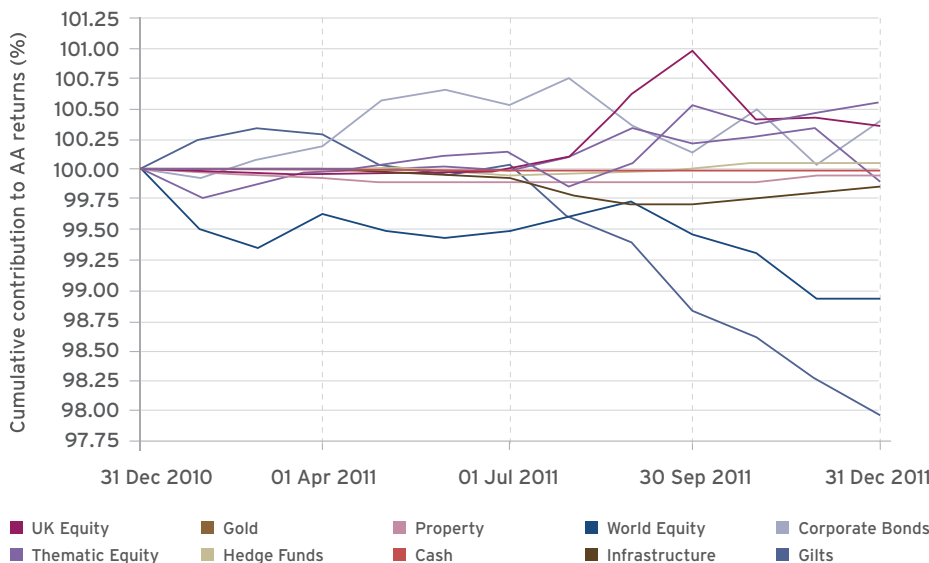


# Thesis Asset Allocation

January 2012

Thesis Balanced Model attribution vs APCIMS



## 2011 Performance

Our attribution analysis for 2011 shows that the asset allocation of our Balanced Model delivered a negative return of 2.03% over the year against the portfolio's APCIMS Balanced benchmark. The greatest cause of this under performance was our underweight allocation to Gilts, which have been significant beneficiaries of the Eurozone crisis and increasing acceptance by markets that low interest rates are likely to persist for some time. We continued to buy Gilts for longer than many and have retained significant holdings in our Cautious and High Income Models. The risks are now skewed to the downside, however and we believe it is prudent to be underweight and lock in gains, although with hindsight we trimmed our holdings a month too early during the autumn. The other main detractor from performance was our overweight to emerging markets, which have struggled to escape the risk aversion and growth concerns in developed markets, despite their lower debt levels and higher growth potential.

These two areas highlight the difficulty of benchmarking against the APCIMS indices.

In contrast to most asset managers the APCIMS models have always used the gilts index as a proxy for 100% of their fixed interest weighting, and do not include many of the most important emerging markets, including China, India and Russia. They therefore significantly overstate the returns most investors will have seen this year. In 2012 we will be contributing data to the ARC Private Client Indices to allow us to compare the performance of our clients' portfolios against those of other wealth managers, which we believe will provide a better yardstick for our returns.

Our thematic equity allocations gave the greatest positive contribution to our asset allocation returns, with technology and pharmaceuticals both outperforming broad equity indices. Our overweight to corporate bonds and underweight to UK equities also delivered positive contributions, although both saw a pull back from their mid-year peaks. Hedge funds, cash and property were broadly neutral. Infrastructure regained some of its mid-year losses, while the fall back in the gold price late in the year saw it give a negative contribution for the year as a whole. The model only includes buy stocks however,

so does not account for gains during the time that gold spent as a hold, and most clients will be in profit having maintained a weighting to it throughout the year. We remain confident in gold's prospects for 2012 and, as described below, have increased our weightings. Turning to currencies, the decision to hedge the Yen exposure on our Japanese holdings reduced our returns, but the hedge on our European allocation came good in the second half of the year. We also benefited from exposure to the US Dollar.

We lost a further 2.32% of performance on stock selection, giving an overall fall in the model portfolio of 7.15%, against the APCIMS index's 2.8% loss. (All figures are in capital terms.) This is partly due to our emerging market holdings being in countries that are not represented in the APCIMS indices and due to fund managers in general struggling to outperform indices in turbulent markets, especially in the US and UK growth sectors. In response to this our Pooled Vehicles Committee has recently added a 'tilted passive' US fund (Schroder QEP US Core) to the buy list, which aims for a low tracking error to the S&P 500 while retaining the possibility of a small outperformance.

## Increases to US and gold weightings

In December we increased our allocations to US equities, funded by reductions in Europe, Japan and the agriculture theme. Both macro data and corporate figures from the US continue to surprise on the upside. Although there remain headwinds for 2012 and historically election years in the States tend to see higher equity market volatility, the US seems the most positive of the developed markets and with a higher multiplier effect (consumer spend on domestic goods) it has potential for growth to be sustained. In addition to this the Dollar is likely to maintain its strength as monetary policy eases elsewhere.

The agriculture theme has had a higher beta during the market falls than we had anticipated, and therefore has not acted as such a defensive asset. We still strongly believe in the agriculture and food production story, via our chosen fund (Sarasin Agrisar) which

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seeks to capture value at all stages of the food production process but the weightings we are now applying for new clients are closer to those of the other equity themes.

At the start of January we used part of the cash balances in portfolios to increase the gold weightings in all models to 4%, following the fall back in the price of the metal below \$1,600 from a high of over \$1,900. The lower prices seemed mainly to have been due to sales for liquidity reasons (for example to meet margin calls) and to indications by the Fed that further Q.E. was not imminent following robust economic news in the US. Following the Fed's latest announcement that interest rates are likely to remain low, our new purchases are already showing useful gains.

In addition to its potential as a safe-haven asset (should further turmoil strike equity or credit markets) holdings of gold bullion by private investors and emerging market central banks remain comparatively low, giving plenty of scope for continued purchases. Taken together with growing demand for gold items as wealth levels increase in emerging markets, this is likely to mean that the price of the metal will be supported for at least as long as real interest rates remain low or negative.

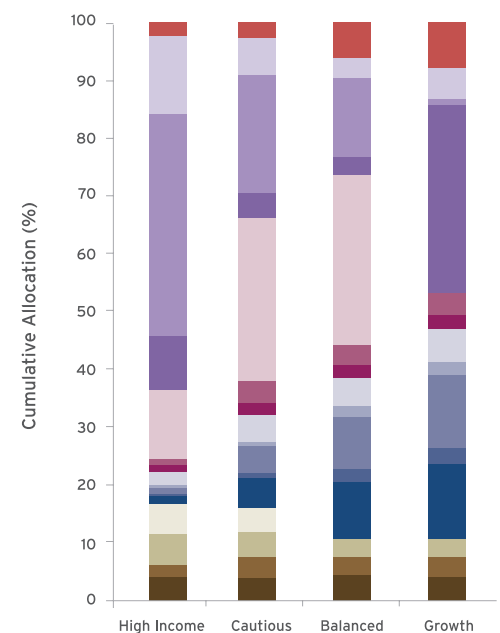
## Risky assets to remain volatile in 2012

Taken together, the changes to our international equity weightings and the increase in the gold allocation slightly reduce the ex-ante standard deviation of all the models. While markets have started 2012 on a positive footing, supported largely by the European Central Bank's injection of funds into the Eurozone banking sector and positive economic news from the US and China, we believe that a moderately cautious stance is still justified. Event risk remains in Europe, with significant debt issuance required this year. Although the picture looks brighter for Eurozone banks since the ECB's intervention, the slow pace of negotiations in Greece and Hungary and the work that remains to be done on the EU Fiscal Compact give the potential for further events that could dent confidence and reverse the rise in risky assets. It is telling that while short term implied volatilities (as measured for example by the VIX index) have fallen sharply, those for longer periods are still elevated. We anticipate that there will be more twists and turns before a continued rally is assured.

## Current allocations

% Allocation	Income	Cautious	Balanced	Growth
<b>Equity</b>				
United Kingdom				
Large Cap	12.05	28.54	29.47	32.55
Mid Cap	1.4	3.31	3.375	3.72
Small Cap	-	-	-	-
Private Equity	0.89	2.11	2.18	2.41
<b>Total UK</b>	<b>14.34</b>	<b>33.96</b>	<b>35.02</b>	<b>38.68</b>
<b>International Thematic</b>				
Alternative Energy	-	-	-	-
Agriculture and Food Production	1	1.75	2	2.25
Pharmaceuticals and Biotechnology	0.595	1.41	1.46	1.61
Technology	0.595	1.41	1.46	1.61
<b>Total International Thematic</b>	<b>2.19</b>	<b>4.57</b>	<b>4.92</b>	<b>5.47</b>
Continental Europe	0.30	1	2	2.80
USA	1.37	4.47	9.06	12.25
Japan	0.30	1	2	2.80
Emerging & Asia (ex Japan)	1.50	5	10	13
<b>Total Equity</b>	<b>20</b>	<b>50</b>	<b>63</b>	<b>75</b>
<b>Alternative Assets</b>				
UK Commercial Property	5	4	-	-
Infrastructure	5.5	4.4	3	3
Gold	4	4	4	4
Hedge Funds	2	3.5	3.5	3.5
<b>Total Alternative Assets</b>	<b>16.5</b>	<b>15.9</b>	<b>10.5</b>	<b>10.5</b>
<b>Fixed Interest</b>				
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
<b>Total Fixed Interest</b>	<b>60.85</b>	<b>30.7</b>	<b>20</b>	<b>6.5</b>
<b>Cash</b>				
Cash / Trading Liquidity	2.65	3.4	6.5	8
<b>Total Cash</b>	<b>2.65</b>	<b>3.4</b>	<b>6.5</b>	<b>8</b>
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

## Current allocations in our model portfolios



- Cash
- **Fixed Interest**
  - Sovereign Bonds
  - Corporate Bonds
  - High Yield & EM Bonds
- **Equities**
  - UK Large Cap
  - UK Mid Cap
  - UK Small Cap
  - Private Equity
  - International Thematic
  - Continental Europe
  - USA
  - Japan
  - Emerging & Asia (ex Japan)
- **Alternative Investments**
  - UK Commercial Property
  - Infrastructure
  - Hedge Funds
  - Gold

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