

## Client Newsletter December 2011

Welcome to the December edition of the Quartet newsletter which we hope you find of interest. As always please do not hesitate to drop us a line if you have any questions or comments.

### Review of the quarter

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Undoubtedly 2011 will go down in history as a tricky year for investing as wave after wave of bad news battered equity markets. Europe's sovereign debt crisis, the Arab spring, the Japanese Tsunami (and subsequent nuclear disaster), an over-inflating China and America's debt downgrade all led to weaker than expected global economic growth and, subsequently, volatile stockmarkets.

The final quarter of the year continued the theme of abnormally high levels of equity market volatility which we had seen all year, albeit on the upside for a change. With an improved outlook for the Euro crisis markets rallied strongly. Here in the UK the FTSE 100 shot up from around 5,128 at 30 September to end the year at 5,572, a rise of just over 8.5%.

Compared to most major global equity markets the UK markets actually performed relatively well in 2011, but rather than this reflecting some fundamental improvement in the UK's situation, the UK appears to have benefited from not being a part of the Eurozone.

#### FTSE 100 Index (1 October - 31 December)



Source: [londonstockexchange.co.uk](http://londonstockexchange.co.uk)

The US equity market was the only major market to end the year in marginally positive territory, although this hides the high levels of volatility suffered with 5% daily moves becoming the norm, not anomalies.

Most major equity markets ended down for the year with the MSCI World Index falling by over 5%. In truth given the amount of negative macroeconomic news we enjoyed over the year major stockmarkets probably did quite well(!).

At the start of 2011 most commentators felt government debt yields could go no lower, but the search for "safe assets" as a horrible macro-economic environment unfurled pushed many investors into the sanctuary of government/risk free (?) debt. It is no surprise then that this was the strongest performing asset class of 2011. However, with some yields now negative (i.e. investors now pay the government to hold their debt), one has to ask can government debt yields really go lower in 2012?

Given that "safe assets" looked expensive a year ago, many felt that equities, with relatively attractive dividend yields, would provide the best returns. As we now know this was not to be the case, but as we enter 2012 the same argument is being put forward.

### Outlook

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In terms of outlook for 2012, we actually find ourselves in a similar position to the start of 2011, asking almost identical questions. Can Government debt yields really fall further? Will Europe address



and remedy its problems? Can Asia (and specifically China) manage its slowdown properly? As one prominent economist recently commented, “2012, different, but the same”!

Unfortunately the Eurozone crisis appears to be having quite a significant impact on the UK economy, and we feel the likelihood of a double dip recession still appears to be high.

In terms of our thoughts for 2012, here are the major issues we think markets currently face. Unsurprisingly, they are similar to those faced in 2011:

- **Eurozone sovereign debt crisis.**
- **Potential unravelling of the Euro.**
- **Weak growth in the UK and US.**
- **Interbank funding.**
- **Iranian tensions in the Middle East**
- **Slowdown in Asia.**

Over the past year the macro-economic picture seems to have grown worse with economies around the world either stalling or showing lacklustre growth, and the tools to remedy these situations quickly running out.

Whilst investors have begun to appreciate the reality of the problems faced, buying “safehaven” investments (such as cash, gold and government debt), going forward they face a choice; stay in safer assets and earn low returns, or take on more risk and consequently face the potential for larger capital losses. Our view is that given the reasonable relative valuations of risk assets like equities these may well surprise investors on the upside.

#### **What does this mean for Quartet’s client portfolios?**

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Given that our prime focus is on the management of client asset allocations, both strategic and tactical, we thought it useful to show in the graphs below how our main risk profiles are positioned strategically and then how we have tilted these tactically.

As you will be aware the building block that we start with in the construction of each client portfolio is one of four strategic asset allocations – Capital Preservation, Cautious, Balanced and Aggressive. These asset allocations are then tailored to each client’s circumstances to create a bespoke client portfolio. Client strategic asset allocations are adjusted on a tactical basis depending upon our views towards different asset classes, regions and the broader economic environment.

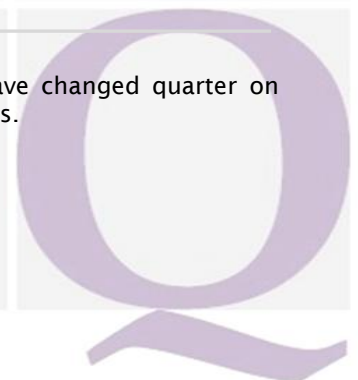
Main actions taken in client portfolios over the past quarter:

- We decreased cash weightings across all risk profiles at the start of the quarter. We do however continue to maintain relatively high cash balances given the various issues that linger over the global economy.
- Evidence suggests that many companies strengthened their balance sheets following the 2008 crisis, reducing debt levels and increasing their cash holdings. This relative strength, alongside the relatively high yields being offered, saw us increase our exposure to corporate debt across all portfolios.
- For our Cautious, Balanced and Aggressive portfolios we increased our equity allocation, preferring specific European and Emerging Market exposure on a relative value basis. At the time of investing European, Brazilian and Russian Equities were all trading on a Price to Earnings ratio of less than 10 times. This has historically been an attractive entry point for the longer term and is favourable compared to US Equities which trade closer to 20 times.

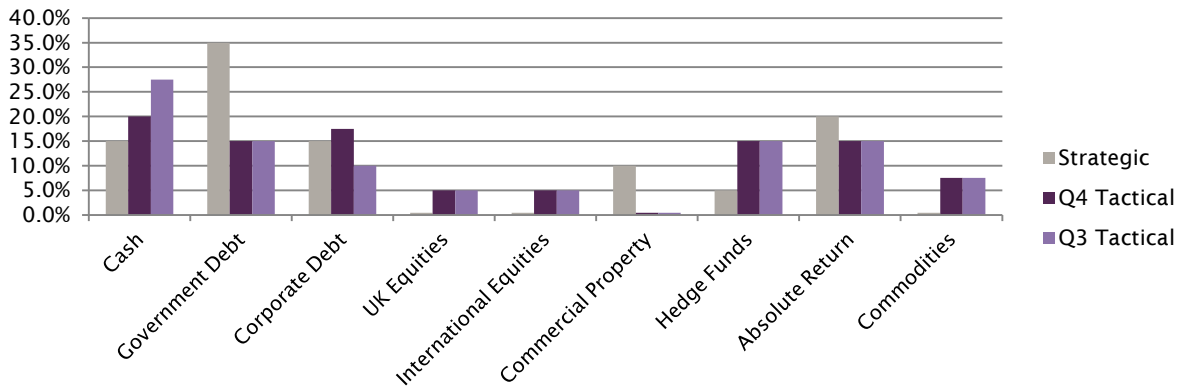
#### **Quartet’s portfolio positioning**

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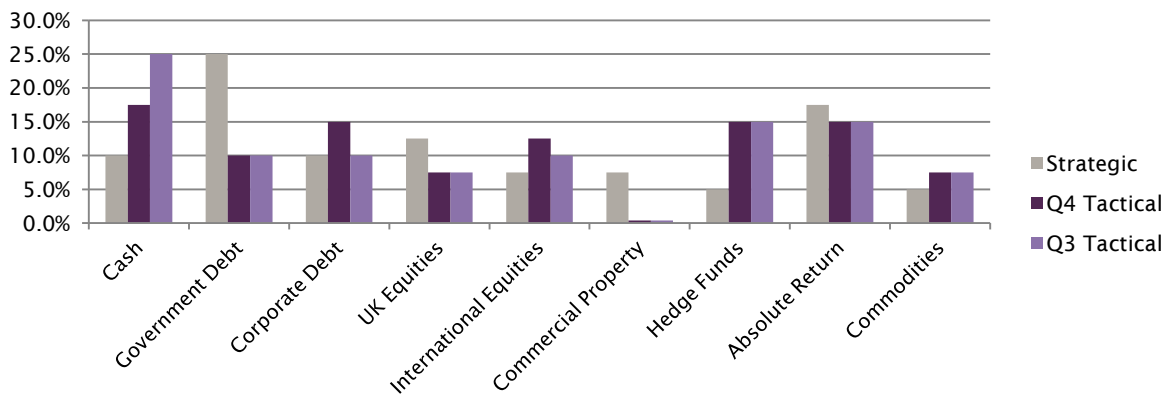
Detailed below are four charts showing how our tactical asset allocations have changed quarter on quarter and also the positioning relative to the neutral strategic asset allocations.



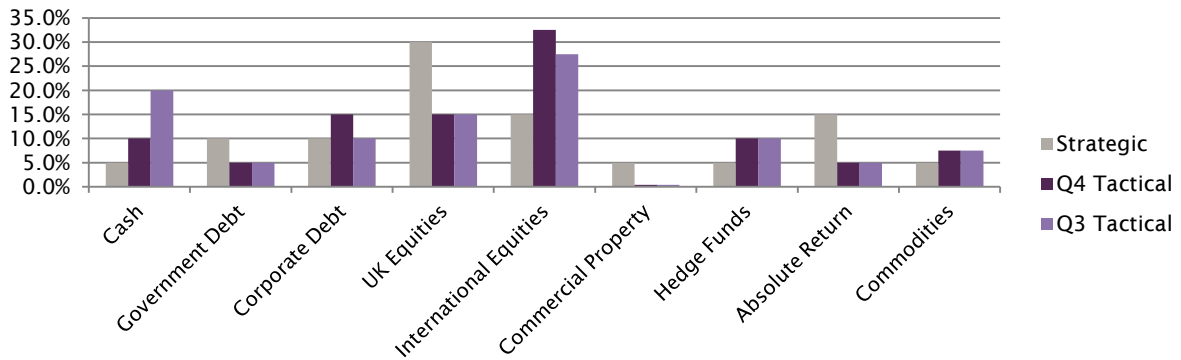
### Capital Preservation asset allocation: Strategic & Tactical Allocations



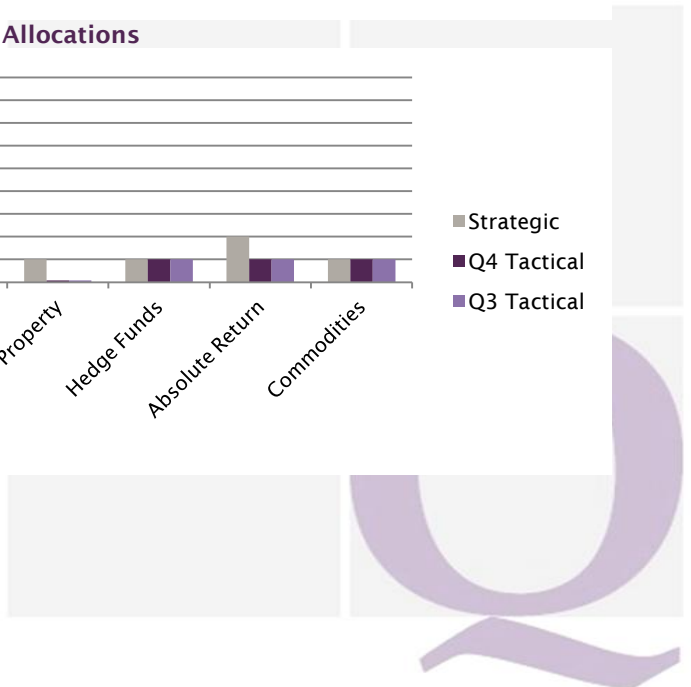
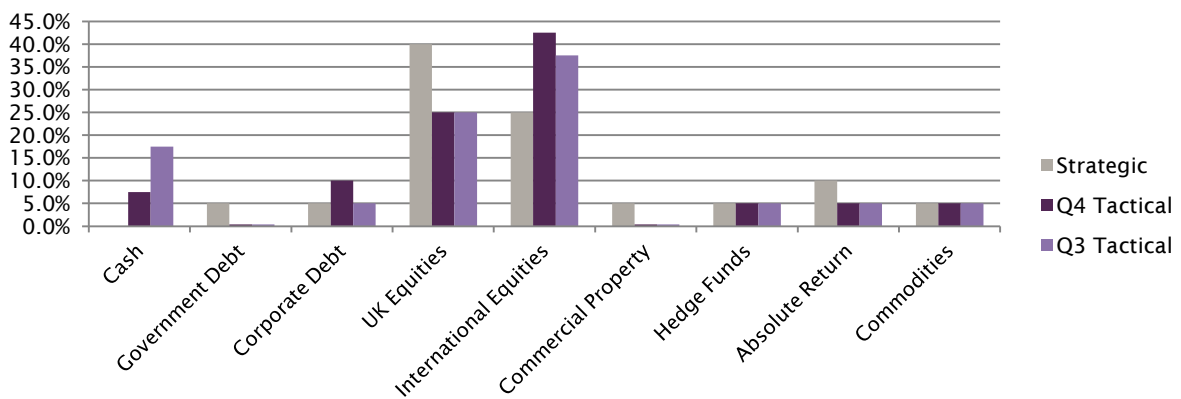
### Cautious asset allocation: Strategic & Tactical Allocations



### Balanced asset allocation: Strategic & Tactical Allocations



### Aggressive asset allocation: Strategic & Tactical Allocations



## Fund news

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Given our increasingly positive view towards equity valuations on a long-term basis, we thought you may find it interesting to see why we hold the Veritas Global Equity Fund in many client portfolios.

### *Veritas Global Equity Income fund*

The key investment objective of the Veritas team is to deliver real (taking into account inflation) returns for investors over the longer-term, but always with a focus on protecting the capital value. The fund has very successfully met these objectives since inception 7 years ago and even managed to provide a positive return for 2011, when the vast majority of stockmarkets fell in value.

Using their own analysis, Veritas aim to invest in undervalued companies with strong long term return potential, and a sustainable income yield. A new holding is only purchased if they believe it can achieve at least a 15% annualised total return (including income yield) over a minimum 3 year period. Once found the idea is to buy and hold these investments, resulting in low portfolio turnover.

The fund is not benchmark constrained and can invest globally, although its stated objective is to outperform the MSCI World index over a 5 year time horizon. It is a portfolio of the manager's highest conviction ideas and currently invests in around 35 companies, whilst presently providing an income yield of 4.8%.

The fund now has over £1.5 billion in assets, and has returned double the MSCI World performance since inception. As with the vast majority of our investments, the fund is daily tradable and provides full investment transparency.

## Quartet Quarterly News

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We are very pleased to announce that Anthony Fernandes has joined our team as an investment assistant. Anthony graduated in the summer, and is keen to help where he can.

We are also delighted to announce the first Quartet baby arrived in December. Emma and daughter are doing well.



## A reminder of what we do

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Quartet Capital Partners focuses on providing discretionary investment management services to high net worth private clients. We believe that the approach we take really is *different*.

We believe that there are a few key points about Quartet's investment approach that make us different.

- **Bespoke portfolios.** We do not believe in shoehorning clients into predetermined investment solutions, therefore all client portfolios are managed on a bespoke basis.
- **Portfolio construction.** We start by addressing each individual client's risk profile which in turn yields a strategic asset allocation. This is then adjusted tactically depending upon our macroeconomic views to finally arrive at a bespoke client portfolio.
- **Asset allocation.** We believe (and studies have shown) that asset allocation is by far the biggest driver behind investment performance. This is what we focus on getting right, and where we believe we add significant value.
- **Investments.** Very few fund managers consistently beat their respective index and they also tend to have high fees and costs. We therefore use passive investment vehicles for core portfolio holdings. Tactical investments which make up the balance of most portfolios are specific investment counters or actively managed funds which are included to try and produce the best risk-adjusted returns (add alpha). All portfolios are managed on a multi-asset basis to diversify risk.
- **Chartered investment professionals.** We are a team of investment managers who have all attained chartered status, have worked together for a number of years, and specialise in managing personalised investment portfolios for private clients.

If you have any questions, queries, comments and feedback, good and bad(!), or if you are interested in a confidential meeting with Quartet Capital, please contact Colin McInnes, Managing Partner, on (020) 8939 2920 or via email at [cgm@quartetcapitalpartners.com](mailto:cgm@quartetcapitalpartners.com).

Quartet Capital Partners LLP  
December 2011

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The portfolio performance information presented in this letter is estimated, unaudited, net of applicable fees and is subject to change. No representation is being made that the portfolios will or are likely to achieve profits or losses similar to those shown on the monthly performance table. Past performance is not indicative of future results and a client may not get back the amount originally invested.

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