

## INVESTMENT NOTE

October 2011

### In Rough Seas –The Advice is “Look to the Horizon”

Market Volatility - However difficult we must look to the future.

When travelling by boat we are told to focus on the horizon to prevent sea sickness and when skiing, not to look at our feet but rather ahead to prevent us from falling. This advice could apply equally to the situation in which we now find ourselves; in an incredibly volatile financial market, one dominated by an endless stream of negative headlines speculating about the collapse of the global economy. Nausea can affect even seasoned investors distracted by wild daily swings. However, we believe that it is wrong to make rash investment decisions based on short term sentiment and ignore underlying fundamentals. Such actions tend to “whipsaw” those who chase their losses and fall into a pattern of buying at tops only to throw in the towel at the bottom.



Below we attempt to answer some of the questions many investors are asking during this unusual period.

**Q: I am concerned about investment return and performance over the past six months.**

**A:** 2011 has been a very challenging period for all investors. Early in the year a tsunami and earthquake hit Japan, the world’s third largest economy. This was followed by ongoing Sovereign credit default across Europe with Ireland, Greece, Portugal and other peripheral nations receiving aid. During the summer a debt downgrade in the US combined with slowing global economic growth and fears that we may even be facing a ‘double-dip’ recession have exacerbated volatility. UK stock markets, at this point, are down around 8.5% for the year (and this was as much as 17% in early October). Such rapid changes in volatility can cause short-term dislocations in the value of assets from their true worth. This is a phenomenon that has always been present in financial markets and can be very conducive for short-term ‘traders’ who take intra-day positions and turn over their portfolios several times a week or day. As one would expect this kind of strategy can be extremely profitable when executed correctly, but equally can be extremely risky and provide dire consequences if executed “out of sync” with the markets. **TAM is not a short term investor, nor presents itself as such.** Whilst we watch our investments and client portfolios on a daily basis, we invest and position portfolios using a longer-term investment horizon. Our Balanced portfolios for example are generally for investors looking at a three to five year time horizon, a period over which the true value of holdings is more likely to be realised. Whilst we understand the concern over short term portfolio volatility, especially when it is negative, we have seen such situations many times over the years and rather than feel compelled to make rash remedial changes, remain satisfied with our high-conviction allocations for the longer term. To reach the peak of any mountain you need to cross valleys and ridges.

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**For Further Information Contact:**  
**TAM International Limited**  
7<sup>th</sup> Floor, Wing B, Cyber Tower  
Ebene, Mauritius  
Tel: (+230) 454 6400  
Fax: (+230) 454 5413

**Q: Don't portfolios always outperform Benchmarks?**

**A: The short industry answer is NO – Benchmarks are measures of relative performance and not guarantees.** At TAM we pride ourselves on our long-term stability for investments and our long term track record. During the 2008 debacle, for example, we successfully protected many clients' assets and even produced a positive investment return through the peaks and troughs. Indeed over the three to four year time horizon, the minimum we recommend for the majority of our portfolios, we perform inline or exceed our internal benchmarks. Investors are often attracted by the way we combine strategic and tactical investments to produce such returns. Whilst this can produce short term periods of out-performance against our benchmarks, it can also create periods where we underperform. This is normal and to be expected as part of our aim of lowering volatility. Since the end of 2010 we have taken a long-term view that UK sovereign debt, or 'Gilts', are overvalued and even longer term capital destructive given real rates of interest. With inflation now at two and a half times the Bank of England's target rate of 2%, and interest rates effectively zero, current yields on a ten-year Gilts offer a negative real yield going forward. Additionally, our expectation of future interest rate hikes made investment in this sector extremely unappealing – though initially proved correct as yields increased this thesis has been proved incorrect (for now) since February as bond values surged. We believe this primarily on safe haven (and occasions panic) buying. TAM benchmarks – unlike the rest of the market – have a high Gilt content within the majority of our risk rated benchmarks. Our present underweight exposure to this sector has had negative consequences for us, relative to benchmark, over the last three months. **Our Investment Note; "Gilt-y as Charged" fully explains our ongoing negative view for the long term on the UK Gilt markets. That being said, the short term UK debt buying and out and out fear re Europe may extend the Gilt bubble and in that context you may see purchases of Gilts, on weakness, in portfolios. This however does not change our long term view but is part of our tactical allocation.**

**Q: Are there other industry benchmarks that can guide me?**

A: TAM expectations of what constitutes a realistic portfolio benchmark may be different from the others. We believe, for example, that an investor with a 'balanced' risk appetite should use a benchmark with an equal weighting between directional equity and Bond/fixed income. Fact sheets are available on line to highlight our portfolio stance. Against other industry benchmarks, TAM performance is notably better on a relative basis.

**Q: Despite the recent volatility I am comfortable with looking longer term and would like to know when TAM expects the investment environment to become more stable?**

A: We are indeed in extraordinary times where investors and investment professionals alike are questioning the future outlook. Over the last ten years, the UK equity markets (ignoring yield), have remained flat and a decade which saw a wholesale shift from equities into commodities – a switch, really, from paper assets to hard assets. We firmly believe that we are on the brink of a new financial period as the world, fuelled by loose monetary policy, will emerge in 2012/13 from the post-recession mire. This period will be one where financial, or paper assets may significantly out-perform hard assets - particularly property as investors realise they are not actually substitutes for pensions on a wholesale basis. This shift has already begun and beyond the present stormy seas, and into 2012-2013, we see a much more stable environment. However intense volatility – increasingly absent for the best part of a decade - is here to stay in the short term.

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Ebene, Mauritius  
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Fax: (+230) 454 5413

## Conclusion

In conclusion, short term volatility is set to remain until the storm over Europe, Bank Balance Sheets and the Global Governments attempts to attack deficit reduction blows over. This will be a running sore for many months to come and intraday volatility on political statements - a relatively new phenomena - will only die out once a structured solution is agreed and abided by.

In the analogy we have chosen to use “the choppy seas” will therefore continue for many months but eventually markets will discount the future news (good or bad) and we will see some forward looking bluer skies and an upturn is inevitable

Shorter term, we believe that the markets may be subject to one more significant sell off and we expect to reduce equities into the present rally to obtain tactical advantage.

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