

Playing it safe

It's often the case that some of the most thought provoking comments come from unexpected sources. It was actually the director of bonds at Rathbones, who also sits on the Bank of England's Debt Management Office consultation committee, who reminded me the other day of the simple fact that in every year since the Global Financial Crisis (GFC) of 2008, the FTSE 100 Index has fallen once at least 10%. That's a sobering thought but closer examination of the data is more unsettling. From 2008 to 2011, there were losses during the year of between minus -17% and minus -33%. Obviously, the FTSE recovered from each of these sell-offs, but few who lived and invested through them, ourselves included, were sanguine about the falls at the time.

Even this year, the FTSE 100 index fell -11% in the first 3 weeks of January. It would be nice to think that if the pattern of history holds, we can be spared more drama until 2017. Unfortunately, life doesn't work that way, particularly with the UK's EU referendum and the US presidential elections looming on the horizon. Both look like close calls and, depending on your point of view, the "wrong" result in either could knock 10% off their respective currencies or stock markets. Or both. Then, of course, there is the

familiar list of dreads that pops up periodically into a market where an unhealthy combination of quantitative easing (QE) and zero interest rates has pushed investors into riskier assets. This makes it all the more likely markets can be spooked into taking risk off by selling stocks and buying bonds, property or just holding cash; basically, any port in a storm.

Fortunately, stock markets seem incapable of worrying about more than one thing at a time and the mini-dramas tend to be short lived. These fleeting episodes can impact stock markets severely, especially when things are relatively quiet and a little selling can move prices further than normal. But they are difficult to trade to one's advantage and trying to do so with portfolios invested for long term returns is both expensive and fraught with danger.

It is also unnecessary if sufficient care is taken to construct client portfolios able to withstand volatile markets and come out ahead when they recover. In other words, to place the emphasis on capital preservation to limit losses in the first instance and to invest with conviction as opportunities present themselves. To be clear, this is not a strategy for all weathers because markets change and one's approach must change with them. But it has worked for us and our clients as global stock markets climbed a wall of worry in the years following the GFC in 2008.

Broadly there are two main aspects to constructing portfolios with some degree of safety in mind. Firstly, the asset allocation between stocks and bonds can be matched with other investments in property and hedge funds to create a portfolio suited to a client's ambitions but also their tolerance of risk and, ultimately, losses. Managed correctly, getting the asset allocation right can easily account for 80% of investment returns over a 10-year period.

Within the asset classes, the TAM investment team look to invest in funds that generate consistent returns and do so by taking less risk than the their respective markets. Whether it comes down to good stock picking, good thematic strategic investment or with a bias towards smaller companies or larger multinationals, good investment ideas can be found away from the turmoil of the main markets whose fortunes, in recent years at least, are more at the mercy of geopolitics and central bank policy decisions which are impossible to predict.

The point is that losses are a part of life and cannot be avoided. It is how we deal with them that matters most. The ability of a portfolio to protect client's wealth and weather significant short term sell offs is essential. Keeping losses to a minimum is one way to elevate performance as it allows us as investors to focus on the next step in investing without the distraction of dwelling on losses that cannot be recovered.

Conscious of the volatility in every year since the GFC, the TAM investment team have sought to invest for consistently good low-risk returns but ready to invest during periods of excessive market falls where we believe the opportunity outweighs the risks.

Our performance record stands testament to this approach with significant outperformance over 1, 3 and 5 years in every risk mandate portfolio, from those with a very cautious investment profile to those that are more speculative.

Looking out to the second half of 2016 and beyond, we see an investment landscape with opportunity but not without risks from any number of influences, both geopolitical and economic, and continue to run portfolios with an emphasis of putting safety first.

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