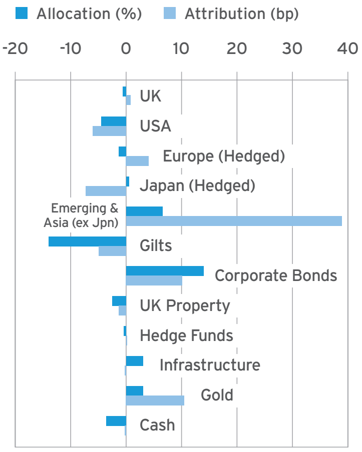
thesis
asset management

Thesis Asset Allocation

April 2011

Our asset allocation models performed strongly during March. The Balanced Model beat its benchmark – by 44bp (basis points) from allocation effects and 20bp from stock selection and interaction effects – to give a total return of 0.72% against 0.08% for the FTSE APCIMS Balanced Portfolio Index.

Thesis Balanced Model compared to APCIMS



Equities react to Japanese earthquake

Markets were heavily influenced during the month by the terrible earthquake and tsunami in Japan, and the nuclear incident which followed. The Nikkei 225 fell by 20% before rebounding to end the month down 8%. Shares in Tokyo Electric Power, the operator of the damaged nuclear power station, lost 78% of their value during March, leading a decline in the utilities sector, with financials, manufacturers and consumer services also showing large falls. Our decision to currency hedge our exposure to Japan, which was implemented during the month, helped somewhat as the yen weakened, but our Japanese allocation in the models still cost us 7bp overall.

Other equity markets also dropped following the disaster. Implied volatility (calculated from option prices) on the FTSE 100 index climbed to levels not seen since last summer, as the index fell below 5,600. The subsequent rally left the UK market still slightly down at the end of the month, though small and mid-cap stocks fared better than their larger cousins which are more strongly correlated with other international markets.

Emerging markets surge forwards

Taking the month as a whole, emerging market equities performed very powerfully, with our overweight position contributing 38bp of our allocation outperformance. Against strong emerging market returns generally, India and Turkey were particularly impressive performers, gaining 12% and 10% respectively, as the central banks of both countries raised rates to rein in credit growth and combat inflation fears.

The euro appreciated 4% against sterling during March as the ECB continued to signal that it would raise interest rates in April, making it the first of the four major central banks to tighten monetary policy. This hurt our currency-hedged allocation to European equities, although it shows as a 4bp positive contribution in our attribution analysis, as our allocation to Europe is underweight by comparison to the benchmark. Our underweight position relative to the large US component of the benchmark cost us 6bp however, following strong performance from US equities late in the month, as the US Bureau of Economic Analysis revised Q4 2010 GDP growth figures upwards from 2.8% to 3.1% in annualised terms.

UK fixed interest robust

UK gilts rallied mid-month during the equity market falls, then fell back to end the month higher overall as the likelihood of a rise in UK rates in the near term diminished, and a fiscally-neutral budget reinforced the coalition government's commitment to reduce its deficit. Our underweight allocation to gilts cost us 5bp, but we gained 10bp on our corporate bond weighting, picking up performance from credit spreads relative to gilts.

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This Months Asset Allocation written by:

Matt Hoggarth
Investment Analyst

Email Matt with any feedback:
matthew.hoggarth@thesis-plc.com

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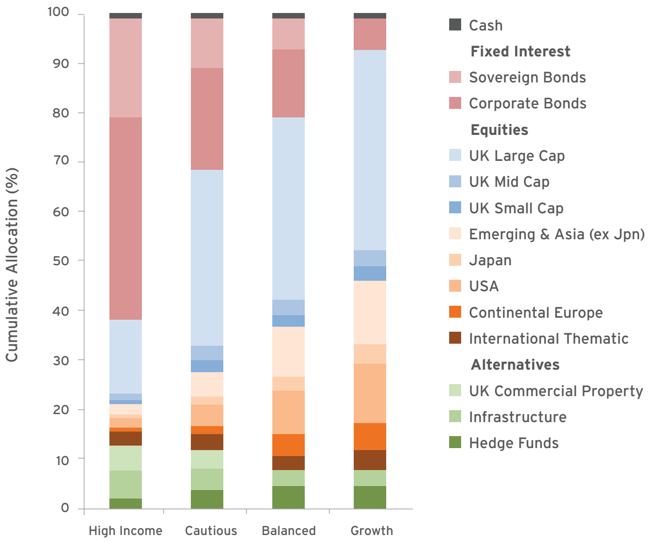
Gold now a hold, replaced by agriculture

We have moved our gold bullion allocation to a hold following further strong performance and a 10bp contribution to our March model returns. During April the price has moved through $1,500/oz. We have always viewed the gold weighting as a defensive holding, and while there is potential for further gains for those clients who already hold it, we believe that purchasing at current levels would be rather speculative.

In place of the gold we have now brought a thematic equity weighting to global agriculture into the models. This aims to profit in the medium to long term as companies involved in all stages of the agricultural production process innovate to meet growing global demand for food, and additionally we believe it will be a defensive holding should equity markets see a short term retrenchment. Caroline Mills has described our chosen fund, Sarasin Agrisar, in more detail in April's Thesis Product Update.

We continue to hold equity weightings which are towards the top end of our strategic range within each model. Corporate news remains largely positive, contrasting sharply with an often less favourable macroeconomic and political backdrop. Instability in the Middle East and North Africa, sovereign debt concerns in the Eurozone, uncertainty over the end of QE2 in the US, and commodity price inflation all have the potential to upset global growth. However we currently see the recovery as continuing, as least in the short term, and do not view equities in most markets as over-priced.

Current allocations in our model portfolios



	High Income	Cautious	Balanced	Growth
UK Large Cap	14.9	35.3	36.4	40.2
UK Mid Cap	1.4	3.3	3.4	3.7
UK Small Cap	0.9	2.2	2.2	2.5
Europe	0.7	1.6	4.2	5.6
USA	2	4.5	9	11.9
Japan	0.6	1.5	3	4
Emerging & Asia	2	5	10	13
International thematic	3	3	3	4
Total Equity	**25.5**	**56.4**	**71.2**	**84.9**
UK Commercial Property	5	4		
Infrastructure	5.5	4.4	3	3
Hedge Funds	2	3.5	4.5	4.5
Total Alternatives	**12.5**	**11.9**	**7.5**	**7.5**
Sovereign Bonds	20	10	6	
Corporate Bonds	40.9	20.7	14	6.5
Total Fixed Interest	**60.9**	**30.7**	**20**	**6.5**
Cash	**1.1**	**1**	**1.3**	**1.1**

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