

## VIEWS FROM THE DESK (VFTD)

May 2015

### Viva Las Vegas!

*'Investing should be like watching paint dry or grass grow; if you want excitement, take US\$800 and go to Las Vegas'.* Paul Samuelson, Nobel Prize winner for economics and the author of *Economics: An Introductory Analysis* (1948).

In one sense we agree with this view, indeed, one of our core beliefs is that *managing assets is a long term assignment*. In another sense we disagree; to us, investing is exciting, thought provoking and at times scary. Each to their own, we hear you say, and rightly so. This said, we wonder whether investing in the current environment is becoming too stimulating or to use another quote (author to remain anonymous!); *'a bit like taking a sleeping tablet and a laxative at the same time – not a good idea!'*

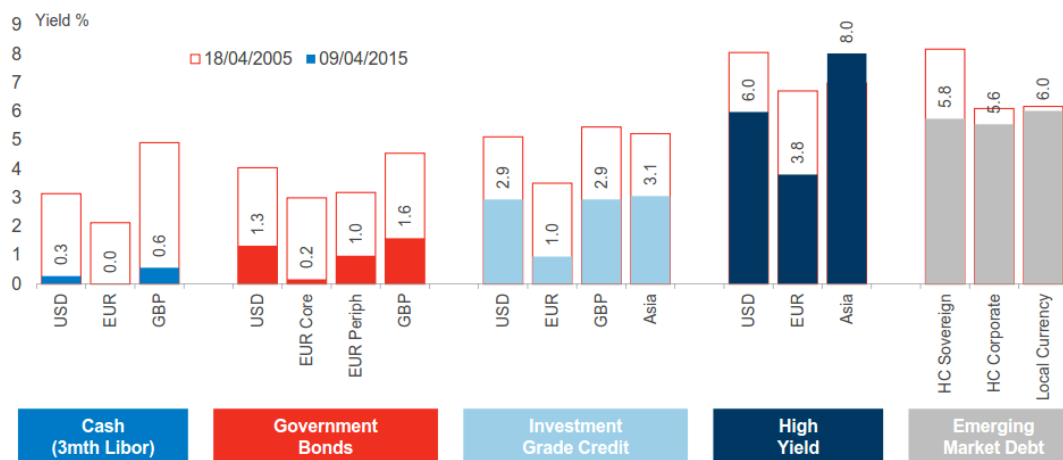
A period of disappointing US economic data, culminating in official Q1 GDP estimates coming in at a meagre 0.1%, has, to varying degrees, both policy makers and investors scratching their heads. The question being why, after several years of massive monetary stimulus, is the US economy performing so poorly? For many, weak aggregate end demand (i.e. a still 'unhealthy' US consumer) remains the culprit and to address this problem the 'prescription' of extremely low interest rates is here to stay – the welcome sleeping tablet in our analogy above. However, if we take a step back, we wonder whether the consensus view that the economy is underperforming is necessarily the correct one. For example;

- > The current expansionary phase has lasted longer than the post war average
- > It has produced record profits, an all time high in US household net worth and a buoyant stock market
- > We have seen strong auto sales, a recovery in retail sales and a solid rise in real wages
- > Innovation continues apace, with a stream of IPOs enabling investment in a range of popular and valuable technologies

To us, the US economy is in a better state than some may think and, whilst it might not yet be in rude health, it is well on the way to recovery. Continuing to prescribe the medicine of near zero interest rates is akin to prescribing antibiotics to a patient that has a viral infection, so argues James Paulsen, of Wells Fargo Capital Management. He believes the problem with the US economy does not lie on the demand side; the issues are weak productivity and population growth, i.e. supply side factors. In his view, continuing with extremely low interest rates to stimulate the economy is much like a doctor increasing the dosage of antibiotics to the patient when the treatment is simply not working. While this does no real harm in the near term – as the infection is viral not bacterial – the patient may eventually become immune to the antibiotics just at the time they are really needed. This is the laxative we described earlier.

## What does this mean for asset allocation and investment decisions?

In our opinion, nowhere in the investment world today better illustrates the sleeping tablet/laxative analogy than blindly investing for income. As we know, the risk-free rate of return is the building block for rational market pricing. When this figure is made artificially low, or even negative, through the distorting effect of central bank policy, irrational market pricing is the result. The reach for yield has become the most powerful change to market dynamics since the global financial crisis (GFC). As the chart below illustrates, yields today are significantly below historical levels, forcing investors along the risk curve.



Source: Fidelity Worldwide Investment, April 10 2015

Clients of Affinity are aware of our uneasiness in being exposed to crowded trades and, today, many income assets fall into this category. QE is blurring investor's market optics and causing unanticipated side effects; why is money being committed to assets guaranteeing a negative return? Recent price action suggests market participants may be waking up to the reality they are simply not being adequately compensated. Whilst others are exiting what has been a very profitable trade. Either way, European government bonds have seen a dramatic reversal. By way of an example, in the past two weeks yields on German 10 year bunds have risen from 0.075% to 0.55% - a 630 percent move (or 5 standard deviations) - costing their holders c.4.3%. This from a so-called "risk free" asset!

Who needs to go to Vegas for excitement?

**Julia Warrander and Russell Waite**

## Performance of Discretionary Strategies

### Income Strategy (£) (Benchmark: 3M Sterling Cash+2%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	1.80	1.38	0.73	-	-	-	-	-	-	-	-	-	3.95	Composite
2014	-0.66	1.62	0.49	0.37	1.18	0.08	-0.42	1.24	-0.04	0.36	1.32	-0.33	5.30	Composite
2013	1.75	0.60	0.75	0.91	-0.24	-2.35	1.28	-0.49	-0.06	1.40	-0.34	0.64	3.85	Composite
2012	2.44	1.95	-0.46	-0.34	-1.42	1.82	1.98	0.55	0.83	0.34	0.61	0.48	9.30	Model

### Income Strategy (\$) (Benchmark: 3M US Dollar Cash+2%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	0.36	1.77	-0.47	-	-	-	-	-	-	-	-	-	1.66	Composite
2014	-1.51	2.43	0.61	0.88	0.93	0.87	-0.88	0.43	-1.82	-0.20	0.47	-0.90	1.26	Composite
2013	-	-	-	-	-	-	-	-	-	-	-0.03	0.97	0.94	Composite

### Real Return Strategy (£) (Benchmark: UK CPI+2%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	2.94	1.43	2.06	-	-	-	-	-	-	-	-	-	6.57	Composite
2014	-0.63	2.19	0.33	-1.26	2.05	-0.04	-0.55	1.71	-1.04	0.59	2.08	-0.33	5.07	Composite
2013	2.63	1.80	0.72	0.15	1.23	-2.25	1.51	-1.45	0.32	2.11	-0.65	0.48	6.68	Composite
2012	3.17	3.15	-0.32	-0.87	-3.31	1.63	2.20	1.00	1.46	-0.56	0.92	0.07	8.34	Model

### Real Return Strategy (\$) (Benchmark: US CPI+2%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	0.13	2.57	-0.47	-	-	-	-	-	-	-	-	-	2.21	Composite
2014	-1.14	3.23	-0.07	-0.85	1.41	0.86	-1.30	0.62	-2.02	-0.19	0.80	-0.52	0.72	Composite
2013	-	-	-	-	-	-	-	-	-	1.35	0.90	1.33	3.61	Composite

### Growth Strategy (£) (Benchmark: UK CPI+3%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	2.58	2.10	2.34	-	-	-	-	-	-	-	-	-	7.19	Composite
2014	-1.19	2.68	0.06	-1.87	1.89	0.11	-0.45	1.92	-1.11	-0.82	1.52	-1.12	1.52	Composite
2013	3.49	2.06	0.91	-0.32	1.50	-2.97	2.18	-2.28	0.61	2.53	-0.97	0.57	7.36	Composite
2012	3.57	3.13	-0.44	-1.23	-3.98	1.85	2.16	0.60	1.84	-0.28	1.03	0.45	8.72	Model

### Equity Growth Strategy (\$) (Benchmark: MSCI All Country World Index)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2015	-1.94	4.61	-1.67	-	-	-	-	-	-	-	-	-	0.87	Composite
2014	-3.26	4.87	-0.84	-1.61	2.22	2.41	-1.31	0.94	-2.21	-1.33	0.70	-2.17	-1.87	Composite
2013	2.51	-0.63	2.00	2.58	-0.45	-2.29	3.56	-1.22	5.78	2.62	*0.66	1.96	17.08	Model & Composite
2012	4.83	4.34	1.14	0.32	-7.55	3.56	1.66	1.35	2.76	-0.77	1.01	2.54	15.17	Model

\*Start of composite data

### Alpha Strategy (\$) (Benchmark: 3M US Dollar Cash+3%)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
<b>2015</b>	<b>0.52</b>	<b>-0.57</b>	<b>-0.10</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-0.15</b>	Composite Model & Composite Model
<b>2014</b>	<b>0.82</b>	<b>1.33</b>	<b>-0.73</b>	<b>-0.96</b>	<b>-0.07</b>	<b>-0.26</b>	<b>-0.00*</b>	<b>-0.11</b>	<b>1.71</b>	<b>-0.78</b>	<b>0.13</b>	<b>-0.16</b>	<b>0.94</b>	Model
<b>2013</b>	<b>1.26</b>	<b>1.02</b>	<b>1.25</b>	<b>1.27</b>	<b>1.74</b>	<b>0.39</b>	<b>1.46</b>	<b>-1.07</b>	<b>0.48</b>	<b>1.51</b>	<b>1.02</b>	<b>0.56</b>	<b>11.09</b>	Model
<b>2012</b>	<b>0.47</b>	<b>1.48</b>	<b>1.14</b>	<b>0.85</b>	<b>-0.15</b>	<b>0.66</b>	<b>0.59</b>	<b>0.87</b>	<b>0.13</b>	<b>0.64</b>	<b>0.54</b>	<b>-0.01</b>	<b>7.33</b>	Model

\*Start of composite data

Last month's composite performance numbers are currently being calculated and may be provided on request.

The performance detailed above is for illustrative purposes only and reflects the returns across Affinity Private Wealth's Income, Real Return and Growth model strategies, net of 0.95% management fees.

This does not constitute investment advice and past performance should not be viewed as an indicator of future performance.

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