

Newsflash: Equity Purchase

29 November 2011

Cash in Portfolios

We have previously explained that we are currently holding high levels of cash in portfolios relative to our historic positions.

On Friday last week we used some of this cash to purchase a FTSE 100 tracker fund for most clients.

To recap our thinking, there are two main reasons why we have been holding additional cash.

Firstly, to provide liquidity to take advantage of opportunities as and when they arise. Secondly, as a “safety net” in case the current crisis continues or escalates.

We used a proportion of the cash we were holding to buy Defined Returns (more later on this in the article). However, up until the recent purchase we still had the following approximate cash levels in our model portfolios:

Portfolios	Tactical Cash as % of portfolio
Defensive	25%
Cautious	14%
Balanced	7%
Adventurous	9%
Speculative	6%

As you would expect, we have always had an action plan in place defining what we will do with the cash in different circumstances.

On Friday, we carried out the first part of this plan, buying equity for most models. We generally purchased 3% of portfolios in the HSBC FTSE 100 Index tracker fund, taking advantage of what we believe are relative market lows. Our plan, prior to this purchase, was as detailed below:

FTSE 100 Level	Action	Portfolios applicable	Amount	Notes
5,100	Buy equity	Cautious, Balanced, Adventurous, Speculative	3% of portfolios	Carried out 25/11/11
5,100	Buy additional Defined Returns	Adventurous, Speculative	2% of portfolios	Carried out 25/11/11
4,800	Buy equity	Cautious, Balanced, Adventurous	2% of portfolios	
4,500	Buy equity	Cautious, Balanced, Adventurous	2% of portfolios	

We hope we will not see the Index going below 5,000 but we need to have a plan in case it does.

Our new trigger point is to sell the equity bought today at a 5% gain or more. We bought at a FTSE level of just over 5,100 and the fund went up over 2.5% from the purchase price on Friday to the midday valuation point on Monday. Markets have gone up again today and at the time of writing the FTSE is approximately 5,330 (12 noon). It is therefore conceivable we could have made this growth in a very short period of time.

If we get this growth, we will bank the proceeds and use the cash to do the same again if markets fall back. If markets rise, we will consider which of the other asset classes to invest in at that time.

If we can continue to bank small gains, we believe these can add up to a big difference over time. We have already done this once, buying a FTSE 100 tracker and gaining around 4% for most clients before we sold again.

You will note that there are no triggers for the Defensive portfolio. This is our “non equity” portfolio, which is generally held with some specific goal in mind. As such we need to remain very cautious and we may therefore hold more cash for longer.

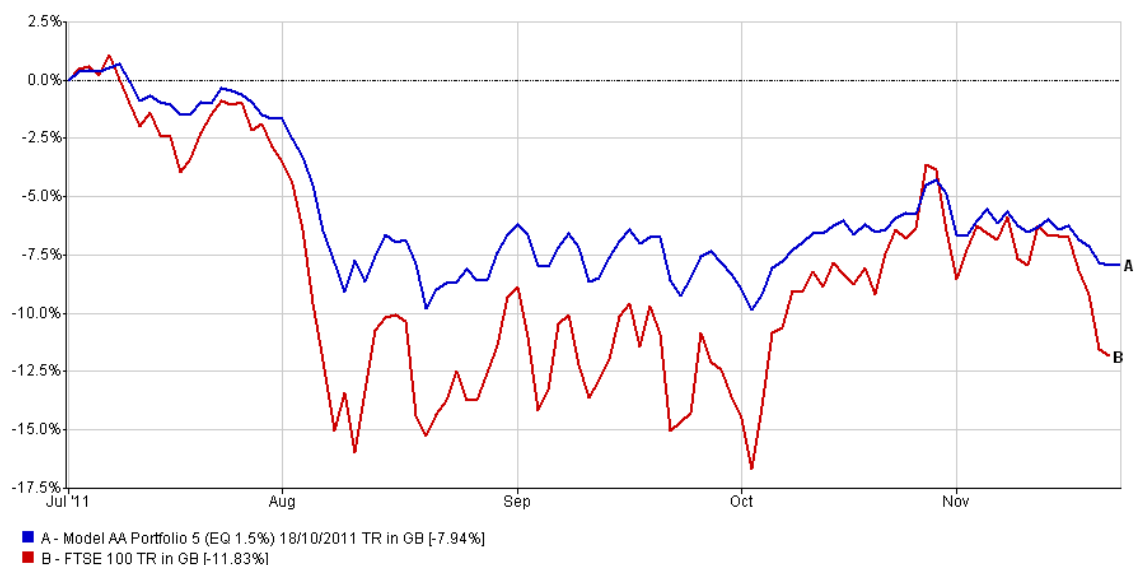
We are reviewing all Defensive portfolios on a client by client basis. Where we believe it is appropriate to retain cash holdings for longer than we envisage for other portfolios, we may discuss returning cash to clients where they can access a better rate directly.

Reporting

Back in July, the FTSE 100 Index stood over 6,000 points in July, falling below 5,000 points in early October.

In times like these we have to work very hard to defend your portfolios against losses. It is not always possible to avoid losses but we aim to keep these to a minimum.

The chart below shows our balanced model portfolio (model 5) after all charges, compared to the FTSE 100 Index, from 1 July 2011 (just prior to the current crisis) to 24 November:



01/07/2011 - 23/11/2011 Data from FE 2011

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Looking at our portfolio (blue line), you will see that after the initial falls to mid August, we've generally kept volatility to a minimum. By contrast, the FTSE 100 (red line) has been relatively unstable and remains highly volatile.

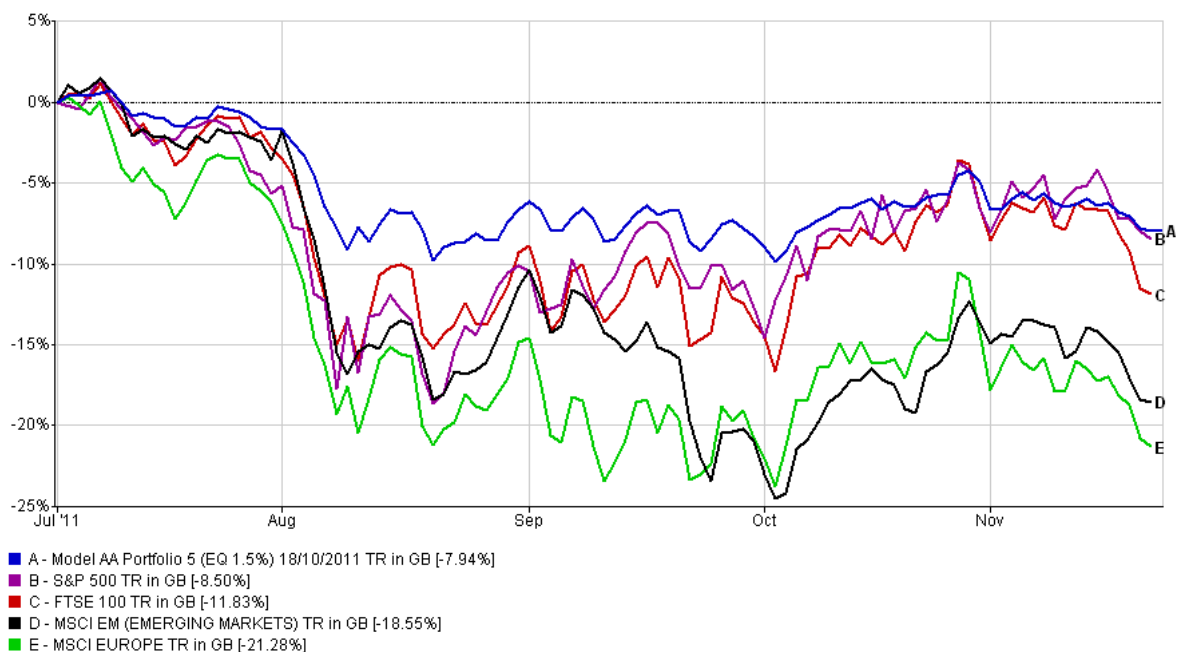
We hope you'd agree that you would rather have had a balanced portfolio than a 100% equity portfolio over this period. However, the volatility of the FTSE is throwing up some anomalies for many of you who have recently received your quarterly valuations.

For example, if your last valuation was 10 August and your latest is 10 November, the FTSE 100 Index went up 9.56% between these two dates. However, the above model portfolio only went up 1.35% between the same dates. This doesn't look very flattering.

One of the reasons is because intraday movements mean the closing price, which we use for the FTSE levels, has frequently been very different from that at midday when funds are priced. On 10 August the intraday swing was 255 points, around 4.9%. On 10 November there was a 100 point move in a day. It makes comparisons very difficult.

We have historically given FTSE returns on our review letters for comparison. The reason we provide this is that it is the most understood index by clients and provides an easy point of reference. However, this is only a relevant benchmark for UK equities. Not only do we invest in other asset classes apart from equities, we also invest in multiple equity markets globally.

The below chart shows our portfolio again, this time against the S&P 500 Index (US equities), MSCI Emerging Markets index, and MSCI Europe Index:



01/07/2011 - 23/11/2011 Data from FE 2011

Not surprisingly, given the Eurozone debt issues, European equities have performed very poorly. Likewise, we'd expect the higher risk emerging market index to fall most when markets fall. America has proved surprisingly resilient, substantially due to the strengthening of the dollar against the pound.

We will continue to provide FTSE comparisons in our letters but will provide more detail in your actual meetings.

Defined Returns

The Defined Returns plans we recently bought for our clients have proved very popular. For a reminder about how these plans work, click [here](#) to read our previous briefing.

A number of clients have requested to purchase more Defined Returns and, where appropriate, we have bought some after the "strike date". Clients who did so should be aware that their returns will differ depending on the price at which they bought. The daily price fluctuates with the rise and fall of the FTSE (amongst other things).

For example, the Barclays product was issued at 100p a share. If the FTSE 100 Index has risen by its first anniversary date, it should return capital plus 12.75% growth. It will therefore "mature" at 112.75p per share in this scenario.

Say a client bought the product at 102p. The maturity price will still only be 112.75p in the above set of circumstances. This would equate to a gain of 10.75p per share, or 10.5%.

If the client bought at 99p, then gain would be 13.75p or 13.88%.

We have recently topped up holdings in our adventurous and speculative model portfolios (models 7 to 10), taking advantage of market falls. The purchase prices were typically below £1 a share, meaning investors will receive a slightly higher return than if bought at issue.

For adventurous models, we bought all three products (Barclays, Credit Suisse, and HSBC). For Speculative, we only bought the HSBC product not previously held in this model.

Mike Deverell

Investment Manager

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