thesis
asset management

Thesis Asset Allocation

December 2011

Our defensive asset allocation lagged the APCIMS balanced model during October's recovery in risky assets. The rally started soon after the beginning of the month with unexpectedly promising US payroll data pointing to growth in the country's economy, and a rising consensus among European leaders that a solution had to be found to the Eurozone debt crisis and its knock-on effect on the region's banks. Doubt over the viability of the European Financial Stability Facility Fund (EFSF) diminished as the final governments persuaded their parliaments to ratify it.

Our attribution analysis shows that our asset allocation gave a 65bp (basis points) under performance, but we made 39bp on stock selection and market timing to deliver a performance 0.26% below the benchmark overall for the month.

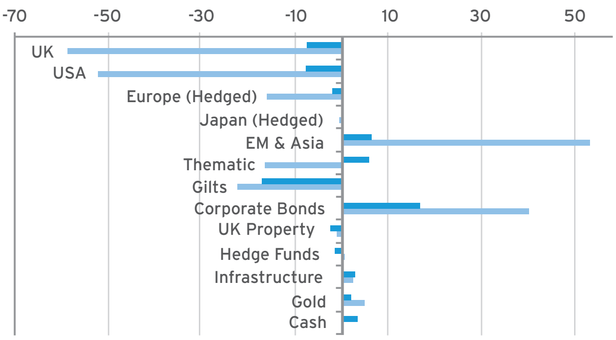
Our underweight positions in developed markets and our more defensive thematic allocations (food production and pharmaceuticals) cost us performance, but this was partially offset by our overweight to emerging markets and our thematic holding in technology companies. Gilts fell back at the start of the month, but regained that ground to end the month slightly higher. Greater risk appetite caused a rise in corporate bond prices, so our overweight to corporate bonds versus gilts benefited our performance. Gold, which had previously fallen from its high point on higher margin requirements and profit-taking to cover losses, gave a small positive contribution, and our overweight to infrastructure against commercial property also made us a small gain.

Outlook

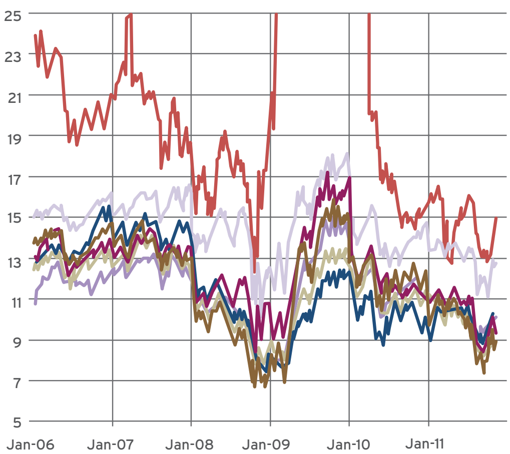
We still believe that a defensive stance with lower weightings to developed equity markets and higher cash balances is justified, and this benefited us through November as Eurozone concerns heightened once again and equity markets fell back. The good intentions of politicians in October have been difficult to convert into practical solutions when the time has come to present the details of proposals. Technocratic governments in Italy and Greece calmed markets briefly, but yields have crept up again in subsequent bond auctions, and even French and German yields have been rising. Even if debt levels are controlled, restoring competitiveness and growth remains challenging. The ECB has cut interest rates, as lower growth forecasts following lacklustre third quarter GDP figures have diminished inflation fears, but this is unlikely to have a profound effect on the peripheral economies of the Eurozone. Some form of debt restructuring now seems likely for Italy, and we cannot discount the possibility of some weaker members leaving the Eurozone.

Despite the backdrop of debt concerns and low growth, recent corporate earnings announcements have generally been positive, and equity valuations look reasonable relative to their long-term averages (see for example the graph below of the estimated forward price earnings ratio for various markets).

For these reasons we are maintaining our current weightings to equities, and not looking to reduce risk levels further. Our UK equity committee has been using the market movements to switch into stocks with good fundamentals, and we have boosted the yield on our corporate bond allocations by striking the defensive structured product backed by HSBC that we introduced in a product update during the latest period of elevated volatility.



Thesis balanced model compared to APCIMS
Allocation (%) Attribution (bp)



Estimated P/E ratio
(Source: Bloomberg)

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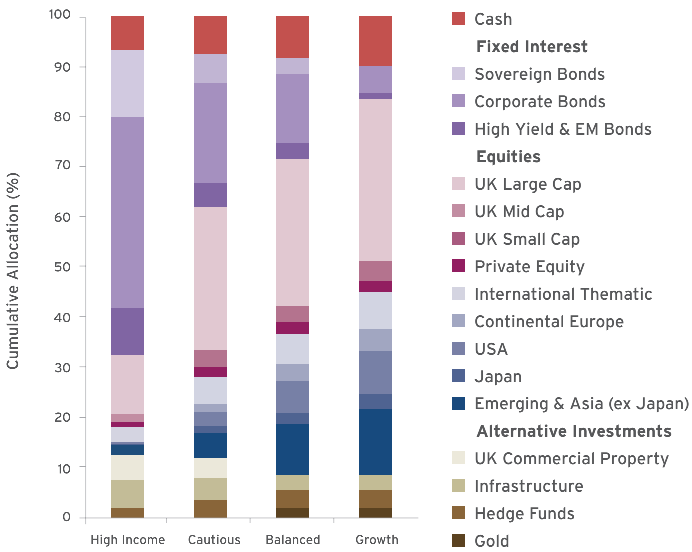
Current allocations

% Allocation	Income	Cautious	Balanced	Growth
Equity				
United Kingdom				
Large Cap	12.05	28.54	29.47	32.55
Mid Cap	1.4	3.31	3.38	3.72
Small Cap	-	-	-	-
Private Equity	0.89	2.11	2.18	2.41
Total UK	**14.34**	**33.96**	**35.02**	**38.68**
International Thematic				
Alternative Energy	-	-	-	-
Agriculture and Food Production	2	2.5	3	4
Pharmaceuticals and Biotechnology	0.6	1.41	1.46	1.61
Technology	0.6	1.41	1.46	1.61
Total International thematic	**3.19**	**5.32**	**5.92**	**7.22**
Continental Europe	0.13	1.6	3.33	4.38
USA	0.25	3	6.35	8.58
Japan	0.1	1.12	2.38	3.14
Emerging & Asia (ex Japan)	1.98	5	10	13
Total Equity	**20**	**50**	**63**	**75**
Alternative Assets				
UK Commercial Property	5	4	-	-
Infrastructure	5.5	4.4	3	3
Gold	-	-	2	2
Hedge Funds	2	3.5	3.5	3.5
Total Alternative Assets	**12.5**	**11.9**	**8.5**	**8.5**
Fixed Interest				
Sovereign Bonds	13.33	6	3	-
Corporate Bonds	38.39	20.1	14	5.53
High Yield & EM Bonds	9.13	4.6	3	0.98
Total Fixed Interest	**60.85**	**30.7**	**20**	**6.5**
Cash				
Cash / Trading Liquidity	6.65	7.4	8.5	10
Total Cash	**6.65**	**7.4**	**8.5**	**10**
Total	**100**	**100**	**100**	**100**

Current allocations in our model portfolios



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