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Monthly Commentary 3rd March 2012

Risk assets continued their onwards and upwards march in February as they continue to climb the wall of worry. World equities rose about 5% and commodities more than 3% (except for gold which fell). Cyclical sectors rallied as did financials. High yield bonds were also up sharply. This is a classic risk-on rally.

As Rick Santoli of Barron's wrote last week: *This is a market medicated by cheap money, investors lulled by the gentle rock and sway of the action, relieved that the violent, all-up-or-all-down, macro-obsessed, contagion-fearing rhythm of last summer has given way to stock-by-stock rotation. The credit markets, usually a pretty good early-warning system, remain placid. Yet there remains a reservoir of skepticism not far below the surface.* Skepticism is often an ingredient for further rises in risk assets.

So what are the "worries" that concern us (and other investors)? The rising price of oil features prominently. There have also been some so called "divergences" in market action that bear watching. These include low trading volumes in equity markets, a fall in small-cap stocks in the US (3% last week), and perhaps most alarming of all the fact that benchmark government bond yields in the US, Germany, the UK and Asia have hardly risen YTD. One would normally assume that when yields are near record lows, standard investment strategy would look to allocate out of bonds into equities. Is the "smart money" looking at bond yields as a warning sign that all is not well on the economic and earnings front?

We cannot answer this question and for now give the benefit of the doubt to risk assets. At the same time, we are not betting the house on these assets.

Traditional portfolios have all benefitted from the equity allocation. The absolute return portions of the portfolios have also performed well and in line with expectations. In February we added some Pimco bond funds as well as an initial holding in Numisma Capital, a new and unique equity market neutral fund. These moves will ensure that should risk aversion return, the portfolios will be well positioned.