Taking some risk off the table

ASHBURTON

28 August 2009

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Across our Multi Asset Funds we have decided to take some equity risk off the table (25/08/09). The equity weighting in the Asset Management Funds, for example, has been reduced from 45% (close to the maximum permitted) to 30%.

There are several motivating factors:

- A significant improvement in investor sentiment, coupled with the recent raft of strong economic and profits data raises the bar in terms of future expectations and increases the risk of potential disappointment.

- Global equity valuations are not yet stretched, but no longer offer the extreme valuation opportunity that was presented earlier this year.

- As a result of the decision, the volatility of our Multi Asset Funds will be lower and there will be less downside risk in the event of an equity market correction, something we view as more likely today than a month ago. The possibility of a correction should not be surprising as equity markets have just provided three years worth of returns (or 20%) since the July lows, and 60% from the March lows.

The 12-month outlook for global equities is still positive in our view, and there is scope for a significant improvement in corporate profitability. We therefore continue to maintain a material equity market exposure across the Funds. When we believe another compelling opportunity has arisen to increase equity weightings once again, we will act accordingly.

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Shift in regional equity allocation

As pre-empted in our previous Strategy Update of 20 July, in early August we shifted the regional focus of our equity holdings in the Multi Asset Funds. Previously, around 50% of our equity exposure was to Asia (including Japan), but that has since been reduced to 25% with US and European exposure increased (to 45% and 30% respectively). A number of factors were behind the decision:

(i) the considerable outperformance of Asian markets had taken the region to a valuation premium to the US market (in the past decade that has only occurred close to the peak of the market in late 2007);

(ii) with most investors now in agreement with the bull case for China there is less scope for positive surprise (relative to the US or Europe); and

(iii) growing risks were appearing over the market reaction to potential policy-tightening measures by the Chinese authorities.

On a very short-term basis, the decision has proved timely in protecting against a decline in Asian equities in August, during which time Western markets have risen strongly.

As with the more recent decision to reduce overall equity weightings, our regional equity allocation remains under constant review. Once we again believe that the risk-adjusted prospects for Asian equities outweigh those of developed markets, we will increase exposure to the region. There is no change to our positive longer-term view on Asian markets, where the case for growth to outpace that of the rest of the world remains valid.

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