Keeping it Simple

PanVIEW

Evercore Pan-Asset's Global Asset Allocation and Investment Review

1st QUARTER 2012

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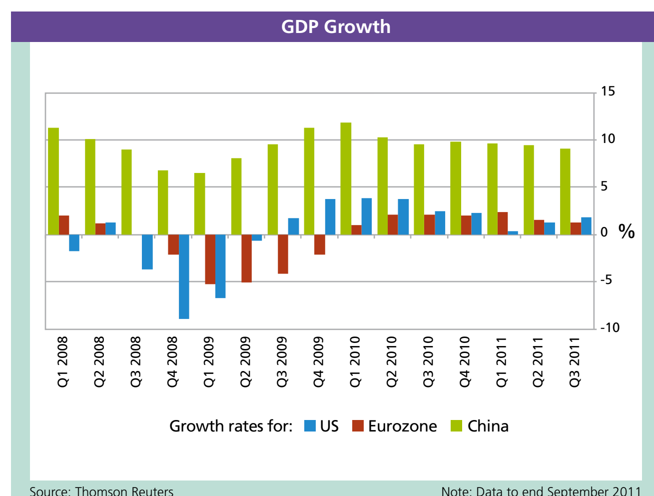
Asset Allocation Overview

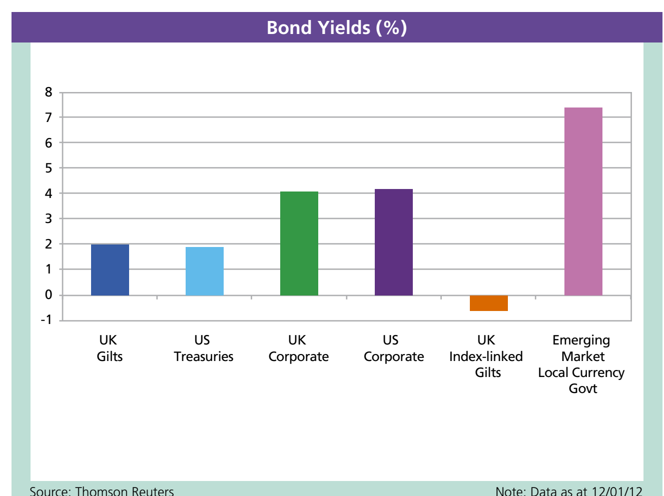
John Redwood

We had a good final quarter in 2011. The US and emerging economy share markets started to get over the autumn wobble, with rises in prices and a bit more confidence. As the quarter advanced the US economic figures improved. The US economy is growing reasonably well, with some improvement in both the jobs and property markets. China started to signal a shift in policy from restraint to bring inflation under control, to a looser stance to keep growth going at a good rate. Brazil also looks ready to cut interest rates and stimulate growth. India is still growing well, despite her inflation difficulties. Her stock market is not as cheap as China or Brazil. These new giants have plenty of scope to boost domestic demand and to trade with one another. 50% of Chinese exports go to Asian markets, and only one fifth to Europe.

sending more money to the distressed countries as grants, and remains against raising more money by borrowing on the common credit rating of the zone as a whole.

Meanwhile, the ECB under new leadership from Mr Draghi is making large sums available to the weak banks of Euroland in an attempt to see them through whilst they raise more capital. He also hopes they will buy some more government bonds, making it easier for the Eurozone countries to continue with their heavy borrowing programmes. So far this has succeeded in staving off bankruptcy for weak banks, by effectively running an interbank market to replace the normal one which has dried up, but it has not led to a sharp rally in confidence or in troubled bond prices.





2012 could be the year in which the emerging market world and the US detach from the struggling Eurozone. In the third quarter of 2011 the Eurozone was the centre of a market plunge which spread out to the rest of the World. For the year as a whole US shares fared much better than European ones. 2012 should see further differentiation between the more successful parts of the world economy, and the Eurozone. The US faces its Presidential election year. It looks likely that there will be a close contest between Mr Obama and Mr Romney, the present Republican front runner for their nomination. Whoever finally wins, the new Presidential term will be about taking more action to curb the large US deficit. In the meantime the Fed and the other main economic actors will wish to avoid big lurches of policy, and will want to keep money fairly loose to aid recovery. There will be plenty of political talk about cutting the deficit, but rather less agreed action to do so.

The Euro crisis remains unresolved. Markets are having to get used to the endless rounds of crisis meetings to save the Euro. The pattern is now familiar. Mrs Merkel and Mr Sarkozy have a "private" summit, which leaks in advance their preferred solution. The proposals usually revolve around more budgetary discipline for the struggling countries. If a country gets into serious market trouble it is required to announce more spending cuts and more tax increases. Germany continues to rule out

The best outcome for the Eurozone from its own point of view is another year of muddling through, at the price of recessions in several of the worst affected countries. We continue to recommend avoiding all Euro area risks. We think it is a good time to be buying into shares and bonds in the emerging market world, where yields are attractive and share ratings depressed.

John Redwood held senior investment roles at Robert Fleming and NM Rothschild in the 1970s and 1980s. Since, he has been a Pension Trustee, Investment Committee member for an Oxford College, Chairman of an investment company and a non-executive Director of a hedge fund and an Investment Trust. An early advocate of tracker funds, he has written extensively on economics and investment.

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Market and Investment Overview

Christopher Aldous

Let's hope that the New Year has brought a new and more rational mood to the markets. The Euro crisis doldrums left markets becalmed at the end of 2011 and Europe looks to be just as paralysed by politics as it ever was, although the detail has arguably improved somewhat.

The sharpest falls in August and September 2011 were caused by rumours that certain European banks were insolvent, leading to the collapse of their share prices and bringing the rest of the index down with them. Whether some of them are technically insolvent or not remains a moot point, but a big change has occurred in terms of their liquidity. At the end of December the ECB issued around half a billion Euros of three year debt with a 1% interest rate. This has thrown the European banking system a liquidity lifebelt and it now seems likely that more such manoeuvres may be forthcoming if needed.

While this underscores our reasons for not risking clients' money in Eurozone assets, it gives us hope that the markets will begin to view other, better quality asset classes more rationally. We particularly favour equities in the higher growth regions of Asia, the emerging markets and the US.

	Strategic View	Tactical View
Economic Growth	Globalisation, rapid technological progress, disinflation, moderate interest rates and the entry of populous China and India into the global economy brought strong growth up to 2007. The Credit Crunch damaged this and overall world growth will be slower over the next decade. Above average growth remains likely in Asia, as more people come off the land into more productive work, and as domestic demand expands. We foresee an increasingly Pacific-centric world economy, with the Eurozone in particular in relative decline as it continues to suffer stresses in banks and sovereign debt resulting from its initial poor construction. The UK and the US need to cut borrowings and their growth rates will be lower than in the past decades due the overhang of debt. The large imbalances in the world economy need to be corrected. From a strategic viewpoint we prefer investment in the faster growing areas of the world especially in Asia and in the commodity producing countries servicing their demand.	2011 saw further growth worldwide, but Euroland and the UK slowed badly in the second half. After initial concerns that the US might be heading back into recession, the tax-break stimulus helped produce healthy growth in the 4th quarter. China and India also grew well, although at a rate well short of 2010 levels as they, like many other emerging economies, struggled to contain price inflation through interest rate increases and special banking measures. Euroland has poor growth prospects in 2012 because the EU authorities have not yet worked out how to tackle the twin problems of excessive public deficits and broken banks in some of the Euro area member states. The US ended quantitative easing last June and is also beginning to consider deficit cutting measures, although it is unlikely that the authorities will do anything to damage growth in a Presidential election year. Nevertheless, global growth could disappoint in 2012, especially if the Euro crisis enters a new phase. As a positive, China appears to have brought inflation under control and be easing lending conditions somewhat.
Inflation	During the early 2000s, inflation was relatively subdued, helped by the cost savings of digital technology and the increasing competitiveness of manufacturers in the emerging economies. In the first half of 2008 inflation rose sharply, driven by excessive credit and reflecting big increases in commodity prices but Western inflation rates have since cooled, mitigated by reduced bank lending and excess capacity around the World. The impact of austerity measures and reduced bank lending in the West should hold down inflation longer term although commodity price inflation is likely as China and India come to the world party. UK inflation is likely to remain at the high end of the range due to heavy state borrowing and loose money policies.	Inflation appears to have come under control in both India and China over the past quarter, after hitting levels of around 10% and 6% respectively. A similar pattern has emerged in other emerging markets. UK inflation, which has been particularly persistent, has also eased somewhat and should fall further in 2012 as VAT and energy price rises drop out of the figures. Tax increases, public sector charge increases, and a wish on the part of many companies to rebuild margins compounded the problem, but these pressures also seem to be abating. US inflation remains muted and we see limited upward pressure in 2012. Japan and parts of Euroland could even have a deflationary problem. Overall, inflation will remain a worry while governments employ measures such as quantitative easing, monetary experimentation, bail outs of banks and high public deficits.
Bonds	The price of government bonds was driven higher in the Credit Crunch. Prices have been falling since, in countries where public finances are badly stretched and market confidence is lost. Government bond yields are low by historical standards due to a greater pre-disposition by portfolio investors to hold bonds, unprecedentedly large flows of trade surplus liquidity into bond markets and the wish of many investors to invest in higher quality assets. The Chinese have built large positions in US bonds. Over the longer term, equities are still likely to produce better returns as lending to governments borrowing large sums at 1-4% is unlikely to prove a good investment. The purchase programmes of the UK and US governments have kept yields lower than would otherwise be the case.	Recently US and UK government bond prices have done well from the so-called 'rush to quality' which has driven down yields to near long-term lows. There is also a shortage of debt available from the better quality governments as quantitative easing programmes have soaked up much of the supply. High grade corporate bonds still seem to be the least bad way of holding lower risk assets, but the headwinds of higher yields in due course will not be helpful. However, rates in the US, UK and Euroland are likely to stay low for the time being. The recent widening of spreads between corporate and government bonds should also provide some cover. Corporate bond markets include substantial amounts of bank paper, where credit risk can be a worry, but the special liquidity measures offered by the ECB to prop up European banks has reduced some of the risks. Index linked bonds have done well but now have negligible or negative yields so if inflation comes down they are likely to suffer.

Christopher Aldous has been involved in wealth management since joining Cazenove in 1981. He has since been a Director of Barclays de Zoete Wedd, an Executive Director of UBS and a Managing Director of Robertson Stephens, the US technology investment bank. He co-founded Absolute Fund Management in 2001, where he managed a fund of hedge funds and was Chief Executive Officer until 2007.

Guy Davies was until recently Head of Charities at Barclays Wealth in London. After a commission in the Army he began his career in investment management at Barclays Private Bank in 1994, followed by roles as private client and charities Director at UBS Warburg, Lazard and Barings. He is a Trustee and Investment Committee member of the Army Benevolent Fund and Army Central Fund.

Jane Bransgrove worked as an investment manager at Sarasin Chiswell (formerly Cantrade) for over 13 years with responsibility for private clients, charities and investment strategy implementation. She is an Associate member of the CFA Society of the UK and holds a degree in Accounting and Financial Management from Loughborough University.

	Strategic View	Tactical View
Equities	During the last decade, investors made little return from Western equities, despite a golden era for company profitability. Immediately after the Credit Crunch in 2008, progress was made as markets looked forward to higher profits and some dividend growth, but equity markets face the problem that distressed investors in other asset classes can always replenish liquidity by sales of equities. Long-term we favour Chinese, Indian and Far East equities. UK equities are a play on global businesses and foreign earnings and may benefit from sterling weakness, but they otherwise have limited attractions. We are concerned that Western equities may now be more like Japanese equities which have disappointed for more than 20 years, when judged against the old high in the market.	2011 was a difficult year for equities. The Eurozone debt crisis made us steer clear of European equities and we will continue to avoid them until a plausible solution to the crisis emerges. Rebuilding after the earthquake may offer some scope for recovery in Japanese equities, but longer term they will be held back by the ageing population, high public borrowing, a high domestic savings rate and sluggish growth. The UK market has a high exposure to banks and natural resources which makes it risky. It looks good value on the numbers but the severe squeeze on consumer spending will hold it back. The US experienced a strong end to 2011 and has started 2012 well, but looking ahead the ratings seem to fully reflect the good news. China remains the cheapest prospect. With a p/e ratio of under 9 times earnings and on almost 4% yield, it has superior growth prospects to most and appears to have come to the end of its phase of credit restraint.
Property	Property is a core, income-generating asset class that offers many attractions yet remains under-represented in most institutional and private investment portfolios around the world. The long-term outlook remains attractive based on economic growth translating into rising tenant demand, with capital values assisted in some territories by land shortages or planning delays. Asian commercial property is underpinned by the long term growth prospects of the respective Asian economies and should be a feature of diversified portfolios. Real Estate Investment Trusts are our preferred way of investing in property through the relevant ETFs, as they are liquid and transparent.	After big falls, better quality commercial properties in the UK rallied during the first half of 2011 as investors sought bargains and went for the relatively high yields. However there have been many voids, and downward pressure on rents. London is performing much better than the rest of the country, where the public sector may have to shed space in the next five years and private demand is weak. We are generally avoiding UK REITs as they remain exposed to weak prospects outside central London and retail rents on average look too high for current trading conditions. We will maintain investments in Asian property and US and Global property which have recovered well from the 2008 crash, but remain relatively low compared to pre Credit Crunch peaks.
Private Equity	Private equity is a geared form of public equity and relies on easy money. Those days are over and capital will no longer be provided so cheaply to private equity firms. The economic backdrop is also less supportive to successful operational performance in the short-term, debt burdens are more onerous and political scrutiny has increased. Once the wheat and chaff have been separated, strong private equity firms will still enjoy attractive long-term prospects, aided by new vulture opportunities in the wake of the Credit Crunch and increased global opportunities. However, shortcomings in liquidity, transparency and regulation plus the absence of an income yield, will continue to argue for limiting private equity investment to a modest part of portfolios.	There is still life in the private equity sector and several funds have substantial cash to invest, but deal flow is slower. The weaker private equity houses have a number of nasty investments to work out and opportunities to dispose of assets via listings in the public markets are limited. The richer and stronger houses can now do new deals but at lower multiples and with less gearing than before. Although future deals will have less debt and be on lower forecast returns, we think the worst is behind this asset class. We have some exposure to this sector via ETFs which hold shares in the stronger companies which have money to invest and a more favourable market position. We like the private equity model and think it could generate good returns for investors over the long term, albeit with a higher level of volatility than is the case with listed equities.
Hedge Funds	This sector went through a major shake-out and period of turbulence in difficult and volatile market conditions. Style and fund selection is therefore crucial. Heavy redemptions were experienced and coupled with market movements, cut the value of funds. Shortcomings in liquidity, transparency and regulation, allied to concerns about fees, levels of gearing and the absence of an income yield, continue to argue for avoiding hedge funds.	The Credit Crunch has highlighted the risks in choosing individual hedge funds. The sector has had a substantial shakeout and weaker funds are offering lower fees. Hedge funds suffered again during the whipsaw markets in the second half of 2011. Some of the more diversified multi strategy funds lost less than their long-only counterparts, but this is still a weak case for investment in them, bearing in mind that they are also likely to underperform in strong markets. Hedge funds need an environment of easy credit to access the heavy leverage they need to earn a good return so current credit conditions are not propitious for them.
Commodities	Rising demand in the developing world, physical shortages, long-term dollar decline and the emergence of a new pool of financial buyers are all likely to result in continuing longer term upward price pressure in many commodities. Towards the end of 2008 we saw a sharp correction as some of the speculative froth was squeezed out and underlying demand was affected by the economic slowdown. Longer term, the relentless increase in demand from the emerging world and constrained supplies will lead to upward pressure on prices.	Commodity prices eased during the second half of 2011, reflecting fears that the Eurozone crisis could cause a global economic slowdown. Some of the sharp sell-offs in precious and certain industrial metals may have reflected the sharp unwinding of speculative positions. Gold remains a useful hedge against inflation and is sought after by both investors and Central Banks in the emerging world. We have invested via gold mining shares which have underperformed the metal substantially and look attractive. Commodity prices have eased since mid 2011, but may be held back by growth fears and uncertainty in the Eurozone.
Cash	A better asset class than many assume, provided that real interest rates continue to be available by virtue of being used by policy-makers as a primary tool in containing inflation. Reserve diversification and a persistent trade deficit are likely to mean secular dollar weakness. Relative economic progress will result in persistent upward pressure on certain currencies in the developing world, notably the Chinese yuan.	Cash has been unattractive ever since interest rates were pushed down to the floor in the West and recovery commenced on the back of easier money. The major currencies of the world have been engaged in a dangerous race to the bottom. The US, UK, Japan and even Euroland have wanted to see their currencies lower to assist exports, China has been reluctant to allow revaluation of an undervalued yuan. As bonds are no longer such an attractive alternative holding some cash could be a wise precaution. Clients should keep in mind the currency of their liabilities.

Lynn Hutchinson joined Cantrade in 1992 which subsequently became Sarasin Chiswell. She was responsible for the investment administration of pension funds, corporate, private client and charity portfolios, including reporting, dealing and investment strategy implementation. She holds the Investment Management Certificate qualification.

Evercore Pan-Asset believes in Keeping it Simple. We say, don't take the risk of individual stocks, buy the index. That way you can keep costs down and avoid taking too big a bet on a share which lets you down. Remember what you are trying to achieve and just pick the degree of risk and income you need. We can do the rest.

You cannot avoid having an asset allocation. Everyday markets trade a portfolio has to stand up to the market test. So why not have someone watching it every day, making changes when necessary? That's Big Picture Investing - concentrating on the decisions that make a real difference.

Keeping money on deposit or buying UK government bonds does not provide you with much income.

That's why PanDEFENSIVE now provides a 5%+* income.

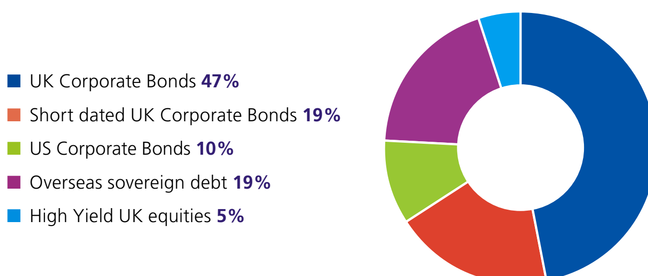
Savers have been getting a raw deal over recent months. Deposit rates are low, and income on some 'defensive' funds is also disappointing. We gave a lot of thought to the poor rates of return and low levels of income available to an investor who does not want to take much risk. We have come up with an answer.

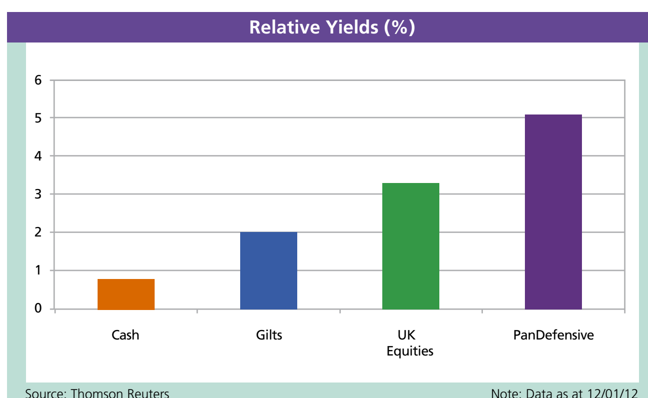
We have made changes to PanDEFENSIVE so it now offers the investor a 5%+* running income. In order to keep risk as low as possible in volatile markets, we have moved the balance between bonds and shares to a cautious 95/5 in favour of bonds. We have some exposure to US corporate bonds and global sovereign bonds, but have not moved into low grade bonds with very high yields. We do not want to make this a much riskier fund. There is now a limited amount of foreign currency exposure but we think this will be neutralised by the likelihood that sterling will weaken as the UK continues to print more money and ease credit.

We think the changes we have made will increase the income in a prudent way. We have sold the very successful holding in index-linked global bonds as this year should see inflation subside in the UK and several of the major emerging economies. Moreover, the price of index-linked bonds rose sharply last year, depressing the yields, and could fall back this year as inflation fears diminish. Instead we bought into a mix of short term and longer term high grade corporate bonds which offer more income. We see little prospect of their prices being hit by fears of higher interest rates in the West. We have also added a holding in emerging market sovereign bonds, which despite their much improved fiscal position tend to yield considerably more than their counterparts in the West.

People who take the trouble to save, who are prudent and want to put something by for a rainy day or for some future purpose, deserve to be rewarded for their trouble. It's been a poor few years if you just kept your money on deposit. We believe that we have structured PanDEFENSIVE so that it gives investors a good income to spend or reinvest without having to draw on capital, but maintains a defensive stance with the aim of limiting losses in difficult markets.

Below is a breakdown of the asset exposures in PanDEFENSIVE:





*Gross yield is currently 5.7% at time of press which equates to 5.1% after deduction of investment management and fund administration costs. Dividends are distributed semi-annually at the end of May and November.

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Income distribution is currently only available with PanDEFENSIVE Class C shares where the minimum size of a direct investment is £50,000. If you are investing via an IFA this minimum is normally waived. For more information please visit our website at **www.pan-asset.co.uk** or contact the fund administrators at the following address to make an application: **Phoenix Fund Services, Springfield Lodge, Colchester Road, Chelmsford CM2 5PW. Telephone: 01245 398 950**

About Evercore Pan-Asset

We are an independent firm providing asset allocation advice to pensions, charities, IFAs and private wealth. This can be on a stand-alone basis or as part of a low-cost integrated investment management service. We use Exchange Traded Funds (ETFs) extensively to implement our asset allocation views and our investment approach allows us to tailor bespoke solutions to match the needs of most investors. We also offer a range of low-cost, risk-profiled PanDYNAMIC Funds and Model Portfolios for smaller investors.

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Evercore Pan-Asset Capital Management Limited
27 Queen Anne's Gate, London SW1H 9BU

Tel 020 7799 5454
Fax 020 7340 9299
Email enquiries@pan-asset.co.uk

www.pan-asset.co.uk

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