

# Thesis Asset Allocation

October 2011

The asset allocation returns for our Balanced model have been roughly in line with its APCIMS benchmark over the past quarter, ending the period down by just 4bp (basis points) overall. The risk reductions across our models during July have paid off in the equity area, with our underweight positions in UK and other developed market equities contributing a total of 235bp during the quarter. Our thematic equity allocations have also outperformed global equities as a whole since we removed the environmental technology weighting in July. They contributed 38bp to our asset allocation returns.

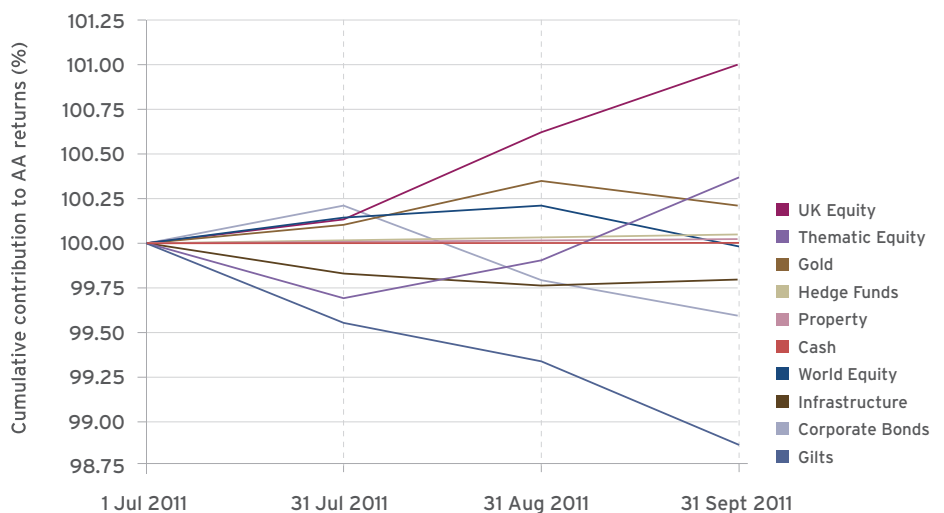
Emerging markets have not been able to decouple from sentiment in the West, and have lost ground as investors' risk appetites have diminished and China's long term growth prospects have been called into question. Our overweight allocation to emerging markets has cost us 136bp.

At the more defensive end of the portfolio, gilt yields have fallen significantly as market interest rate expectations have come down and UK government securities have benefited from outflows from less solid sovereign bonds. Our underweight position in gilts has cost us 113bp. Alongside this, credit spreads for all but the highest quality borrowers have been rising, hitting our corporate bond holdings and costing a further 40bp.

Property and hedge funds have shown their usefulness as low correlation assets, both holding their value. Infrastructure, which has a slightly higher beta, has underperformed by 21bp however. Gold delivered strong returns during July and August but fell back in September, as increased margin requirements on futures contracts and higher short term interest rates following the start of the Fed's Operation Twist increased the opportunity cost of holding it. Over the quarter as a whole gold contributed 23bp.

Stock selection has continued to be challenging in both the equity and bond arenas. Liquidity has also been low, leading to the need for our dealing team to work sell orders for some equities and investment trusts over extended periods to ensure we could exit without moving prices substantially. These factors cost us 114bp, leaving the Balanced model down 10.2% overall in capital terms at the end of the quarter, against the APCIMS portfolio's 9.02% loss.

Thesis Balanced Model attribution vs APCIMS



## Outlook

Sovereign debt concerns and lower forecasts of economic growth continue to dog the markets. The response to the outcome of last week's European Council and EcoFin meetings will set the tone for the rest of the year. After a brief relief rally we will see whether the plans for bank recapitalisation and expansion of the European Financial Stability Facility (EFSF) are on a large enough scale to backstop Italy and Spain successfully, and stop investors from trying to predict the next domino to topple.

Economic data from the United States have recently become brighter, and corporate earnings surprises in the US have more frequently been positive than disappointing (in contrast to Europe where the two are more evenly matched) which has fed a return to risky assets by some investors. We still see the situation as finely balanced however and there is potential for this to be a false dawn, with economic figures perhaps revised downwards in later releases. Our asset allocation remains on a reduced risk footing at current market levels, with good levels of cash to give some protection against any further falls and to provide dry powder for reinvestment when the time is right.

## Gilt weightings reduced

Over the past two years our Fixed Interest Committee has expected interest rates to remain low for longer than many investors were forecasting, leading us to maintain our gilt weightings when some others shunned them. Market expectations have now fallen into line with us, leaving our gilt holdings with strong gains. Although further price rises are possible, we have decided to top-slice the holdings, as the UK government's current privileged borrowing status may not be sustainable if deteriorating economic growth or a worsening situation in the Eurozone leads the credibility of its deficit reduction plans to be called into question. We have halved the gilt holding in the Balanced model, sold two-fifths of it in Cautious portfolios, and a third in High Income mandates. The proceeds are being reinvested in a defensive structured product backed by HSBC, which was described in detail in the October edition of our Product Update.

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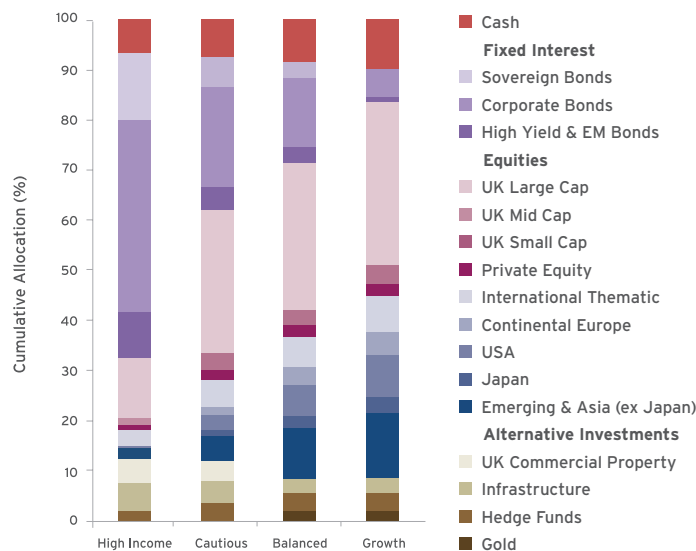
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## Current allocations

% Allocation	Income	Cautious	Balanced	Growth
<b>Equity</b>				
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
<b>Total UK</b>	<b>14.34</b>	<b>33.96</b>	<b>35.02</b>	<b>38.68</b>
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
<b>Total International thematic</b>	<b>3.19</b>	<b>5.32</b>	<b>5.92</b>	<b>7.22</b>
Continental Europe	0.13	1.6	3.33	4.38
US	0.25	3	6.35	8.58
Japan	0.1	1.12	2.38	3.14
Emerging & Asia (ex Jpn)	1.98	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	-	-	2	2
Hedge Funds	2	3.5	3.5	3.5
<b>Total Alternative Assets</b>	<b>12.5</b>	<b>11.9</b>	<b>8.5</b>	<b>8.5</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	6.65	7.4	8.5	10
<b>Total Cash</b>	<b>6.65</b>	<b>7.4</b>	<b>8.5</b>	<b>10</b>

## Current allocations in our model portfolios



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