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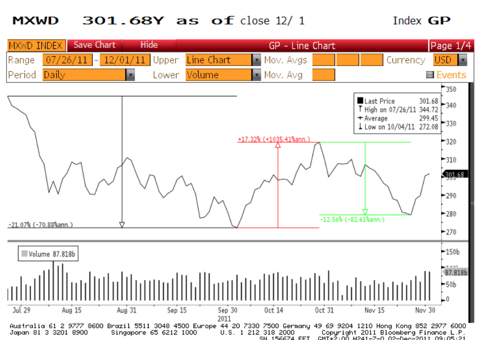
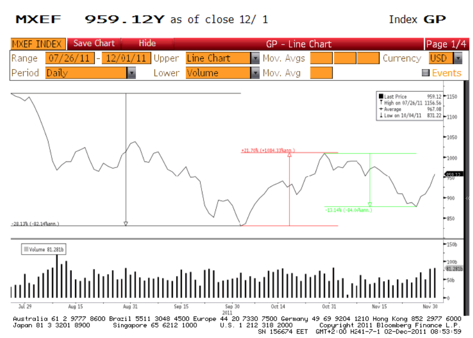
Monthly Commentary 2nd December 2011

We had a true roller-coaster ride in November. The risk-on/risk-off trade has been playing havoc with most managers' abilities to gauge the next move. World equities declined 3.2% for the month, having been down as much as 10%. Emerging market equities fell by 6.6%, having been down by 12%. (Note that they have already clawed back half these losses on December 1st). German benchmark bonds, that are considered the safest in Europe, had risen by 5% at some point, only to give it all back and ended up losing 2.6%. Volatility rules as markets react to news driven by politicians.

Below are charts of the MSCI World Equity and Emerging Market Indices since the falls of early August. As you can see, they have recently made a round trip (almost) in a very volatile manner. MSCI World has risen or fallen more than 4% 13 times since early August! In the annotations, we have only shown the larger moves, which in themselves are most unusual in such short periods.





Where from here? Bank of England Governor Mervyn King said recently that the euro zone's debt problems will cause widespread economic damage in a way *"characteristic of a systemic crisis."* He went on to say *"No-one could deny the current situation is extraordinarily serious and threatening"*

Of course this is just one view, albeit from a pretty serious policymaker.

Referring the coordinated action by Central Banks and also the push in the EU for fiscal union, Chris Wood of CLSA wrote:

World stock markets greeted the above development with euphoria on Monday simply because Euro policymakers appeared to be doing something. There is also the natural hope amongst risk seekers that a more concrete move towards fiscal union will make Berlin more relaxed about ECB debt monetisation (quantitative easing).

And Chris goes on to say:

Still, as has always been the case so far in the Eurozone crisis, the likelihood is that equity markets get ahead of themselves in making assumptions that are not fulfilled.

So we too remain sceptical as many Eurozone bond yields are still elevated, at the same time bonds yields in the US, the UK and Japan are near their all-time lows. As Jim Grant recently wrote: *Government Bonds have turned from offering a **risk-free return** into becoming a **re-turn-free risk***.

While most funds in our Absolute-return portfolios made modest gains, the quantitative and long-short managers who have a lot of conviction in their processes lost money as they where whipsawed. In particular the AC Risk Parity Fund, which is still positive for the year, lost more than 5% in November. Similarly the likes of Nevsky and Longstone also lost money. It is extremely frustrating for us, as it must be for you, to see this happening. We have not changed our opinion that almost all the managers we use will serve us better than the markets will over the next 3-5 years as risk-on/risk-off continues to dominate markets.