

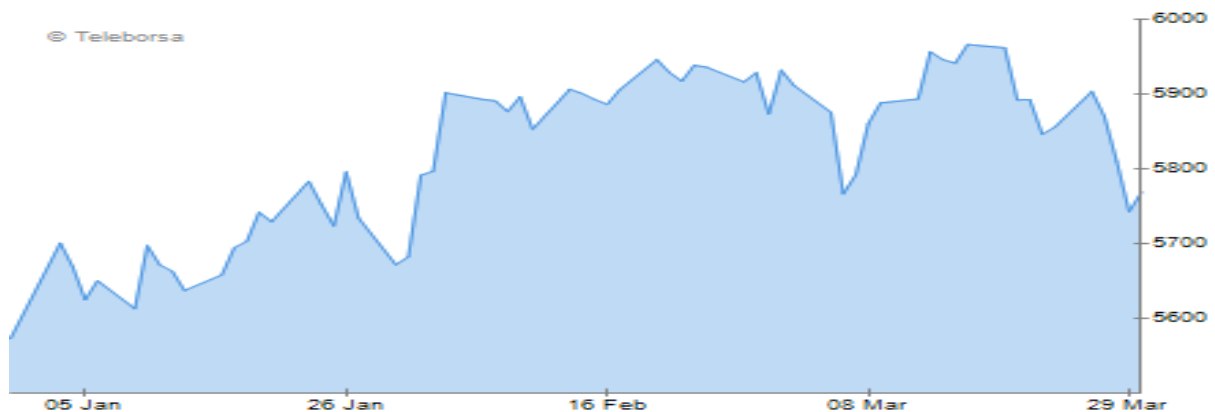
Client Newsletter March 2012

Welcome to the Spring edition of the Quartet newsletter. As always we hope you find it of interest and please do not hesitate to drop us a line if you have any questions or comments.

Review of the quarter

The start to 2012 has been fairly explosive, with global equity markets enjoying their strongest first quarter in 14 years. As the stockmarket momentum which started in December continued through January, February, and the first half of March, investors worldwide decided the time was right to take on more risk, moving from cash and other “safer” investments into equities.

FTSE 100 Index (1 January - 31 March)



Source: londonstockexchange.co.uk

A combination of factors helped to fuel the renewed confidence in risk assets like equities, and the subsequent stockmarket rally:

- Short-term resolution of Greece defaulting
- The European Central Bank introduced a further £489bn tranche of funding for banks via its LTRO program (effectively quantitative easing by another name)
- Both Japan and the UK announced further quantitative easing measures while expectations remain that the US will follow suit
- Increasingly positive economic data continued to emanate from the US

Historically government intervention (in the form of quantitative easing) has always become less effective the more it is used, and this is again proving the case as the resultant stockmarket rallies become shorter and less pronounced with each new bout of QE. As a consequence, whilst the Chinese year of the dragon initially ushered in some good luck for investors, the stockmarket rally faltered in the last two weeks of March.

Like a boomerang the European debt crisis fears returned again at the end of the quarter and continue to linger. Late March saw Standard & Poors (the ratings agency) highlight that Greece required yet another restructuring of its debt. Effectively this would mean a restructure of the debt restructuring just agreed! Added to this are the growing problems in Spain, where youth unemployment has reached a 50 year high and ever harsher austerity measures are being introduced. The risk of a double dip recession is also gathering pace across Europe, with France the latest casualty.

Overall, whilst the problems we have been highlighting for a while still reside in the background, we have seen a good start to the year for equity markets.



Outlook

In previous letters we have focused on the short-term macro economic problems, our “Wall of Worry”, and 12 months on from initially highlighting these factors, not much has changed. It all feels a little like déjà vu with the following issues still a problem and this is likely to remain the case for a while to come:

- Eurozone sovereign debt crisis.
- Potential unravelling of the Euro.
- Weak growth in the UK.
- Fears over US growth evaporating later in the year.
- Iranian tensions in the Middle East.
- Slowdown in Asia, especially China.
- Global credit deleveraging.

As we have said for a while now, we feel the European problems will continue to plague stockmarkets until politicians make a concerted effort to address the structural issues that exist. Unfortunately they are unlikely to be resolved anytime soon especially with several key European figures facing domestic elections to stay in power.

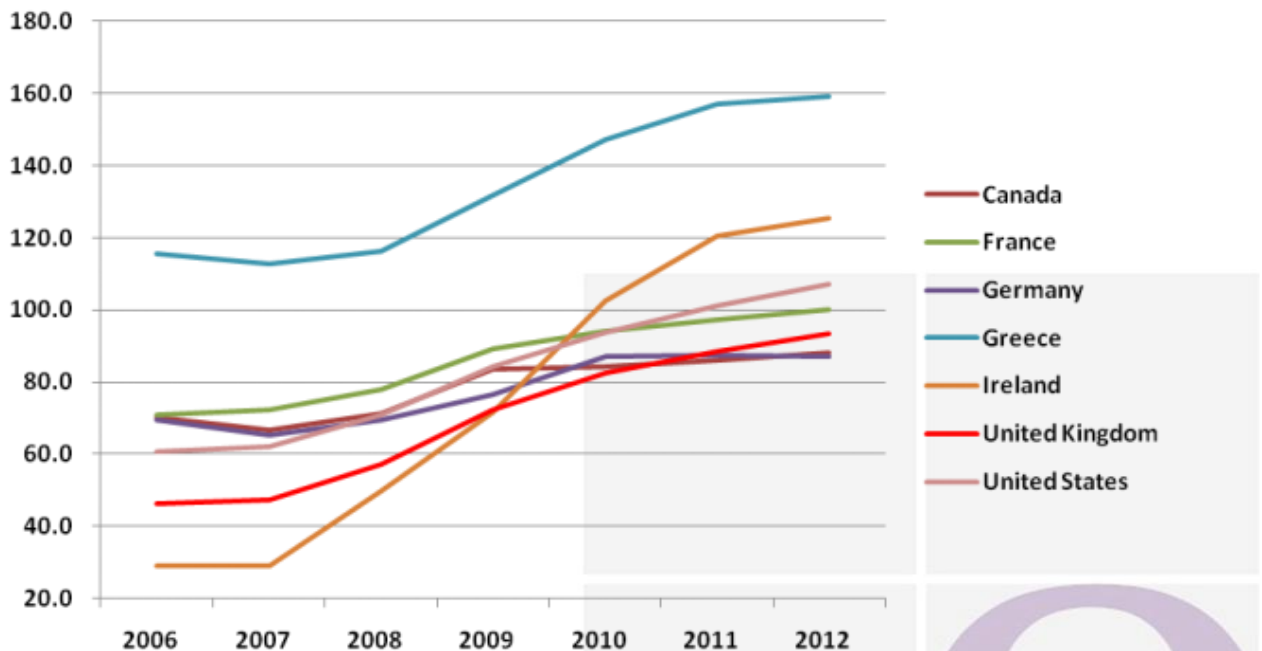
We will look to discuss more of these themes in our letters from time to time but will focus here on the Western World’s attempt to de-leverage.

The transition to a world with less debt

Over the last 30 or so years we have experienced a debt super-cycle where all sides of the economy, whether governments or households, went on a credit binge. The provision of endless credit had become the norm and it took the credit crisis of 2008 to make us focus on the problems that this has caused.

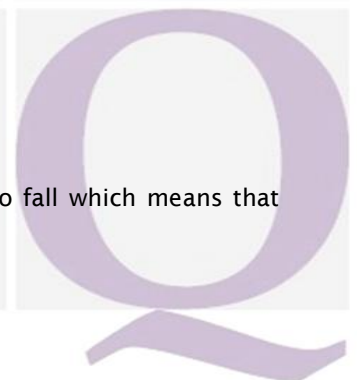
Four years on from the credit crisis and most countries have struggled to curb their reliance on credit, with many Western countries seeing their balance sheets move further into the red despite implementing massive austerity (de-leveraging) packages.

Government debt as a percentage of GDP



Source: OECD May 2011

The slowdown in the growth of the global economy has caused tax receipts to fall which means that paying back the debt already accumulated becomes harder.



Western economies are effectively caught in a trap - cutting spending slows growth which impacts tax receipts, whereas to ultimately pay down this accumulated debt increasing tax revenue or economic growth is needed.

What does this all mean when investing? We feel the biggest change will be a fundamental shift in the perception of what is a “safe” investment. For too long countries with high debt levels like the US and UK have received the highest credit ratings (or deemed to be the safest), and over the coming years we are likely to see this change. With government debt levels, as seen earlier, getting ever higher the risk that a country will default on its debts becomes ever more likely. For those who have read our letters previously, you will already know that we invest in the New Capital Wealthy Nations Bond fund, which looks to invest in countries that are cash rich.

The change in attitude of credit agencies to rating government debt is unlikely to happen overnight however. We therefore feel that over the medium term investors should seek greater safety from companies with strong balance sheets and higher income yields, rather than governments with weak balance sheets and all time low yields. As a consequence we have been increasing our exposure to corporate debt over the last six months for all portfolios, specifically using the Jupiter Strategic Bond Fund (and we have provided more details on this fund later in the letter) and also adding to our passively managed corporate debt exposure.

Finally the increase in stockmarket (and other asset class) volatility is likely to remain for some time to come and will require investors to be more tactical in managing their asset allocations. Choosing the correct asset class or region will become increasingly important in generating returns.

What does this mean for Quartet’s client portfolios?

Given that our prime focus is on the management of client asset allocations, both strategic and tactical, we thought it useful to show how our main risk profiles are positioned strategically and then how we have tilted these tactically.

As you will be aware the initial building block that we start with in the construction of each client portfolio is one of four strategic asset allocations – Capital Preservation, Cautious, Balanced and Aggressive. These asset allocations are then tailored to each client’s circumstances to create a bespoke client portfolio. Client strategic asset allocations are adjusted on a tactical basis depending upon our views towards different asset classes, regions and the broader economic environment.

Main actions taken in client portfolios over the past quarter:

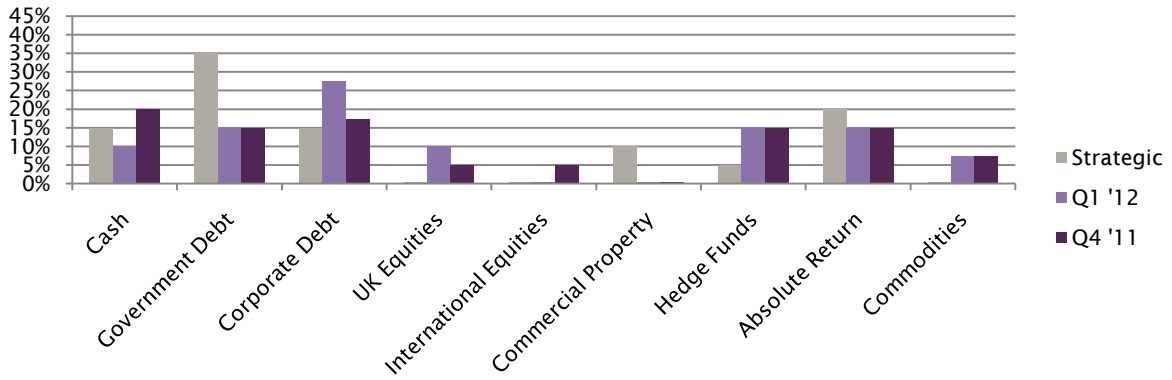
- As mentioned in our last newsletter, evidence suggests that many companies strengthened their balance sheets following the 2008 crisis, reducing debt levels and increasing their cash holdings. This has become more evident in the US since the beginning of the year, and consequently we increased exposure to both US Corporate debt, and the US Dollar in general, for Capital Preservation and Cautious portfolios in February.
- Since increasing our equity allocation via exposure to Europe and Brazil (for all but the lowest risk portfolios) in October last year, both stockmarkets have provided returns in excess of 11%. At the beginning of March we felt that the global stockmarket rally witnessed was not sustainable, and in a tactical move for portfolios we sold the entire position in Brazil and substantially reduced the European equity allocation.
- Despite reducing equity allocations in the short-term, we remain very positive on equity markets longer-term. We will look for an appropriate opportunity to increase this exposure in portfolios.

Quartet’s portfolio positioning

Detailed below are four charts showing how our tactical asset allocations have changed quarter-on-quarter and also the positioning relative to the strategic asset allocations.



Capital Preservation asset allocation: Strategic & Tactical Allocations



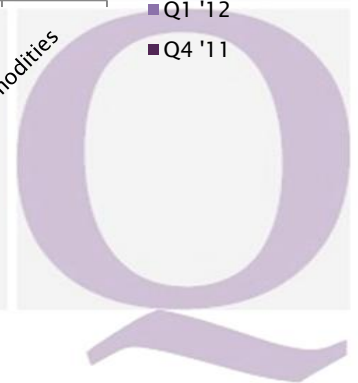
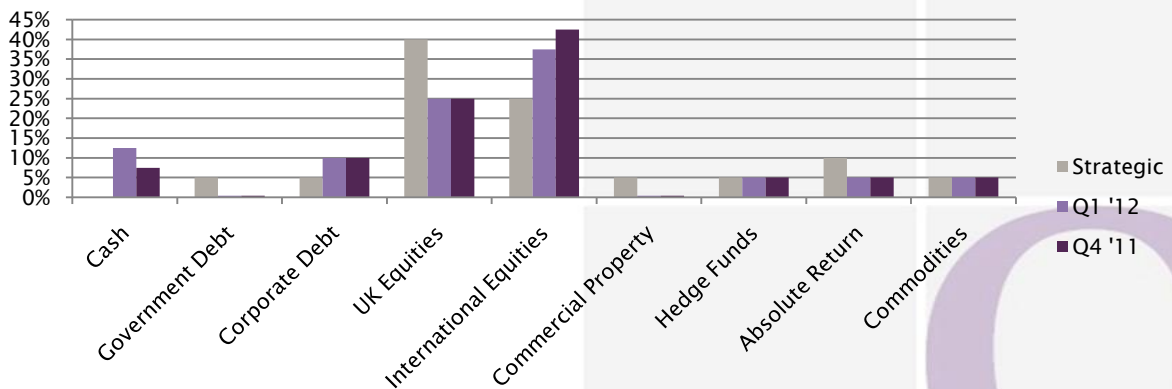
Cautious asset allocation: Strategic & Tactical Allocations



Balanced asset allocation: Strategic & Tactical Allocations



Aggressive asset allocation: Strategic & Tactical Allocations



Fund news

We have recently introduced the Jupiter Strategic Bond fund for the majority of client portfolios, and we thought you may find it interesting to know more about the holding.

Jupiter Strategic Bond fund

Managed by Ariel Bezalel, the Jupiter Strategic Bond fund aims to provide a high income yield, currently 6.5%, with the prospect for capital growth.

The fund is not benchmarked or geographically constrained, meaning it can invest across the entire spectrum of the global bond world. If necessary it can seek the safety of government bonds, or it can take on more risk when good opportunities in corporate or high yield bonds arise.

Ariel typically starts with a top down approach meaning he formulates his own views on the global economic situation. Having decided on his preferred “asset allocation” he finds the appropriate bonds to match his thoughts.

More recently Ariel’s views on the global situation have seen his fund move away from low yielding government bonds and into higher yielding corporate debt. He insists on holding company bonds that are as high up the credit rating scale as possible (preferably secured against an asset), and recently explained to us that he looks for companies with robust business models, strong cash flows and competent management teams. His aim is to invest for the long-term and portfolio turnover is relatively low.

The fund has an exceptional track record and should fit well into portfolios. As with the vast majority of our investments, it is daily tradable and provides us with full investment transparency.

News

We are now in a new tax year (2012/2013) and stocks and shares ISA allowances have increased to £11,280 per person. As a reminder we can manage ISA portfolios alongside traditional taxable portfolios.



A reminder of what we do

Quartet Capital Partners focuses on providing discretionary investment management services to high net worth private clients. We believe that the approach we take really is *different*.

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

- **Bespoke portfolios.** We do not believe in shoehorning clients into predetermined investment solutions, 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.
- **Chartered investment professionals.** We are a team of investment managers who have all attained chartered status, have worked together for a number of years, and specialise in managing personalised investment portfolios for private clients.

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.

Quartet Capital Partners LLP
March 2012

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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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