

# Thesis Asset Allocation

August 2011

Summer is here, and it seems an appropriate point to review the performance of our asset allocation for the first half of this year, and outline our views and positioning for the second half.

## Performance

Our attribution analysis shows the Balanced model asset allocation ended the half-year fractionally ahead of the APCIMS Balanced Portfolio. The greatest contributors to performance have been the fixed interest holdings, where our overweight allocation to corporate bonds versus gilts has allowed us to profit from credit spreads in addition to falling interest rate expectations. The thematic equity allocation to global agriculture and food production which was added to clients' portfolios in March has also enhanced our returns. Our allocations to overseas equities have in general held the model back however, especially the overweight position in emerging markets, which suffered from a sell-off early in the year following its very strong run during the autumn, and has struggled to regain ground during periods of risk aversion.

The last six months have been difficult for stock selection, with many active equity fund managers struggling to outperform their benchmarks, especially in the choppy markets during the recent uncertainty over sovereign debt. Many of our equity fund selections have performed well in relation to their peer groups, but lagged their comparator indices.

Overall taking both asset allocation and stock selection into account our Balanced model produced a total return of 0.7% for the half year, against 2.6% from the APCIMS index.

## Prognosis

In the second half of the year we see our theme of good companies in a bad macro-environment continuing to hold, with equity markets likely largely to trade sideways and opportunities to pick stocks up cheaply on the dips. The current falls are too large to dismiss as just a dip, and although we see plenty of value in the market it is possible that momentum could cause the FTSE to break through 5,000 before buying pressure reverses the trend. Looking at fundamentals, corporate balance sheets are generally not overstretched however, the market is well below the highs seen in 2007, and is offering an attractive well-covered dividend yield relative to gilts, together with some level of protection should current levels of inflation persist for longer than anticipated. Within our UK equity model we will be looking to switch holdings where we can buy strong earnings at a reasonable price.

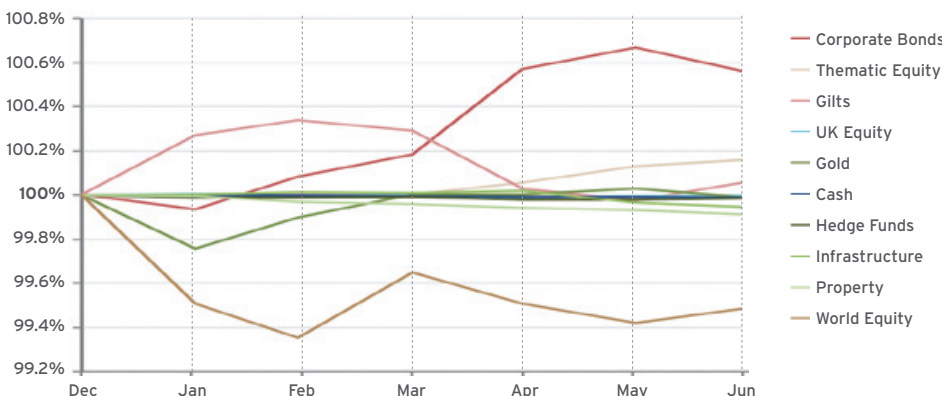
Other developed markets present a similar story. High quality Japanese and European shares with internationally diversified revenues can be bought at reasonable prices. We are continuing to hedge our currency exposure to these two markets however (despite these hedges having worked against us to date), as the further potential profit to be made from holding the euro or yen seems smaller than the likely downside should they weaken. The US, which until recently has performed strongly is probably the greatest concern in terms of potential for reversal, with too much emphasis being placed on a potential QE3 being the ultimate support for current asset prices.

We are keeping a close eye on the softer economic data currently being published.

Beyond the standard national income (GDP) and production figures, shipping metrics such as the Baltic Dry index are looking weaker, which could be an indicator of a global slowdown, or possibly just a consequence of the natural disaster in Japan, the economic effects of which are still working their way through the system and causing a shortage of components and raw materials in certain industries. The lower levels of liquidity in the interbank market are also a concern, with a steepening of the money market yield curve for many borrowers indicating an increase in risk aversion in banks' dealings with other banks, which could create barriers to the smooth functioning of the global economy if taken too far. None of the evidence so far is strong enough to change our central view on equities, but we are considering a variety of instruments with low or negative correlation to equity markets which we could potentially use to protect portfolios should the chances of further falls increase in the coming months.

The sovereign debt difficulties continue to rumble along, with politicians in Europe and the US seemingly intent on doing the minimum to avoid each impending catastrophe, and postponing the electorally unpalatable long term solutions. In the medium term there must be a deleveraging by governments and consumers in the developed world, and with that background the low growth, low interest rate environment seems likely to persist. This should provide further opportunity for holders of gilts and gold to profit. Equities in the emerging world which doesn't have these headwinds should also outperform, assuming increasing local demand can make up for decreased consumption in the west.

Thesis Balanced Model attribution vs APCIMS



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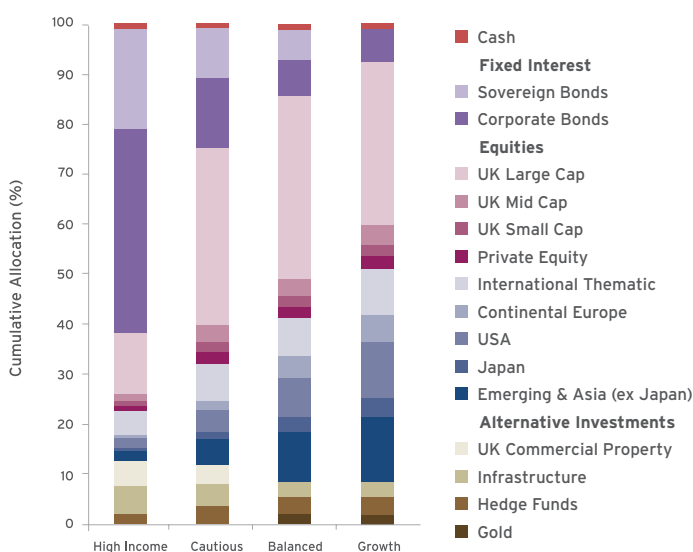
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## Current allocations

We have not made any changes to our asset allocation weightings this month, although the presentation has changed slightly, with private equity and three global thematic equity weightings (alternative energy, pharmaceuticals and technology) which previously formed part of our large cap UK equity model now listed separately to reflect better their international exposure, and to allow them to be included independently in our attribution analysis going forward.

% Allocation	Growth	Balanced	Cautious	High Income
Large Cap	32.55	29.47	28.54	12.05
Mid Cap	3.72	3.38	3.31	1.4
Small Cap	2.48	2.25	2.21	0.93
Private Equity	2.41	2.18	2.11	0.89
<b>Total UK</b>	<b>41.16</b>	<b>37.27</b>	<b>36.17</b>	<b>15.28</b>
Alternative Energy	2.01	1.81	1.76	0.75
Agriculture & Food Production	4	3	3	3
Pharmaceuticals & Biotechnology	1.61	1.46	1.41	0.6
Technology	1.61	1.46	1.41	0.6
<b>Total International thematic</b>	<b>9.23</b>	<b>7.73</b>	<b>7.58</b>	<b>4.94</b>
Continental Europe	5.58	4.20	1.62	0.68
USA	10.93	8	4.52	1.98
Japan	4	3	1.5	0.63
Emerging & Asia (ex Jpn)	13	10	5	1.98
<b>Total Equity</b>	<b>83.90</b>	<b>70.20</b>	<b>56.39</b>	<b>25.5</b>
UK Commercial Property	0	0	4	5
Infrastructure	3	3	4.4	5.5
Gold	2	2	0	0
Hedge Funds	3.5	3.5	3.5	2
<b>Total Alternative Assets</b>	<b>8.5</b>	<b>8.5</b>	<b>11.9</b>	<b>12.5</b>
Sovereign Bonds	0	6	10	20
Corporate Bonds	6.5	14	20.7	40.85
<b>Total Fixed Interest</b>	<b>6.5</b>	<b>20</b>	<b>30.70</b>	<b>60.85</b>
<b>Cash</b>	<b>1.1</b>	<b>1.3</b>	<b>1.01</b>	<b>1.15</b>

## Current allocations in our model portfolios



This update is for information only and is not an invitation to engage in investment activity.

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