Occasional Commentary from the Chief Investment Officer, Tuesday, November 06, 2018

An Update on our current Asset Allocation:

30% Top Tier, Large Equities, Deep Value Bias
15% Commercial Property / REITS
15% Residential Property / REITS
25% Tactical Trading & Futures Hedging Strategies
0% Corporate Fixed Income (Investment Grade), GBP & USD, Short Duration
15% Cash

Key Comments:

The vast majority of our communications for quite a few months now have been of the instant message/bite-sized variety which seems more in keeping with the current tactical and politicised environment. However it now seems time again to draw our recent observations together into an update.

Where to begin? Perhaps with recent broad changes to overall asset allocation… more granular detail may follow in a subsequent note…

Real Estate….

Over the preceding 12 months, we have had a median allocation of ~40% in Commercial and Residential Property, inclusive of REITS. Taking into account the disposal of a large amount of REIT holdings from a tactical perspective, the allocation is nearer 30% at the moment. We tend not to use much leverage on the land assets in the portfolios and generally view these holdings as long term holds based on their characteristics of uniqueness and irreplaceability. Our tactical ambition and cautious stance is expressed through the flux in REIT holdings, where we do bob, weave and counter a fair amount. We may shortly re-visit the listed REIT sector but (with only a few exceptions) are not enamoured at the moment.

On the ground, certainly with London as a key example, we observe that residential rental values in trophy areas are down c. 20% when compared with last year. Commercial lease break clauses are being exercised in almost every case we have come across, and the rhetoric revolving around the high street's demise at the hands of online shopping is hard to deny. What is broadly unsaid is the effect of food price inflation and an apparent reduction in available discretionary income (leading to tightness in discretionary spending) for British consumers. An economy which appears benign at the surface level has more than a few signs of turbulence underneath. NAVs of shopping centres also seem vulnerable to downward revaluation. Brexit worries have contributed by reducing deal flow and causing many to defer their decisions for the time being. We also notice that while the marquee zone of London & the South East remains internationally attractive (a weak GBP is helping), there is certainly a retrenchment in play by the expat EU community and this can only be a drag on asset values in the region.

From an economics perspective, the irony is that a cyclical recession is probably due in ~2020 according to a calendar rule of thumb - but the Brexit outcome (whatever it is) and a well telegraphed gradual normalisation in interest rates will probably get the blame nonetheless.

Top Tier Equities….

We are not fans of the parabolic share price chart, (and since the day a long time ago when we saw Cisco at a P/E so vast it was forecast to consume the world) nor are we chasers of P/Es into the clouds – so we are not playing any long FAANG….our mantra remains constancy of purpose. Long term value and sensible valuations. When value is out of fashion and underappreciated, as it has been of late, it suits us perfectly. A couple of sectors look interesting and a few others have been a joy tactically (admittedly the odd dog too). For now, we are most optimistic on the Telecoms, with holdings in Telefonica and Orange as two examples, inter alia. We notice a lot of media kerfuffle around the Oil Sector being the cheapest it's been since forever – we are not convinced that this is quite as universally applicable as it seems. There is some value emerging (ENI, Total) and a few household names in the space are almost on the radar, but the Sector as a whole is not quite yet on the shopping list.

We like to be paid to play and there is a growing universe of yielding investments with covered and sustainable payouts to consider, relative to just a few months ago. We do circulate our watch list, on request.

As long as there is M&A, activism and cash on balance sheets, there are events, special situations and arbitrage opportunities. It seems like a leaner year in 2018 than 2017. Nevertheless, there have been and continue to be some reasonable risk-adjusted opportunities out there.

Tactical Trading….

This is where the most flow and activity has been for us over the last 12 months. We do sometimes wonder what we will do with ourselves when Brexit, Trump and the huddles in the DMZ are in the rear view mirror. On Brexit, we suspect that GBP is a long term accumulate at these general levels, deal or no deal. If no deal, we expect that there will be a scramble and some chaos but a fix eventually. If a deal, then the ship sails on and by that we mean that GBP should re-assert its credentials as the more nimble currency from a policy response perspective vs the leaden and inherently dogmatic Euro, and gradually appreciate.

Other instruments of choice for swift tactical response and pre-emptive positioning remain Bond Futures which we continue to view as a short term car park with which to express a short term bullish or bearish tilt, Bond Futures Spreads (for example, the Bund-Iti spread), Volatility futures, Select commodities and a short raft of currency crosses. Our stance on these varies so frequently that we tend to update investors and interested parties with interim updates instead upon request.

Fixed Income….

Over the preceding 24 months, the Corporate Fixed Income allocation has been allowed to run off and this year, we reached zero. Whether bonds have matured or been called, the proceeds have simply been re-allocated to Tactical Trading, Equities or Real Estate. Aside from occasional special situations, we doubt that Corporate Fixed Income will represent a material allocation for us in the coming 12 months.

Cash….

More cash on portfolio accounts currently than at this time last year. Although seasonality could lead one to be bullish on Equity Indices from now until year end, there does seem to be potential for some more market turbulence at both Index and Sector level and so raising a little cash from booked profits didn't seem to be a bad idea. We expect that the cash allocation could rise a touch over the next few weeks as we book returns on some current holdings, with a view to being ready and in place to capitalise on any opportunities that might arise. Position before submission, the ground-fighters' motto and very applicable here.

Investment Style….

We remain predominantly unrestricted and this allows us to completely avoid sectors and geographic regions as we deem appropriate. We do also utilise Sharia-compliant, Ethical, Income-focused and other bespoke strategies for interested investors. Using investment discipline learned from the comedy, chaos and fury of the last 25 years (or longer depending whose memory you are mining) we will generally only focus on investments where there is a high level of price discovery, a developed secondary market and sufficient liquidity to enter and exit swiftly with neither drama nor market disruption. No gates, no barriers, no restrictions. What's yours is yours. These simple attributes are in place to provide peace of mind to our investors as well as being true to our own long term ideals.

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