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Monthly Commentary *3rd August* 2012

July was a reasonably good month for asset markets, with Equities and Bonds up modestly and commodities rising strongly on the back of gains in oil.

As ever, the question is "what next"? Instead of giving you our opinion, this month we have decided to quote some well-known and some not-so-well-known figures, followed by our short comments on each.

Brand Balter of Balter Capital Management LLC: "*Ongoing systemic shocks are resulting in market behaviour that is consistently inconsistent"*

We say: It is no coincidence that some of the most respected and brilliant macro managers (Ray Dalio/Bridgewater, Alan Howard/Brevan-Howard , Louis Bacon/Moore, Andrew Law/Caxton Associates) have had a hard time reading the markets this year.

Yanis Varoufakis: "*On 20th August, the Greek government will have to borrow 3.2 billion from one arm of the Eurozone (from the EFSF) in order to repay another (the ECB). Yet Greece is insolvent. The very idea of an insolvent entity borrowing more from a community, like the Eurozone, in order to repay that same community is obscene".*

We say: Let Greece go its own way and concentrate on countries that are worth saving.

Joan McCullough, East Shore Partners: "*The ECB have inserted themselves so profoundly into the financial mix that they are really no longer behaving like a central bank as they are no longer fostering stability. Rather, by taking huge risk on their books like any other run-of-the-mill commercial bank, they are putting the system in jeopardy. Think in any terms you wish; the easiest way to get there is to wonder aloud how they exit this hellhole they have dug even deeper. In the meanwhile, what is their contribution to solving the problems the Euro system is facing? The only lender to the banks was the ECB. The only lenders to the sovereigns were the banks. The more the sovereigns borrowed, the more the banks loaned them. The more the debt racked up by the sovereigns, the more they are pressed to implement austerity. The more austerity that is enacted, the slower the growth. The slower the growth, the closer to default they creep. A long line of collapsing dominoes...*"

We say: Who will pay for all this in the end? No wonder the Germans are the sole highly sceptical and disagreeable member of the ECB governing council – they have most to lose.

Bill Gross of Pimco: "*Yet the100-year 6.6% real annual return (in equities from 1912 to 2012) belied a commonsensical flaw much like a Ponzi scheme. If wealth or real GDP was only being created at an annual rate of 3.5% over the same period of time, then somehow stockholders must be skimming 3% off the top each and every year. If an economy's GDP could only provide 3.5% more goods and services per year, then how could one segment (stockholders) so consistently profit at the expense of the others (lenders, labourers and government)? ...*
...Together then, a presumed 2% return for bonds and an historically low percentage nominal return for stocks – call it 4%, when combined in a diversified portfolio produce a nominal return of 3% and an expected inflation adjusted return near zero. ***The 6.6% real appreciation, therefore, is an historical freak, a mutation likely never to be seen again as far as we mortals are concerned.*** *The simple point though whether approached in real or nominal space is that U.S. and global economies will undergo substantial change if they*

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mistakenly expect asset price appreciation to do the heavy lifting over the next few decades..."

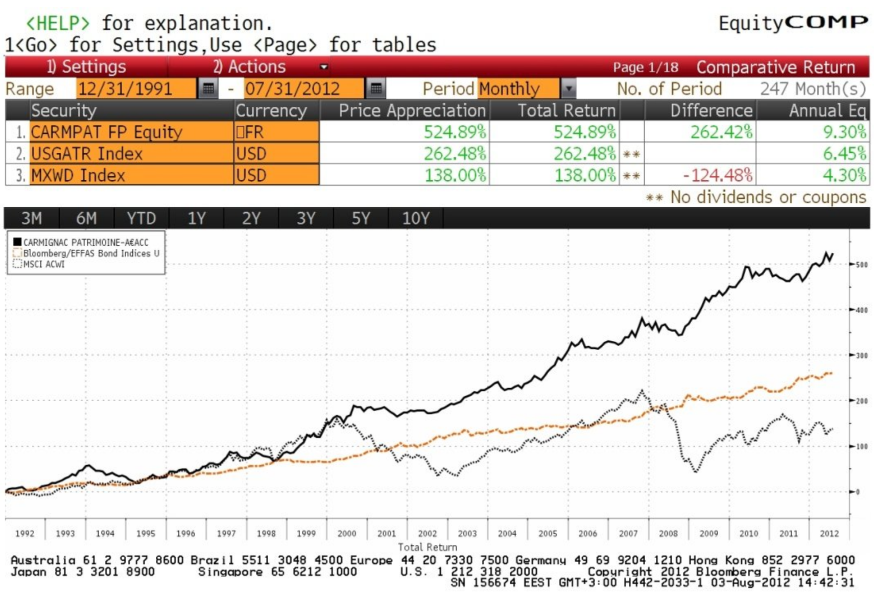
We say: Read the whole article http://www.pimco.com/EN/Insights/Pages/Cult-Figures.aspx It raises some startling alarm bells. It could of course (if you are a contrarian) also be a reason to start buying equities.

Mohammed El-Erian in the FT: "*So while markets have been conditioned to expect ever greater central bank intervention whenever the data weakens or sovereign spreads spike in Europe, the cost-benefit equation within the Fed has gotten considerably trickier. There is now much greater appreciation that the policy response, no matter how imaginative, can do little on its own to address decisively America's challenges of too little growth and employment, too much long-term debt and too great a political polarisation*".

We say: The markets expect further stimulus by the Fed. This is widely expected to boost markets. We suspect the boost will indeed occur but might be short-lived.

Most of the funds we use were positive in July, with managed futures up strongly. Market neutral funds were mixed with AC Risk Parity 7/12 rising but Numisma falling.

We also finished due diligence and we shall start using the Carmignac Patrimoine Fund. While we generally do not use multi-asset funds in our portfolios, we decided that this fund, which has been around since 1989, is worth using. We were intrigued with the way they use tactical positioning effectively – something that most managers have tried and failed. Below is its performance versus equities and bonds in the last 20 years.



Unit-Linked portfolios performed well in July with much less volatility than the markets. Exposure to broad indices and high yield bonds helped.