



## Client Newsletter September 2011

Welcome to the September 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 last quarter

What a quarter! Stock markets have become extremely volatile (daily moves of 2% or more are becoming the norm rather than the exception) and finally seem to be waking up to the global economic troubles we have been highlighting for a while. Over the quarter the FTSE 100 has fallen by over 13%.

#### FTSE 100 Index (30 June - 1 October)



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

Readers of our newsletter will already be aware of our “Wall of Worry”, and when reviewing this we are reminded of Monty Python’s Black Knight in the Holy Grail. No matter how many blows he suffers, or limbs he loses, he keeps on fighting the inevitable outcome, “Tis but a scratch.....I’ve had worse” is his answer to losing his first arm and after having all his limbs cut off, “All right, we’ll call it a draw”.

This analogy seems particularly apt when looking at the enveloping Eurozone crisis. So much political time, effort and money has gone into the Eurozone “project” that politicians are now almost willing it to remain on course. Failure is not an option and the hope is they can drag the current situation out long enough for some miracle to magically reattach all the limbs!

Turning to the “Wall of Worry”, here are the major issues we think markets currently face:

- **Euro-zone sovereign debt crisis.** The debt dominoes are finally beginning to tumble. The proposed 2<sup>nd</sup> Greek bailout seems to be faltering and consequently has failed to calm markets. There is now little the authorities can do to prevent Greece from defaulting (in some form), which leads one to ask “where will this all end?” Spain and Italy are seriously wobbling, with yield spreads close to 3% higher than fellow Eurozone member Germany. For Spain and Italy this equates to yields approaching 6% - an important barrier if trying to avoid default. Interestingly Italy has the 3<sup>rd</sup> largest bond issuance in the world (behind the US and Japan) and France and Germany combined would be unable to manage that size of default. Is this the beginning of the end for the Euro currency as we know it?
- **Weak growth in the UK and US.** With the austerity package starting to bite in the UK, unemployment remaining stubbornly high in the US, and consumer spending still weak on both sides of the Atlantic, the UK and US continue to look susceptible to a double dip recession. Deflationary pressures persist, in part explaining why we continue to see interest rates held at their record low levels. How long will it be before we see further QE (quantitative easing) in both countries? STOP PRESS.... An additional £75 billion announced in the UK today!



- **Interbank funding.** As the threat of a Greek default lingers, the exposure banks have to troubled European debt has come under the microscope. However, a lack of clarity over each bank's exposure has created an air of mistrust and seen interbank lending begin to dry up. Reminiscent of 2008, this may well lead to several banks requiring a government bail out (just see what has happened to Dexia over the past few days).
- **Inflation in the East.** The official inflation figures for China continue to rise and will only become worse whilst the currency is pegged to the US dollar (and the US maintains its low interest rate policy). The further increases in interest rates by the Chinese authorities are failing to apply the brakes as they would wish and, whilst they maintain they have control of the situation, only time will tell if they can prevent a hard economic landing.

Since the start of the year the macro-economic picture seems to have grown worse, with economies around the world either stalling or over heating, and the tools to remedy these situations quickly running out.

Whilst investors have finally begun to wake up to this reality, and more recently sought "safehaven" investments (such as cash, gold and government debt), going forward they face a choice; stay in safer assets and earn an interest rate close to zero, or take on more risk and consequently face the "Wall of Worry".

### 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.

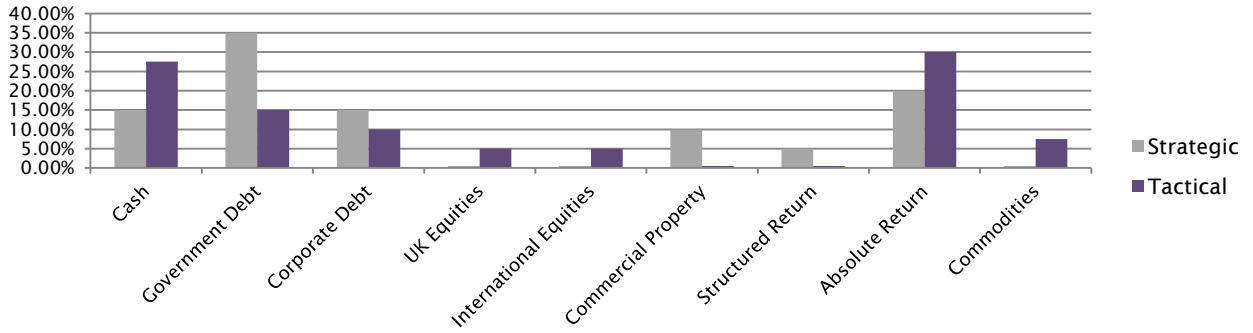
As you will be aware the building block that we start with in the construction of each client portfolio is one of four strategic asset allocations - Capital Preservation, Cautious, Balanced and Aggressive. These asset allocations are then tailored to each client's circumstances to create a bespoke client 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 portfolios over the quarter:

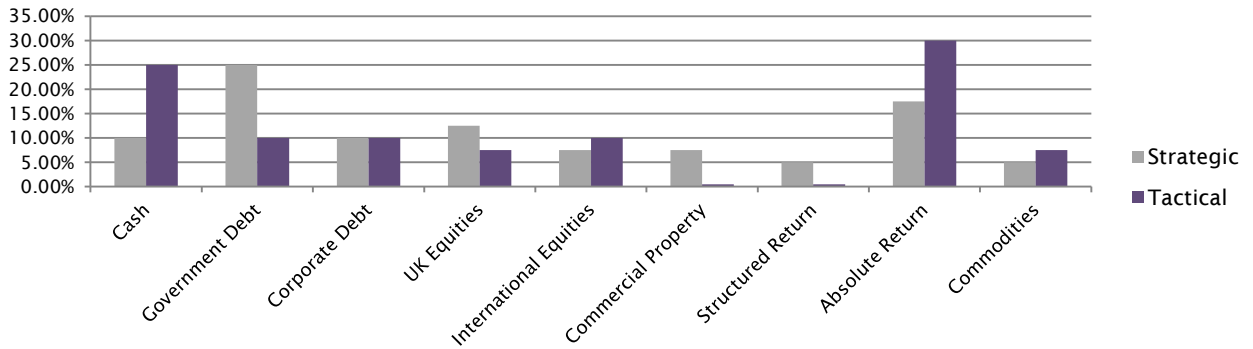
- We increased cash weightings across all risk profiles at the start of the quarter. We have been relatively cautious over the last few months but still felt it prudent to increase cash levels or maintain high cash balances as the current uncertain market outlook worsened.
- In the Capital Preservation and Cautious portfolios we reduced our Corporate Bond and Gold weightings in favour of cash. We reduced our exposure to Gold given its strong run and increase in volatility but we still maintain exposure within portfolios as we feel that it offers a form of disaster insurance, although in the shorter term it is exhibiting the attributes of a 'risk' asset, in part due to traders requiring cash and selling profitable positions. We sold a Corporate Bond ETF as we were concerned that we could see a repeat of 2008 where corporate bonds sold off significantly.
- In Balanced portfolios we also sold the Corporate Bond ETF.
- In both Balanced and Aggressive portfolios we reduced our Equity exposure, predominantly to the US market.
- Within Balanced and Aggressive portfolios we have introduced some US Dollar exposure. We have done this by switching from some sterling hedged Equity ETFs into the un-hedged US Dollar equivalents. The reasoning behind this is that we feel that the US Dollar is undervalued against most major currencies and expect to see a recovery in the US Dollar. This started to happen through September in part due to the Euro-zone's intensifying debt crisis.
- More recently we have started to see some value emerge within European Equities and have started to add some exposure across portfolios. European Equities are now trading on a Price to Earnings ratio of less than 10 and yielding circa 6%, this has historically been an attractive entry point for the longer term and is favourable compared to US Equities.



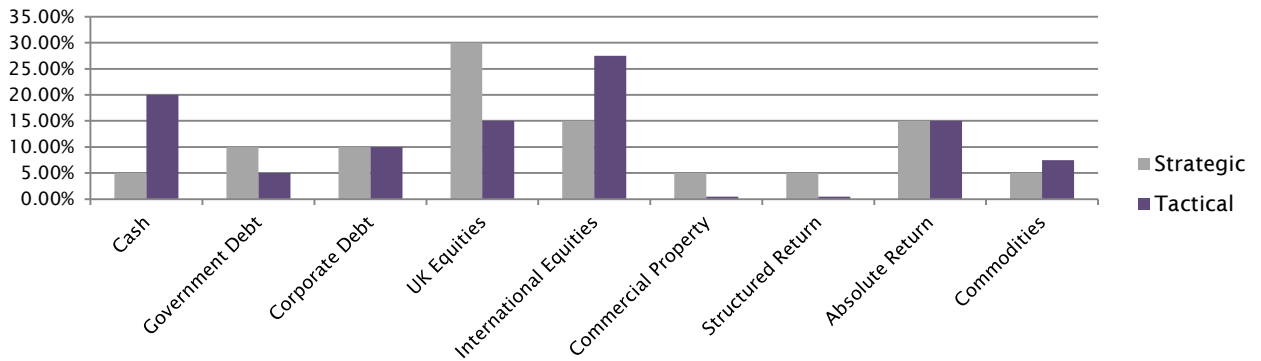
### Capital Preservation asset allocation: Strategic & Tactical Allocations



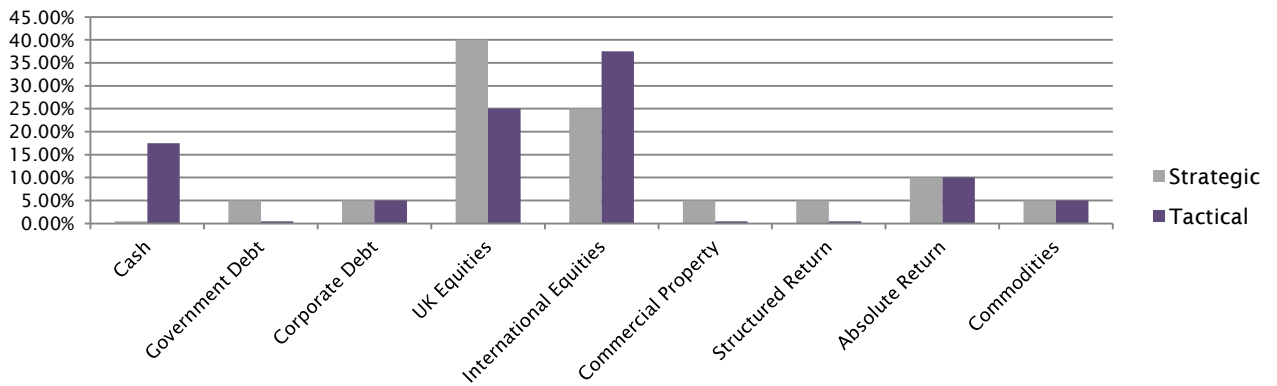
### Cautious asset allocation: Strategic & Tactical Allocations



### Balanced asset allocation: Strategic & Tactical Allocations



### Aggressive asset allocation: Strategic & Tactical Allocations



## Fund news

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Given our positive view towards absolute return funds, we thought you may find it interesting to see why we hold the Troy Trojan Fund in many client portfolios.

### *Troy Trojan fund*

The primary aim of the Trojan fund is to preserve capital, whilst growing the value in real terms (after inflation) over the long term.

Managed by Sebastian Lyon at Troy Asset Management, the fund has an outstanding 10 year track record and has never lost investors money in any calendar year. Such performance obviously attracts attention, and the fund is now closed to new investors in an attempt to prevent any slippage of performance (please note that existing investors are able to add to their holdings, so Quartet are still able to invest).

The fund takes a fairly basic approach when investing. They are not trying to do anything fancy or complicated and generally only invest in direct equities, bonds, precious metals, cash, and occasionally collective funds (i.e. unit trusts or investment trusts). They allocate to these asset classes actively, and as such can have up to 50% in cash, or as little as 25% in equities if they feel these are the correct weightings given their global outlook.

Overall we feel the fund's approach complements other "absolute return" strategies in portfolios, and the track record speaks for itself. As with the majority of investments we purchase, this fund offers daily liquidity and full investment transparency.

## 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).



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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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