Occasional Commentary from the Chief Investment Officer, Wednesday, March 19, 2014

Where Now?

The broad equity market has continued to climb every wall of worry so far and seems only momentarily phased by the prospect of a Crimean standoff, despite the conceptual comparisons of this dialogue with the origins of the Great War. We think this war dance is far from over.

Economically, we don't really see too much material change from our perspective at the beginning of the year. Equities still behave like the go-to asset class and volatility still has yet to find any follow-through to the upside. Hence, the consensus still seems to be a Fed-held marketplace with few practical alternatives aside from equities for pools of investable cash. We would prefer to see some earnings expansion rather than just multiple expansion and for this reason, within the equity sphere, we hold a cautious bias rather than one led by momentum ideas.

However, we still remain of the view that investors should make the most of this sustained period of cheap portfolio insurance. It may well be a tough task to avoid a sizeable weighting in the equity market but there are still no meaningful cost barriers to having this exposure without any hedging or protection tools. That remains our core message for now.

Within the equity space, we continue to mine for value globally but are focusing less so on the pure play of dividend yields and instead look for a confluence of underperformance, self-help cases and attractive fundamental valuations. We still do find sustainable and well covered dividend yield plays but increasingly see special situations such as buy-back programmes and special dividend events being of more tactical interest.

We continue to accumulate companies with robust cash flow and high balance sheet discipline which reside in out of favour sectors, UK food retail is one example, drillers is another. We have also accumulated a fractional position in select Russian companies, Lukoil, Rosneft and Sberbank. With P/E's that you can count on one hand and (for the oils) extremely cheap valuations when viewed as $/barrel of oil equivalent reserves, full and comprehensive sanctions by the World against Russia are the main risk. We can hold companies that are this cheap for quite a few years.

We have been and remain averse to mining and banking but valuations for the latter are now becoming interesting. A name like HSBC which is disjointed and due an overhaul may soon start to fit our self-help criteria.

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We also take an interest in some technology businesses but given our value bias, this clearly rules out most of the high P/E and 'concept now revenue maybe later' businesses. Nvidia is one example of the type of company we like.

Allocations at the top level have not changed greatly in recent months with equities and property still representing the 1= spot and corporate debt in third place. However, we have started to see a little widening of the money flows in property outside the trophy spots, probably indicating a plentiful supply of investable cash and a shortage of inventory. Consequently, we are applying some of our acquisition criteria not just in flagship areas but now very carefully to secondary zones as well, akin to moving along the risk/credit curve by a notch. As a UK-specific point, today's UK Budget statement on Stamp Duty for properties over GBP 500,000 bought by companies will most likely accelerate this shift of asset price appreciation further away from SE England.

Additionally, we are looking at more residential developments than before as compared to commercial sites.

Loves, Hates and Hedges....

Land price inflation in Japan still piques our interest but timing is dicey for REIT and property investment there. Elsewhere in Japan, we expect an increase in frequency of corporate events and special situations. We don't desire an index exposure as that would expose us to Japanese policy risk but we do expect our Japanese tactical exposure to increase over coming months. For a short while to date we have hedged our Brazil and China exposures but don't yet feel it is time to take an aggressive directional position and intend to wait until this evening's Fed event is out the way before re-evaluating.

Commodities

After an extensive period of being long of NY Arabica Coffee, we recently took the opposing view, shorting the strength over 1.95 (NY Arabica) and are doing so now with a very tight risk discipline and tactical bias. We are also tactically long of Sugar. In conjunction with our positive outlook on Sugar, we also own Suedzucker.

A final word on overall asset allocation

We remain with equities and property as our joint top allocations and have used the US 30 Year and US 10 Year Treasuries only as short term car parks, we don't see much or any intrinsic investor value in either but both are useful for short periods. We favour GBP as our main currency. We continue to be short of EUR/GBP and long of GBP/CHF, primarily on tactical grounds.

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Johnny Mehta

Chief Investment Officer

jmehta@axis-im.com

+44 20 7713 4889

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