Occasional Commentary from the Chief Investment Officer, Friday, December 05, 2014

A review of 2014's Investment Performance

Simply put, 2014 went according to plan, which is pleasing. Easy money continued throughout the year despite concerns over the end of the QE era and speculation over the dates of rate rises in the UK and the US. As is common knowledge, our primary asset allocations were in property and large capitalised equities – both of which have returned unleveraged double-digit returns this year. Tactical trading was also modestly positive with gains in US Treasuries and VIX trading more than offsetting the costs of hedge protection. The currency book spent the first half of the year fairly flat as our long-USD bias didn't pay off until Q3 and Q4. Overall, with an equity market where the S&P 500 is currently set to return an annualised return of over 15% and the FTSE 100 is set to return around 4% before dividends, we are content that our approach has led the Central Portfolio to outperform both. Returns for specific portfolios vary from this depending on chosen risk profile, investment restrictions, specified investment objectives and the extent to which leverage was allowed if at all.

We want to say Thank You to All of you that supported us in 2014. We hope to celebrate our Parent Group's 30th Birthday with some of you in early 2015 (established in 1985).

Outlook for 2015

There were certainly areas of pain in 2014 and we hope to identify areas of long term value amongst the carnage and fire sales. Some examples are Oil Services, Energy and UK Supermarkets. Oil is certainly precarious with a USD 60 handle for WTI increasingly likely, but there seems to be an excessive focus on a return to the previous low in 2008, where US WTI traded c. USD 40. As this could happen again, we are baking in such a scenario when considering how best to invest in this sector. There are several Oil E&P names, Drillers and Oil Services stocks that can still muddle along at such a price and it is these 'survivor' names that we plan to accumulate on any continued weakness. At the Macro level, we would also seek to identify opportunities where Oil Importers build advantage at the expense of Oil Exporters.

Geographically, we are still optimistic on China, which was an excellent tailwind for us in H2, although the Composite's steep rise in a short space of time has to be viewed with some caution. We now have the facility to invest into China directly through the Hong Kong – Shanghai Connect system which has allowed foreign investment directly into locally listed China equities.

We held a dim and negative view of Miners, Resources and Banking for the duration of 2014, expressed either by avoiding them altogether or shorting them, depending on the portfolio mandate. For 2015, at least at the outset, we would need a reason to have faith and we're not quite there yet. There are

pockets of value in Financials but not in the Banks in our view. From the perspective of money flow, the high quality yielding sector of the equity market has been quite strongly squeezed to such a point that in a few cases, perhaps the reduced yield for fresh money is no longer worth the risk. Hence, yield-focused buyers may look further afield in 2015 to Asia, as well as to the larger resources businesses and re-insurance – both of which might perform well next year. As a headwind, Resources may still struggle near-term due to the declines in Industrial and Precious Metal Commodity prices; a stabilisation in these is a necessary precursor to any sector recovery.

While the QE era seems at least to be nearer to the end than the beginning in the UK and the US, it seems to just be starting in China and Japan. We are already positive on select names in Hong Kong and China but are conscious that the China landing may have a few bumps along the way. After our most recent trip to Japan in November 2014, we came away with a resolve to concentrate more on Japan in 2015 than we had done in 2014. We are continuing with our plan to invest more in Japanese property, via direct ownership or via Property Equities and may well launch a specific offering on this in the New Year. European equities seem to be fundamentally cheaper than the US and probably offer a better risk-weighted equity play than the US, which seems to be priced to perfection. Overall, at Index level, we expect changes of leadership and sector rotation to be centre stage as the US Indices generally may have a less spectacular year in 2015.

We will be attending a range of UK and EU Property Industry Events during the course of next week, if this is an area of interest for you, please let us know and we shall circulate our findings.

On Fixed Income, our tactical call in April of holding onto Sovereigns proved to be correct in the end and we are still cautious of policy errors that may prolong the period of dis-inflation. Consequently, we expect to trade the Sovereigns tactically again in 2015 and currently hold a position. The core corporate bond holding allocation is unlikely to increase in 2015 and the duration of the allocation we do have is also likely to stay relatively short.

We will continue to buy hedging protection when it is priced as cheaply as it is currently and on occasions where we feel complacency has become excessive. With Elections in Japan this December, the UK next year and a host of other catalytic events across all asset classes, we expect 2015 to be another volatile and eventful year.

An end-note – Fund Structures vs Managed Portfolios

In the context of Professional Investing, a wide range of complex strategies that were previously the domain for Institutions are now easy to cheaply replicate by investors using their own trading accounts. Also as the costs of trading have fallen to just a few basis points, the Fund and Portfolio Management Industry has rightly had to focus more on the performance outcome rather than transactional fees. Hence, for simple long-only, long-short and numerous other equity-based strategies, the case for

investing in Fund units is not as compelling as it used to be. Fund structures have running expenses, (often opaque) transactional expenses, unclear transactional frequency and overheads that are ultimately billed to and paid for by the Fund's investors. So, there may well be a case of economy of scale for some Funds with a specific management style or those of a certain size but not necessarily so otherwise. Some Managers or Promoters also subsidise these costs to minimise the burden on investors. In comparison, a managed account that utilises a wide range of exchange traded instruments (eg. equities, derivatives inter alia) may be operated much more cheaply with no dilution of the desired strategy, simply because a whole structural layer of costs are not required. Another criterion to consider when comparing Funds with Managed Portfolios depends on the chosen strategy and whether or not it can be replicated by an individual portfolio as cost-effectively. For Funds that invest in Property, Private Equity, Venture Capital or Infrastructure Projects, it will likely be challenging for an individual investor to access such a broad range of exotic assets and build a proxy on his/her own. Lastly, investors should also be mindful of how their assets are protected. Offshore Funds are often very professionally administrated but such jurisdictions sometimes use placement documents that don't ring-fence assets particularly elegantly. Put another way, although unlikely, there could conceivably be a situation where a completely un-related Fund melts down and other Fund's assets (where both are under the same administrator or Cell Structure) could be put at risk. Always worth reading the Subscription Documents carefully. On this point, Managed Portfolios typically benefit from SIPC, Lloyds re-insurance or other segregated account protection, which seems to be highly valued by investors. Lastly, if an investor's objectives or circumstances change, the composition of a managed portfolio can be adjusted to cater for this. A Fund investment may simply have to be redeemed if it ceases to meet the investor's revised requirements.

Best wishes for 2015,

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