Asset allocation strategies

Can we learn from November 1982? Cheviot Asset Management believe so and they also believe there are exceptional opportunities in all asset classes.

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In November 1982 exuberant behaviour in stockbrokers' offices was frowned upon, but nothing could stop the cheering when the FT30 finally reached 600 breaking clear of the trading range that had persisted since 1968 when the index first moved above 500. Those in the room who had survived the 1970s had every reason to celebrate.

Are the lessons of this period of any relevance today? Also, is a respectable rally of nearly 30 percent over the last three months the start of a multi-year bull run? Our view at Cheviot is that the answer to the first question is yes and we are managing our portfolios accordingly. So far as the second question is concerned, it seems unlikely.

The collapse in confidence that the markets experienced last year was almost without precedence. The reaction of governments and central banks has been unique. The end result of this massive monetary and fiscal experiment is unknown. What is clear is that steadily appreciating indices and low volatility are an unlikely combination.

At Cheviot our investment policy is based on multiple pillars;

- The events of the last two years are presenting investors with exceptional opportunities in all asset classes.
- Thorough research is required to identify these opportunities. This is the time in the cycle to be an active rather than a passive investor.
- The "reflation trade" that started in March – outperformance by cyclical stocks, credit, commodities and emerging markets – may continue, but confidence is brittle and any hint that the funding of government stimulus packages is running into trouble will lead to a rapid reversal.

Our portfolios have benefited from the recovery seen in the last few months, but all are highly liquid and we reserve the right to change our mind if facts change.

Summarised below is our current asset allocation for clients looking for growth with lower volatility than might be expected from a pure equity portfolio.

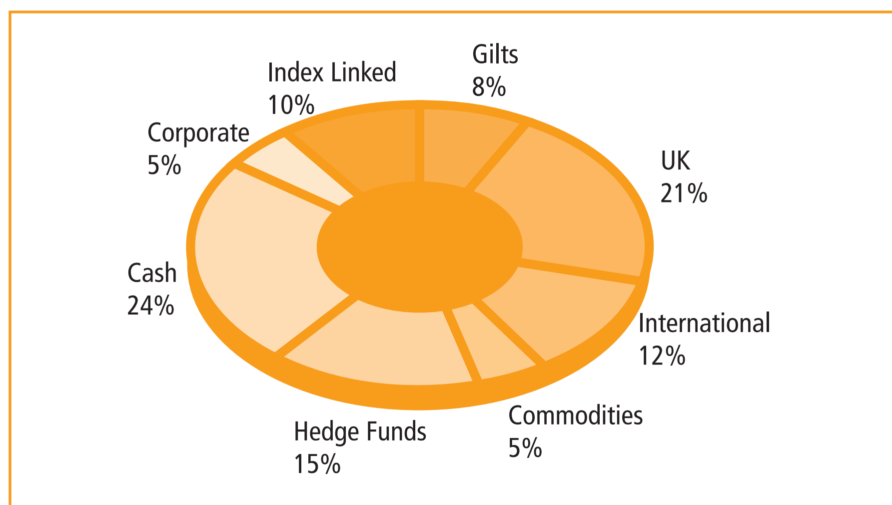
The withdrawal of risk capital from markets, particularly by banks, has reduced the capacity of the market. As a result relatively light trading volumes can lead to significant price movements. We saw an example of this last year when index linked gilts fell by 15 percent in the autumn as concerns about deflation surfaced. By Christmas prices had fallen to reach levels discounting deflation for seven years which presented us with an opportunity to buy. Prices subsequently recovered all that was lost last year.

Similarly, share prices continue to fluctuate within wide ranges thus presenting stock pickers with many opportunities to add value.

Although commodities are seen as a way of benefiting from economic recovery, we have allocated to less cyclical areas such as gold and agricultural products as a counter balance to equity exposure.

We have also increased exposure to hedge funds this year. Well managed funds have quietly produced returns of nearly 10 percent on average so far this year. In addition, investors in the London listed hedge funds have benefited from price rises in excess of 30 percent as discounts have narrowed.

In summary we see plenty of opportunities in a wide range of asset classes. In the 1970s passive investors saw their wealth destroyed by inflation. In 2009 those either waiting for a reversion to the average of the last ten years or alternatively structured for Armageddon are likely to be similarly disappointed.



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