Occasional Commentary from the Chief Investment Officer, Sunday, June 15, 2014

Where Now?

Across both asset classes where we have our highest weightings, global large cap equities and property, we seem to notice a levelling out of the valuations at this level, perhaps not total exhaustion but certainly a lack of conviction for further upward progress.

Markets remain underpinned by a lower for longer outlook (small shake-up by Carney aside) but with the VIX and other similar risk metrics priced at historically low levels, we are managing our risk by using hedging tools and also by de-leveraging. The Property book is practically debt-free and our Core equities holdings are also un-leveraged. We haven't yet been so concerned about the medium or long term outlook that we would liquidate positions en masse. Being in the market (and being paid while we wait) with a decent amount of cheap protection seems to be a comfortable place for us.

We continue to favour companies that have already turned the corner into positive Free Cash Flow territory rather than those which are promising to deliver this. By and large, this puts us more on the Value side of the fence rather than the Growth side and certainly rules out the fad stocks which we tend to trade only tactically rather than retain as core holdings. US 'Old Tech' continues to be a theme we like (examples are Cisco, Intel, Nvidia). We also like some of the names in the out-of-favour UK supermarket sector, the US Offshore Drillers and US Oil Services. The general reach for yield has pushed Energy and Utilities up to quite full valuations, so we have not added to our existing holdings in these areas for some time now. Also under evaluation are the Precious Metals Miners, where we are studying the companies that have succeeded in maintaining financial discipline and profitability, despite the relatively weak price of Silver and also of Gold to some extent.

In the equity space, the Event-Driven and Special Situations space has been very frothy with plenty of activity, M&A, consolidations and special dividend events. However, some of the sharp price drops that have ensued from earnings disappointments do lead us to wonder if we are reaching a perfection point on broad valuations and whether or not this particular theme is becoming too crowded. We view this as another hint to reduce long leverage wherever possible. Globally, we continue to cherry pick in HK/China but have had no long exposure in Japan at all for quite a while, with the exception of Canon. In our opinion, for Abe-San's policies, it's far too early for a victory lap and we would actually be surprised if there wasn't an economic miss-step or speed-bump on the horizon.

On Fixed Income, our corporate bond allocation has remained stable but is set to run down further over the next 12 months. Any proceeds are likely to be allocated to one of equities, commercial property or residential property.

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Tactically, for US Sovereign FI, we circulated our observation on April 25th that the ratio of the S&P 500 Index to the US 30 Year Bond was at the most extreme point it had been at since late 1999 and late 2006. Both those dates coincided with sharp market shocks. This observation supported a successful long tactical US bond position at the time. However, although we find the trading in and study of the US 10 and 30 Year to be immensely useful, we do not anticipate ever holding US Sovereign FI as a longer term core position. The same applies to the European Bond Markets, which possess great tactical value but don't hold enough long term value at these levels for us to utilise them for anything other than trading reasons.

Our FX perspective is much the same as before, we prefer GBP and USD, vs the EUR and CHF. Both the BRL and ZAR are on the radar, both of which look tactically vulnerable vs the USD.

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