

Multi-Manager Diversity Tactical Fund

Fund commentary – Q4 2011



Market review

Reading the stream of year end summaries for 2011 suggests that few will look back fondly at a year which has tested the resolve of many investors. Indeed for a great deal, the fourth quarter proved as tough as any to read as once again sentiment and market reaction swung from one end of the scale to another with each passing announcement.

Europe's travails continue to be the obvious focus, and the quarter has undoubtedly seen moves to bring some greater conviction to restructuring attempts. However, bond yields continue to suggest that we are some way from an ultimate solution to the Eurozone's problems at this stage even if the near term funding issues of many of the regions' banks appear to have dissipated for now. Further moves towards fiscal union seem likely and, whilst unpalatable in the longer term, perhaps we will even see the stance towards quantitative easing soften at some stage. The onset of recession or signs of German disinflation may at least increase the likelihood of a discussion about the potential for a bout of more explicit European money printing.

Alongside Europe, our eyes continue to be drawn to Asia. With Asia one of the largest recipients of European financing in recent years, focus is switching to the resilience of Asian growth in the face of a European liquidity squeeze – particularly if the impact of the recent policy tightening measures has not been judged correctly.

There are areas, though, that may surprise positively. The US may well be the one bright spot with low growth but, at least, some signs of stabilisation in both confidence and activity. Indeed, the ongoing European banking issues could yet provide a welcome boost to US banks, who appear to be further down the recapitalisation path than their western peers. For all of this, though, it remains unclear how the impending presidential elections will impact near term sentiment and policy as both sides of the political spectrum jostle for the limelight.

Performance review

The Fund generated a return of +2.4%* over the quarter. This compares with an IMA sector** average return of +2.9%*. The Fund was ranked in the third quartile* for the period and top decile* for the year.

Activity

In the UK, we switched our holding of Invesco Perpetual Income into Fidelity Special Situations.

Outlook & positioning

Macroeconomic concerns will continue to dominate headlines through the coming year. Markets are likely to be at the mercy of politics, making forecasting a somewhat difficult task given the speed at which newsflow can change. However, it does not feel rash to suggest that a European recession appears likely and that western growth, where it is apparent, will be sluggish at best.

Despite this, we continue to find attractive opportunities, where much of the bad news is already priced in. As such, our increased level of activity over the last quarter reflects a gradual move to a more progressive stance on selective valuations if not yet the macroeconomic outlook.

We have long talked about the ‘optionality’ of cash in periods of high volatility – providing us the opportunity to invest should markets correct to more favourable valuations. Our large holding in cash through the middle of the year preserved capital as most asset classes fell. Furthermore, we positioned a portion of our cash holding in US dollars – historically a more defensive currency – to provide additional preservation to the overall portfolio. However, as valuations have adjusted (in both credit and equity markets) we have used this optionality to invest.

In equity markets, the de-rating of more cyclical sectors saw our defensive holdings (the likes of Invesco Perpetual Income & JOHCM UK Opportunities) outperform significantly. As an example in the UK, the tobacco sector outperformed the mining sector by some 60% over the year. As 2012 gets underway, we are beginning to see value appear in some of these more “beaten up” areas. Although not necessarily our base case, should macroeconomic conditions (or at least sentiment) improve, these areas would likely outperform strongly. More importantly from here, we feel it is unlikely that any further downward trend in equity markets – outside of any extraordinary event – will see the same degree of outperformance of defensives over cyclicals. As such, it feels prudent to bring our equity holdings towards a more neutral position. In recent weeks, therefore, we have started to rotate the likes of Invesco Perpetual Income into funds such as Fidelity Special Situations – in particular at this stage, funds more exposed to some of the more domestic cyclical areas of the market – be they financials; media; retailers et al.

Outside of the UK, we continue to find attractive valuations in European equity which bore the brunt of the mid-year pull back and look to have fully priced in the recession that many are now forecasting. As such we continue to add to our European holdings, in preference over both Asia and the US.

With no gilt exposure, we chose to replicate these defensive characteristics through our alternatives holdings – concentrating on finding areas that were truly uncorrelated or negatively correlated to most major asset classes. The likes of Eclectica & Majedie Tortoise provided strong positive returns through the year, benefiting from having relatively cautious positioning – long the more defensive areas of the markets and short the more cyclical / global growth orientated areas – each in their own way. Pleasingly, a number of

these funds have started to rotate into some of the areas of value that we have touched on above and so should provide a degree of upside should sentiment improve from here whilst still offering us relatively uncorrelated returns.

We continue to be mindful of the many economic headwinds that still exist. However, in looking for an acceptable balance of risk versus reward in our portfolios we feel able to take on a degree of greater risk at this stage given the adjustments in valuations that have occurred. As such, we remain cautiously optimistic about the outlook for investors. Credit crises have never been solved within a year and we remain some way from clear water in macroeconomic terms. However, as with 2011, opportunities will undoubtedly offer themselves up for the tactical investor and, as ever, we hope to take advantage where possible.

Regulatory Information and Risk Warnings

*Source: Lipper, A Acc, net income reinvested at 30/12/11. **Now the IMA Flexible Investment (previously IMA Active Managed Sector).

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