Quartet Capital Partners LLP

September 2010

Welcome to the fifth edition of Quartet Capital Partner's newsletter. As with previous newsletters 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 delighted to report that we have now accrued over a year's performance. As can be seen in the table our returns since inception have been strong and I believe vindicates the fundamental premise behind our investment approach, active asset allocation is where the majority of investment returns are generated. Our returns have also, to my mind, been generated assuming significantly less equity market risk then the relevant benchmarks.

Investment Performance

	01 August 2009 31 July 2010	01 August 2010 31 August 2010		Since Inception
Risk Profile				
- Capital Preservation	7.39%	0.78%		8.23%
- Cautious	10.31%	0.14%		10.46%
- Balanced	15.71%	-0.16%		15.52%
- Aggressive	15.44%	-0.63%		14.71%
Benchmarks				
FTSE All Share Index	15.38%	-0.69%		14.58%
FTSE World Index	8.40%	-3.92%		4.15%
FTSE UK Gilts All Stocks Index	2.74%	3.26%		6.09%
ARC Sterling Cautious	7.70%	1.40%	*	9.21%
ARC Sterling Balanced	10.56%	0.70%	*	11.34%
ARC Sterling Steady Growth	13.09%	-0.10%	*	12.98%

Returns are net of all fees and charges. Past performance is not a guide to future performance and the value of investments can fall as well as rise.

* ARC performance figures for July & August 2010 have been estimated by Asset Risk Consultancy

Sources: FT.com, assetrisk.com

Returns over the past month has been relatively weak, the positioning that has aided performance over the past year proved exactly wrong in August.

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 month the investment performance was hindered, by tactical asset allocation decisions and also by weak relative returns from one of our "alpha enhancing" investments:

Tactical Asset Allocation:

- Whilst retaining our pessimism about the prospects for the UK we continue to maintain a bias to non-UK exposure. As can be seen from the earlier table the FTSE World Index returned -3.92% versus the FTSE All Share Index only falling by -0.69%, a big relative discrepancy. This adversely affected all portfolios bar the Capital Preservation portfolio which has maintained a 0% equity allocation. In addition the US Dollar has weakened by a few percent over the past two months relative to sterling.

- In terms of good decisions, we maintained our view that a double dip recession is more likely here in the UK then the general media think and also that deflation risk remains high. As such we have maintained a position in physical Gold and also conventional debt securities. Both appreciated over the month.

Alpha Enhancing Investments:

- When I last wrote I commented that our Special Situation position in a listed property company appreciated by 10% during May and June. Well this gain reversed during August. We remain convinced that significant upside exists and to our mind fits the perfect asymmetrical trade idea that we look for (big upside and little downside).

Asset allocation going forward

Unlike previous newsletters I want to briefly dwell on what our big macro-economic views are. This then dictates how we view individual asset classes and hence our portfolio positioning. I must credit our partners, ARP, for much for the following text.

The Economic Outlook

The summer produced several surprises on the economic front, as verified by the growing divergence between Europe and the United States. Germany did particularly well, producing very robust growth (the cynics amongst us may even say that Germany was the only eurozone country which did well), whereas the US went from one disappointment to another.

The U.S. economy is still stuck in a confidence crisis which is evidently a bi-product of the persistently high unemployment, which Americans are not used to. Despite enormous fiscal stimulus, the unemployment rate has only dropped marginally, and there are no indications to suggest that this picture will change dramatically any time soon.

The muted confidence is having an effect on bank lending which continues to decline. One may argue that it is in fact the banking sector which is unwilling to lend, not borrowers which are unwilling to borrow; however, studies in the U.S. suggest that, at least in recent months, the declining lending activity is driven by customers' unwillingness to borrow, not the other way round.

This is all perfectly consistent with the view we have held for well over a year now, i.e. that the U.S. economy is stuck in a balance sheet recession. Unlike 'normal' recessions, balance sheet recessions are driven by the urge to pay down debt, and they take a lot longer to unwind.

At the same time, bank lending is a leading indicator of economic activity (with a 9-12 month lead on average), suggesting that the strong upswing in U.S. economic activity in the first half of 2010 may prove short-lived.

Meanwhile, in Europe, news on the economic front has been surprisingly good. Despite having recovered somewhat from the lows of early June, the euro is still down almost 12% year-to-date against the US dollar, giving Europe's largest exporters a much needed boost at a critical juncture. Europe's problem is that not everyone benefits from a weaker euro. Of the bigger member countries in the eurozone, Germany exports the most to the rest of the world (as a % of GDP). This would explain why the German economy has fared so much better than everyone else's over the past couple of quarters.

Of all the European countries in need of some good news, only Ireland's exports to the rest of the world (i.e. to countries outside the EU-27) account for a bigger share of GDP than Germany's. Southern Europe is characterised either by relatively modest export sectors (such as Italy), or they export mostly to other European countries (e.g. Greece, Spain and Portugal), in which case a weakening euro makes not one iota of difference.

Now, domestic demand in Europe continues to be relatively weak, exposing Europe to a slowdown in America and/or Asia, should that happen. In fact, German factory orders (a leading indicator for exports) have already started to slow down, following a very strong period earlier this year.

In the UK, the economy is on a knife's edge. Whereas the economy grew by 1.2% in the second quarter, the effects of the government's newly implemented austerity programme will only begin to kick in during Q4 of this year. It is anyone's guess how resilient the economy will prove to be, but a return to negative GDP growth is very much a possibility.

All in all, the economic barometer points towards slow economic growth over the next 6-12 months, but the global economy should prove strong enough to escape a double dip; however, several countries are at risk of slipping back into recession (as Spain did last quarter). Much depends on whether Obama opts to extend the tax rebates implemented by the Bush administration when they expire in January 2011. Without those tax rebates in place, the probability of a U.S. double dip suddenly rises to uncomfortably high levels. And, if the U.S. economy slips back into recession, so will many other countries.

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 at the start of September, are as follows:

Equities (Neutral)
Over the short term we are Neutral to marginally bearish on equity markets. If however we see a 5 - 10% pullback in markets our view would change to being Neutral/Positive. Historically the best time to own equities has been the latter stages of a recession. The stockmarkets ultimate destiny will probably be determined by whether or not we enter a double dip recession.

We continue to have a bias towards the US and the 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.

Fixed Income (Neutral/Positive)
We see a no change to our position from our earlier newsletter. Whilst many commentators are negative towards the bond market and argue that bond yields have entered bubble territory we continue to take a relatively bullish stance because everything happening around us is deflationary (cuts in government spending, high unemployment rates to name but a couple). We therefore think the short end of the yield curve offers decent upside potential, in particular as a hedge against any equity market falls. This is because Government debt is negatively correlated to equities in crisis periods.

We believe some value exists in highly rated corporate bonds but have concerns due to yield compression that the “easy money” has been made. 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 albeit this has hurt us over the past two months and we remain very wary about the Euro. Euro/US Dollar parity may well just happen!

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. If the UK and European economic recovery remains lacklustre property investors may be disappointed with returns going forward.

Commodities (Neutral/Negative)
We maintain 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 potential market falls.

Hedge & Absolute Return Funds (Positive)
We remain very positive towards this asset class. Hedge fund returns have however been mixed year to date. We maintain a bias towards managers that are macro orientated in nature and have little exposure to equity-related strategies.

Quartet Capital’s progress
We continue to be delighted by the positive response that we have received from professional advisors, clients and potential clients. We are glad to report that assets under management continue to grow at a healthy rate. More is always welcome!

We need to congratulate Nigel who is now a Chartered Fellow of the Securities Institute. Colin and Peter have now passed all the exams and are waiting on their Chartered status being awarded, watch this space.

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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.

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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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