figures do not include the previously reclaimable tax credits applicable to ISAs. 1. Asset Allocation Dynamic sector. 2. Equity UK sector.

Market and Portfolio Commentary

by Colin McLean, SVM Asset Management

In our last update we wrote that the main concern for central banks globally was slower growth and a potential for rising inflation. Falling house prices, an end to cheap credit and rising unemployment all presented a difficult environment for the UK economy. This was putting severe pressure on the banking system. What happened subsequently was as a result of that pressure. The collapse of Lehman Brothers precipitated a period of extreme volatility for the world's financial system, which brought it close to collapse. Equities fell heavily as risk aversion increased dramatically.

Into recession

The troubles within the global financial markets triggered a collapse in confidence across the broader economy and the UK officially entered recession in the fourth quarter of 2008. Central banks unveiled urgent measures amid concerns that the world economy was entering a dangerous new phase. The Bank of England cut interest rates to their lowest level in three hundred years and global central banks, eventually, launched a coordinated round of interest rates cuts providing massive monetary stimulus.

Over the worst?

Although equity markets continued to decline into 2009, a turning point was reached in early March as some economic indicators turned more positive, albeit from depressed levels. The stock market began to rebound, anticipating economic recovery. So the key questions now must be: are we past the worst of the volatility and what is the outlook for equities?

We are generally positive on the outlook for equities though retain a cautious stance on some parts of the stockmarket. Volatility has fallen, but sentiment remains fragile. For stock pickers, these periods often present excellent opportunities to pick up bargains. The irrational selling that occurred in the fourth quarter pushed many stocks down to valuations that simply offered outstanding value. It is pleasing to see many of our holdings bounce back strongly in a more rational environment.

We remain nervous of the consumer, particularly in economies such as the UK and Ireland where personal indebtedness is high. Rising unemployment, increased levels of taxation and the need for households to repair balance sheets all point to a difficult environment for cyclical services and other consumer focused businesses.

The environment remains extremely difficult for businesses with debt and also where business models are broken. Although bank lending has increased, often where companies have sought to raise finance, it is often on poor terms and costly.

Rising impairments and a tougher regulatory environment will continue to impact bank profitability, although those banks which lent more prudently and which have an investment banking business are profitable. We are generally more positive on the bank sector. A rising equity market will help to bolster global balance sheets with large amounts of new equity value and should supply banks with the new capital that would allow them to step up lending.

The UK and beyond

UK equities continue to offer dividend yields that are attractive relative to returns on bonds and cash and valuations remain undemanding. Dividends in some companies have been cut and this, along with pension deficits, are issues that we are focusing on closely as part of our ongoing company analysis.

The US economy has shown signs of stabilising and Chinese and other emerging markets continue to grow strongly. Confidence amongst investors has improved and a large amount of cash is being re-invested in the market. In the absence of a sustained period of rising inflation, we believe equities should perform well and continue to recoup recent losses, although some volatility is to be expected.

Portfolio review

Performance in 2009 has been strong for both the Managed Growth Fund and UK Growth Fund portfolios. Over this period, the Scottish Friendly Managed Growth Fund has returned 11.4% which was comfortably ahead of the average Balanced Managed fund's performance over the same period of 7.0%. The Scottish Friendly Managed Growth Fund also outperformed the FTSE All Share Index over this period and the fund was ranked in the first quartile within its sector. The Scottish Friendly UK Growth Fund returned 12.6%, again outperforming the FTSE All Share Index which returned 10.9% over this period*.

Certainly a more rational market has existed in the last six months and the wave of panic selling has given way to a more optimistic market as economic data has turned more positive. Undoubtedly many of the companies that saw their dramatic share price decline in 2008 have rebounded strongly in the last few months. We continue to identify many businesses that are trading on low valuations and are not yet pricing in recovery; within the Managed Growth portfolio many of the closed ended funds that are held for overseas exposure continue to trade at large discounts to asset values and we believe this gap will continue to close and deliver strong returns.

*Source: Lipper 21/12/2008 to 05/08/2009 Balanced Managed and UK All Companies Sectors