

June 2010

Welcome to the third of Quartet Capital Partner's newsletters. As with previous newsletters the format remains the same - we report on our investment performance, our views on portfolio asset allocation going forward and Quartet Capital's development.

Quartet Capital focuses on providing discretionary investment management services to high net worth private clients. We believe that the approach we take really is *different* and as a reminder, we have set out what we do at the end of this newsletter.

Absolute Return Partners LLP (ARP) is a founding partner of Quartet Capital and we rely heavily on their economic views and analysis in constructing Quartet Capital's portfolio asset allocations. ARP's latest newsletter is attached for your interest.

#### **Investment Performance**

Although all our client portfolios are bespoke, we reference each portfolio against one of four model portfolios dependant on risk profile to ensure we are not deviating too far from how we would like to position a client for assuming a defined and agreed level of risk.

We are glad to report that all of our model portfolios have stood up reasonably well through the recent market turbulence:

<b>Investment Performance</b>	<b>01-Aug-09 30-Sep-09</b>	<b>01-Oct-09 31-Dec-09</b>	<b>01-Jan-10 31-Mar-10</b>	<b>01-Apr-10 31-May-10</b>
<b>Model Portfolio Risk Profile</b>				
- Capital Preservation	3.83%	2.43%	2.57%	0.11%
- Cautious	4.47%	3.97%	4.01%	-0.87%
- Balanced	7.90%	7.18%	4.75%	-2.87%
- Aggressive	8.40%	6.77%	5.90%	-4.30%
<b>Portfolio Comparators</b>				
FTSE Gilts UK All Stocks Index	3.85%	-2.01%	1.14%	2.91%
FTSE All Share Index	5.62%	7.79%	5.41%	-8.58%
FTSE World Index	7.84%	6.86%	7.59%	-6.19%

Whilst performance was on the whole negative over the period, returns were considerably better than markets, which was of some consolation.

Given that around half of client portfolios are invested in passive or index tracking investments where the returns match their respective index, any outperformance (or under performance!) is due to one of two factors: our tactical asset allocation and/or the performance of our “alpha enhancing” investments.

Over the course of the last two months the investment performance was aided, and in one case hindered, by tactical asset allocation decisions and helped by good relative returns from our “alpha enhancing” investments:

*Tactical Asset Allocation:*

- We start with the bad decision! In early May we increased equity exposure by approximately 10% across all “model portfolios”. Well, talk about bad timing. Our decision was influenced by valuations which we believed to be compelling. A few days after carrying this out the World changed. To start with Greece fell off a cliff and Germany started to make nasty noises about speculators and banned naked short selling across a range of stocks. In addition to this the technical picture indicated markets were very vulnerable to a big collapse. Our partners headed their last newsletter with a quote from Maynard Keynes: “When the facts change, I change my mind”. We followed his advice and reversed our action. All in all this round trip cost our portfolios close to 0.5%, an expensive exercise.
- In terms of good decisions, we added more short dated Government debt which benefited portfolios as Government debt appreciated due to its perceived status as being risk free.
- At the same time as adding to our Government debt position we added a holding in physical Gold. This has subsequently risen as investors fled “risky assets”.

*Alpha Enhancing Investments:*

- The holding we have in a listed commercial property company appreciated by approximately 10% over the past two months. We think there is much more to come and we continue to hold for more upside.
- Our other “alpha” holdings on the whole marginally outperformed their respective indices.

**Asset allocation going forward**

In terms of our positioning of client portfolios going forward our views on the major asset classes, based on the conclusions from our Investment Committee meeting in late May, are as follows:

*Equities (Neutral)*

To say we are Neutral on equity markets is not really a true picture of our views. In the medium term equity markets, at current levels, offer good value. In the short term we would not be surprised if we saw further falls. Markets are suffering extreme levels of volatility and are subject to big swings based on skittish market sentiment.

Overall we continue to have a preference for the US and UK and for the very aggressive a very small allocation to some parts of Europe. Emerging market stocks and, in particular, BRIC markets remain expensive and in our opinion do not offer good risk adjusted value at current levels even after recent falls.

*Fixed Income (Neutral)*

We see a couple of changes to our position from our earlier newsletter. Longer dated Government debt in the UK, US and Japan remains risky on a medium term outlook due to the threat of inflation. As we still fear deflation in the short term we think the short end of the yield curve offers decent upside potential, in particular as a hedge against any further equity market falls. This is because Government debt is negatively correlated to equities in crisis periods.

We believe some value exists in better quality corporate bonds but have cut exposure as yield spreads have compressed. We now have no exposure to high yield or emerging market debt as the risk spread does not represent good value on a risk adjusted basis.

*Currencies (Positive US\$; Neutral £; Negative €)*

No change from the last newsletter, we prefer the US Dollar relative to Sterling and are very wary about the Euro. Euro/US Dollar parity may well just happen, see our partners newsletter for more on this.

*Commercial Property (Positive/Neutral)*

The sector has, over the past few months, been overbought and whilst we may be close to the bottom of the property cycle a wall of money is chasing what opportunities are around pushing prices up. Despite this special situations do present themselves and we currently hold one main position where, despite solid performance over the past two months, is in our opinion conservatively 50% undervalued.

*Commodities (Negative)*

Thankfully we cut back exposure further as prices fell substantially in commodity stocks (not just BP!). As mentioned earlier we added a position in physical Gold as a bit of disaster insurance. This may strike some readers as odd given our previous warnings about speculative bubbles but it has not been added based on any fundamentals and rather as a hedge against market falls.

*Hedge & Absolute Return Funds (Positive)*

We remain positive towards this asset class. Hedge fund returns have been mixed year to date and many suffered big drawdowns in May. Underlying managers however remain very optimistic and see good opportunities. We have a bias towards managers that are macro orientated in nature and have little exposure to equity-related strategies. Thankfully this has stood us in good stead over the past two months.

**Quartet Capital's progress**

A very busy last two months but glad to report that we continue to be delighted by the positive response that we have received from professional advisors, clients and potential clients. We really do believe we offer a unique client proposition. We are glad to report that assets under management continue to grow at a healthy rate. More is always welcome!

In late April Nigel, Nick and Colin took part in the London Marathon for a variety of good causes. We are glad to report that all finished in one piece and have sworn off running till the next time. Nigel has not quite seen the light and is taking part in the London to Brighton bike ride in two weeks, the rest of the team will be cheering from the sofa!

**A reminder of what we do:**

We believe that there are a few key points about Quartet Capital's investment approach that make us different.

- Bespoke portfolios. We do not believe in shoehorning clients into predetermined investment solutions, therefore all client portfolios are managed on a bespoke basis.
- Portfolio construction. We start by addressing each individual client's risk profile which in turn yields a strategic asset allocation. This is then adjusted tactically depending upon our macroeconomic views to finally arrive at a bespoke client portfolio.
- Asset allocation. We believe (and studies have shown) that asset allocation is by far the biggest driver behind investment performance. This is what we focus on getting right and where we believe we add significant value.
- Investments. Very few fund managers consistently beat their respective index and they also tend to have high fees and costs. We therefore use passive investment vehicles for core portfolio holdings. Tactical investments which make up the balance of most portfolios are specific investment counters or actively managed funds which are included to try and produce the best risk-adjusted returns (add alpha). All portfolios are managed on a multi-asset basis to diversify risk.

If you have any questions, queries, comments and feedback, good and bad(!), or if you are interested in a confidential meeting with Quartet Capital, please contact Colin McInnes, Managing Partner, on (020) 8939 2920 or via email at [cgm@quartetcapitalpartners.com](mailto:cgm@quartetcapitalpartners.com).

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The portfolio performance information presented in this letter is estimated, unaudited, net of applicable fees and is subject to change. No representation is being made that the portfolios will or are likely to achieve profits or losses similar to those shown on the monthly performance table. Past performance is not indicative of future results and a client may not get back the amount originally invested.

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