Multi-Manager View

Robin McDonald,
Fund Manager,
Cazenove Capital

Howard Marks' book, The Most Important Thing, is an investment classic. I recommend it to anyone with any interest in investing.

One of my favourite chapters is devoted to what Marks terms "the pendulum-like oscillation of investor attitudes and behaviour". He writes: "The pendulum swing regarding attitudes to risk is one of the most powerful of all. In fact, I've recently boiled down the main risks in investing to two: the risk of losing money and the risk of missing opportunity. It's possible to largely eliminate either one, but not both. In an ideal world, investors would balance these two concerns. But from time to time, at the extremes of the pendulum's swing, one or the other predominates."

2011 was, for the most-part, a year when guarding against the risk of losing money proved dominant. This was evident in the extreme during the final quarter when defensive assets outperformed a strongly rising market. We were happy to end the year with our diversity and diversity income funds both having registered positive returns.

Yet, as Marks warns: "The swing back from an extreme is usually more rapid - and thus takes much less time - than the swing to the extreme." As thus it has been so far in 2012.

At a party recently, a fellow investor claimed to be more "worried" about the 5 per cent cash in his portfolio than the 95 per cent he has "at risk". I guess this captures the swing to euphoria.

Many markets are testing their highs from last year. Having added risk to our portfolios in Q3 and again in Q4 as a positive turn in leading indicators began to support our earlier value case, we have captured this move fairly well.

"The swing back from an extreme is usually more rapid - and thus takes much less time - than the swing to the extreme."
Howard Marks

But what about the future?

Energy prices have been rising rapidly. Petrol prices are increasing at the same pace (in percentage terms) as they were last year. The difference is the much higher base price. This remains a key risk and the main reason why the Federal Reserve will not be embarking on QE3 any time soon. Any overt strategy to weaken the dollar at this point would be likely to send oil higher to nip any recovery in the bud, so QE3 would be counter-productive at this point.

With the Fed pretty much the only major central bank not loosening monetary policy, we believe the bias to the dollar should be up, not down. Market participants have got used to a strong dollar being negative for risk appetite and consequently asset prices but we continue to believe the world (and financial markets) would benefit at this stage from a strengthening dollar.

In terms of what this means for portfolios, where we are taking cyclical risk, we prefer to concentrate on domestic Western sectors over the emerging market dollar-bloc beneficiaries of the last decade. Not only would domestic sectors benefit from a strong dollar/falling oil price, but they also enjoy a margin of relative valuation support. Hence our recent purchase of Fidelity Special Situations.