equilibrium

Briefing Note – Equities

23 March 2011

When we sent out our investment newsletter last week we also told you that we had bought some equity tracker funds within our alternative equity portfolio.

This briefing explains in more detail what it is we did, why we did it and how we came to that decision.

Our thought process

Following the events in Japan and the subsequent market falls around the globe, our investment committee met to discuss how we should respond.

When the FTSE 100 was approaching 6,100 points in February, we had been cautiously optimistic about the potential for equity returns. Whilst we felt some of the more bullish predictions for the markets were a little over the top, there were sound fundamental reasons for our optimism. Valuations of many companies looked attractive based on declared earnings and, with earnings predicted to rise, we felt that many equities looked cheap.

Despite the tragedy that unfolded in Japan, we don't feel any of this has really changed. If we felt UK equities looked good value at almost 6,100, then at just below 5,600 as the market was on 16 March, it represented a great opportunity.

Naturally, the Japanese market had fallen even further. Even though the Japanese economy (like our own) had some major problems even prior to the tsunami, we had been relatively bullish towards Japanese equities and many looked great value.

Arguably, given Japan is the world's third largest economy (having only recently been overtaken by China), our typical holding of around 8% of an equity portfolio is an underweight position relative to global market capitalisation.

We felt that the market falls were likely to be overdone, and that this would be a good buying opportunity, taking an 18 month view.

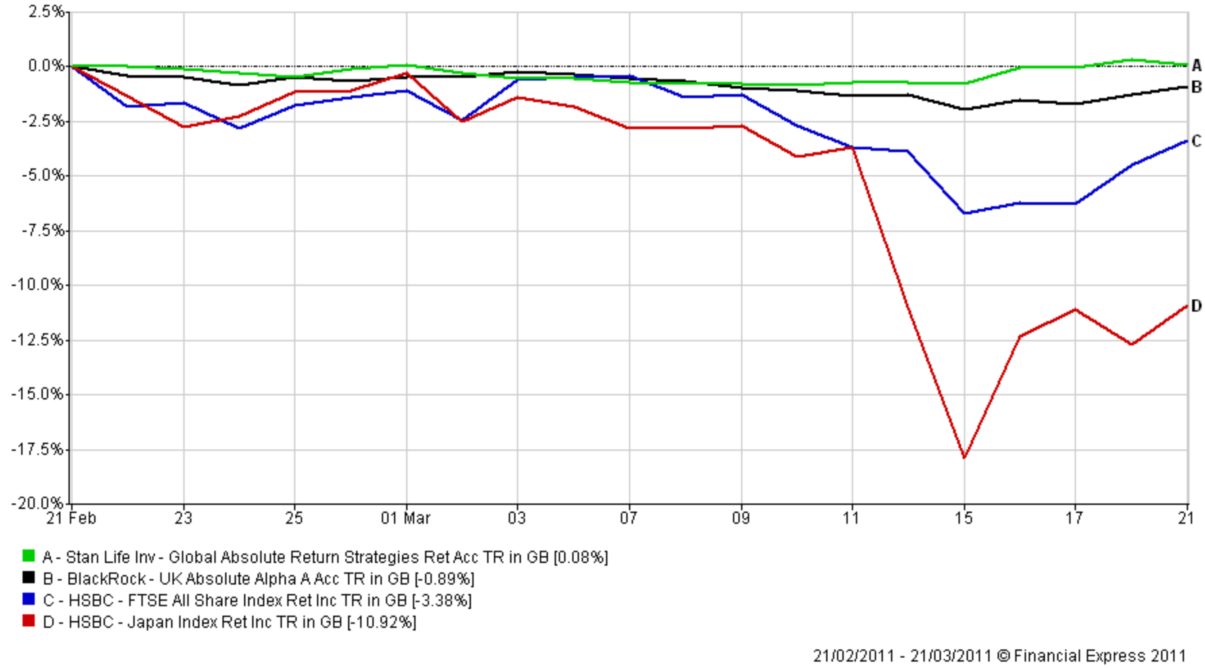
How to proceed?

We discussed how best to capitalise on this opportunity without unduly increasing risk for our clients.

Most of our portfolios were at their maximum tolerance for what we class as "growth" assets - equity and alternative equity combined. This was due to our positive outlook for equity compared to fixed interest and property. As you would expect, we will not increase risk above the remit that you have given us.

We therefore decided to switch two of the funds within our alternative equity portfolio from absolute return style funds to equity funds. We sold our two most defensive funds, the Blackrock UK Absolute Alpha and the Standard Life Global Absolute Return Strategies funds, and switched to the HSBC Japan Index and HSBC FTSE Allshare Index tracker funds.

The chart below shows how these four funds behaved over the past month (21 February to 21 March 2011). As you can see, the two funds we sold (green and black lines) held their value well, whilst the two tracker funds (blue and red lines) fell:



The idea behind the switch is to move into those funds that have fallen with the intention of investing at relative lows.

The aim of our alternative equity portfolio is to make money from rises in the equity market but protect your investment when markets fall. It will most likely lose less than equities when times are hard, but in turn it will make less when markets are growing. The portfolio as a whole should still behave in the same way, but will hopefully capture more of the upside if equity markets recover.

There is the possibility that some clients may have to pay some capital gains tax (CGT) on the funds we've sold. This is unlikely to be a large amount, particularly as we have only held the Standard Life fund for a short time.

We do always say that we don't think tax should be a barrier to making good investment decisions. You only pay capital gains tax on successful investments!

What next?

If markets recover then we will most likely reverse this position, perhaps buying back the funds we sold unless we come across more attractive alternatives in the mean time. This will most likely be in the next tax year which should minimise any CGT implications.

The Japanese equity market rose 4.4% on 22 March as the situation at the Fukushima nuclear plant became more optimistic. The one thing markets hate is uncertainty, and once much of this is removed we think that markets will continue their recovery.

The information in this briefing describes the actions we have taken for our discretionary clients. It does not constitute advice. Please do not take any action without speaking to your adviser.