Sailing the investor storm

Charteris Treasury Portfolio Managers CEO, Ian Williams, looks at which asset classes could provide you with a safe harbour in these turbulent times

In the midst of the current turmoil what should investors do in the face of seemingly unremitting bad news, do they look to park their money only in safe assets with little or no risk? However, what constitutes a risky asset and what constitutes a safe one? The absolute key point here, is that risk relates to the price of the asset not the asset itself: i.e. you can buy the best house in the street at the top of the market & you will lose money – or you can buy the worst house in the street at the bottom of the market & you will make money, so investors cannot assume that gilts for example are a safe asset, as they are grossly overvalued on every basis known to man. Equities on the other hand are extremely cheap on historical valuations. Also what do investors make of the inexorable rise in the price of gold?

But surely, if the world enters a double dip recession, will not equities go down & gilts go up? Firstly the global economy, far from going into recession it is in the middle of one of its biggest booms in history. The world economy is growing at about 3.7 per cent (having slowed down a bit from its 4.2 per cent rate a few months ago). This is nowhere near zero & not likely to go anywhere near zero. The global economy has doubled in size in the last decade from $30 trillion (£19.1 trillion) to $60 trillion today and is set to double again in the next decade. Needless to say, all of this growth is in Asia & Emerging markets. Europe meanwhile faces years of stagnation sorting out legacy debts in the context of a single currency that is turning out to be the disaster that euro-sceptics predicted it would be. The West and East both have a problem with economic growth, namely that the West has too little whilst the East has too much. The recent pullback in growth (referred to above) is due to a deliberate policy by the Asian central banks to try and stop their economies from overheating.

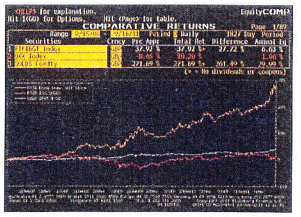
At Charteris I manage three funds in each of these sectors (gilts, equities and gold) , so my horizon tends to be a bit broader than some of my peers in the industry, as we have to take simultaneous decisions on all three asset classes.

Firstly looking at Equities we are quite positive on a medium term view (i.e. three years) assuming that the underlying companies are in the right space to benefit from this polarised world economy.

This economic growth in the emerging markets is the big reason why we expect overseas earners in the FTSE 100 (of which 70 per cent of the Index is made up of) will outperform companies reliant on the UK economy and/or UK consumer due to higher growth rate overseas and the long term deterioration in the sterling exchange rate. This is why The Elite Charteris Premium Income Fund holds stocks such as Fresnillo, Xstrata, Unilever, Reckitt Benckiser, Rio Tinto, Vodafone and Standard & Chartered. All these companies earn the vast proportion of their profits outside the UK and have substantial percentages within the Fund.

Secondly, as we have already remarked, gilts are trading at lows in yields (highs in price) not seen for 50 years. As such, they are a very high risk investment and are not the low risk asset that many people think they are. Furthermore, the risk with gilts is asymmetric in that the potential losses are quite large, whereas any potential gains from here are strictly limited. Also the UK public sector finances look dreadful. The on-balance sheet debt is now over £1 trillion whilst The off- balance sheet expenses such as civil servant pensions and other hidden costs amount such as PFI to another £1 trillion for which the issue of gilts (other than printing) is the traditional way to pay for this.

Thirdly, what about gold, is that not a risky asset given that it has gone up from $250 an ounce in 2000 (when Gordon Brown famously sold off half the UK's gold reserves) to the current price of $1850 an ounce? Well, not necessarily. Unlike gilts, gold represents a genuine safe haven from the ravages of the printing antics of the western central banks. The current debts of the US and Europe are so large that there is no realistic possibility that they can ever be repaid with honest money. (I.e. money raised from taxation). The only way out of this mess is for the ECB to indulge in some vast money printing exercise on the lines already seen by the Fed & Bank of England. Central Banks cannot print gold and therein lies its attraction. Also, whilst gold is at an all time high in nominal terms it is nowhere near it's high in real terms (i.e. allowing for inflation). We have seen constant flows of money coming into the WAY Charteris Gold Fund as investors (and institutions) seek a greater exposure to the metal and they are doing this via the fund. It is structured so that it doesn't "short" or "hedge" the gold price, It is long only, non-leveraged and this is a strategy that investors want and have been very pleased with returns having nearly made 40 per cent on a total return basis since launch in March 2010.



Fourthly, Foreign exchange, it isn't just the sterling exchange rate that will deteriorate, but the dollar and euro will join it. The strong currencies of the next decade will be those of China, India and Korea along with Canada & Australia dollars respectively due to the ongoing boom in commodities that flows from the growth in Asia. There are some signs, however, that the situation in the US is not quite as bad as it is made out to be. The USA has witnessed a complete collapse in the housing market over the last four years which has meant for the first time in 30 years, it is cheaper to buy a house in the many parts of the USA than rent. This should lead to a more balanced housing market as the backlog of unsold homes should now be cleared. Once this is underway construction activity will begin to return to the housing market with a beneficial impact on construction jobs. Also, US corporations now have more cash on their balance sheets (over $1 trillion) that at any time in history. The corporate sector is in rude health – it is the public sector that is sick. That is why equities are a much better bet than government bonds – especially given the fact that investors can switch bonds into equities on terms that are close to the best for 50 years.

In conclusion, equities represent superior value in the long term, gold is nowhere near the end of its bull market super cycle and fixed income represents a lot more investor risk than a lot of people realise.

IAN WILLIAMS, Charteis Treasury Portfolio Managers CEO

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