

# STOCK TAKE

## QUARTET POSITIONS PORTFOLIOS FOR DEFLATION



DANIELLE LEVY  
dlevy@citywire.co.uk

Colin McInnes, managing partner at wealth boutique Quartet Capital Partners, is positioning private client portfolios for deflation and believes the risk of a double-dip recession has been underestimated.

As a result, the investment management team has increased exposure to bonds and decreased their equity allocation over the past year. McInnes said: 'One has to see whether or not globally we go into a double dip. If one reads the broader media, you

could see a 10% chance. We think there is a 30% chance. There is still a 70% chance we will not double dip, but the risk is higher than perceived.

'We have specific concerns over the US and UK. In America, the consumer is not spending, he is deleveraging. Unless Obama extends the Bush tax break, unemployment will be running north of 10%.

'I think October will be at the margin in the UK. If we do not slip into a double dip and do not see strong figures, growth is going to be weak.

'We look at everything on a risk-adjusted basis, so if growth looks weak, it is difficult to see a tremendous run in equities over the short-term. That is not to say it could not happen, but there looks to be more risk of a pull-back.'

Equity exposure in a balanced model has reduced by 10% to 30% over the year, with about 10% in UK equities and the rest in overseas markets, predominantly the US. The team only has a small exposure to emerging markets because they believe valuations look expensive.

The team believes deflation risk remains high and has allocated about 25% of a balanced private client portfolio to fixed income. This breaks down as 15% in conventional gilts, with the balance in corporate credit.

McInnes explained: 'Since we started the firm in November of last year, we have been concerned by deflation. Over the medium term, one does need to fear inflation, because you can't print money and not expect it to be inflationary, but we are not seeing an increase in the money supply being used by consumers on spending.

'This does not bode well for a sharp rebound in consumer spending, so we see a lot of deflationary factors around and have not held any inflation-linked bonds for some time.'

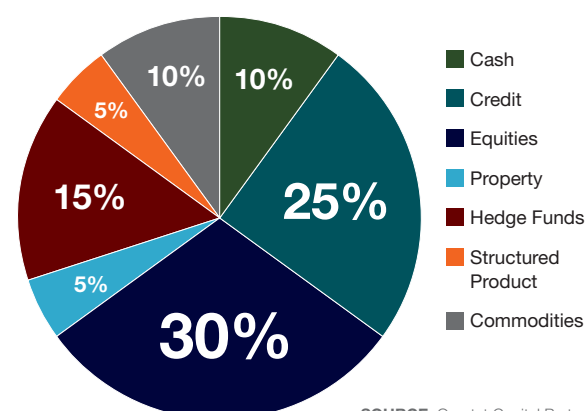
McInnes prefers to back exchange-traded funds over active managers in the fixed-income space, pointing to the effect of charges and fees.

'I think there is more money to be made in yield compression, but not for active managers because of the fees involved. Interest rates are at 1% and fees and costs come in close to 1% for a fund. The manager has to take more credit and duration risk just to get back to the starting line,' he said.

McInnes highlights the deflation call, particularly the compression in conventional gilt yields and steering clear of index-linkers, as a key driver of performance. This helped a balanced private client portfolio to post a 15.7% return over the 12 months to the end of August. Over the same period, the ARC Sterling Balanced index was up 10.6%. Since launching late last year, the fledgling boutique has amassed £25 million in assets.

Introducing gold to portfolios around February-March also helped to boost performance.

### BALANCED PORTFOLIO BREAKDOWN



SOURCE: Quartet Capital Partners

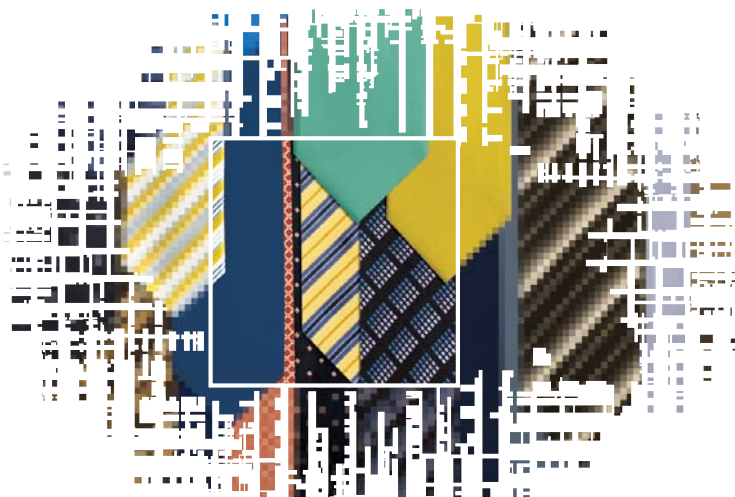
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