ARTORIUS WEALTH

MARKET COMMENT

12th February 2016

MANCHESTER LONDON ZURICH

BAGGING A BARGAIN?

With equity markets severely down since the start of the year, the urge to buy can be overwhelming. However, with the start of Lent, this is the season to avoid and not to yield to temptation.

The book *Investing: The Last Liberal Art* suggests how investing works in the context of a number of seemingly unrelated disciplines. These include psychology and neuroscience.

A recent study by Brian Knutson, a professor at Stanford, identified via MRI scans something what he called a "hedonic competition between the immediate please of acquisition and an equally immediate pain of paying." In other words the 'pleasure' of the purchase and the 'pain' of the price triggered different elements of the brain.

When individuals thought about whether they wanted a product, the scans showed increased blood flow to the nucleus accumbens. This is an area of the brain particularly receptive to dopamine, a chemical that promotes desire.

On the other hand, when the person evaluated the price, he detected greater activity in an area called the insula, which is associated with unpleasant emotions.

When shops cut prices, the part of the brain that registers the 'pain' of the purchase feels less 'pain'. By giving the impression that you are getting more for less, retailers exploit the biological weakness for an apparent bargain. The thrill of a bargain enhances the underlying 'pleasure' of the item being purchased. The result is a wardrobe of 'bargains' that are never worn or used.

We wonder whether such neuroscience could explain the desire for people to rush in and buy when the price of equities falls. It is vital from an investment point of view to keep such natural instincts separate, so that our decisions are governed only by economic fundamentals and valuations.

Tactics used by retailers to 'trick the mind' to enhance the 'bagging a bargain' mentality including discounting previously marked-up items. We wonder how much potential investors think they are getting something cheap just because the price has fallen recently. The reality is that the previously very expensive investment may have only become slightly less expensive.

Investing into a falling market

As a strategy, the investment team maintain the underweight position in equities, expressed via the selling of US equities and holding cash.

We maintain a full exposure to bonds, which have rallied in 2016 as yields have fallen.

For new clients with cash seeking to be invested we adopt a three month investment cycle. We can adopt this according to client requirements where a client has a documented caution to investing in the current climate.

The three month investment window provides Artorius Wealth and more importantly the client with a framework to understand the investment process. No one investment process will be perfect as market volatility makes exact timing impossible

Caution

We remain cautious of equity markets, as markets remain expensive alongside slowing economies that are likely to depress profits in the near term. The good news is that the balanced portfolios have benefitted from the rise in bond prices.

Asset Allocation Views

Equities	⊖ (negative)
US	Negative
UK	Neutral
Europe ex UK	Neutral
Japan	Neutral
Pacific ex Japan	Neutral
Emerging Markets	Neutral

Fixed Income	Neutral
Government	Neutral
Investment Grade	Neutral
High Yield	Neutral
Emerging Market	Neutral
Cash	Positive

Alternatives	Neutral
UK Real Estate	Neutral
Infrastructure	Neutral
Private Equity	Neutral

= Positive view

= Negative view

= Neutral

Source: Artorius Wealth

Our Tactical Asset Allocation (TAA) tilts to the SAA reflect our shorter-term cyclical views. Actual client portfolios will vary according to mandate, benchmark, risk profile and the availability of individual asset classes in different regions.

Asset Class Overview

Equity	SAA	Commentary	TAA
US -3 **-2** -1 0 1 2 3	22%	We increased our negative stance on US equities from 'slight' to 'moderate' in early December. From a valuation perspective the US equity market appears fully valued and earnings revisions are weak. The risk of higher interest rates and tighter credit conditions, as seen in surveys, threaten the subdued economy.	-7%
UK -3 -2 -1 **0** 1 2 3	7%	We prefer mid-caps, implemented through exposure to the FTSE 250 Index, as they avoid the dominance of the commodity related companies found in the FTSE 100 index.	-
Europe ex UK -3 -2 -1 **0** 1 2 3	7%	We are of the opinion that the ECB's commitment to its asset-purchase programme will remain intact and continue to support the region's recovery.	-
Japan -3 -2 -1 **0** 1 2 3	0%	Following the Yen's depreciation, the earnings growth of Japan has been robust but challenges remain longer term such as demographics.	-
Pacific ex Japan -3 -2 -1 **0** 1 2 3	5%	With economic challenges emerging in developed economies Asian and emerging market economies and their equity markets have already slowed and fallen respectively.	-
Emerging Markets -3 -2 -1 **0** 1 2 3	5%	The outlook is mixed as valuations are lower than in developed markets but the weakening momentum is a risk that we will look to manage in coming months	-
Global -3 -2 -1 **0** 1 2 3	3%	In contrast to our regional asset allocation we have a global equity theme of water. As the global population grows, water resources are stretched and companies in water industry should benefit from increased expenditure.	-

Fixed Income	SAA	Commentary	TAA
Cash -3 -2 -1 0 1 **2** 3	0%	We opt for cash in the face of unattractive opportunities, in other asset classes. Long term we look to deploy cash holdings in higher return generating assets, but in times of turbulence cash offers a safe haven.	+7%
Government -3 -2 -1 **0** 1 2 3	14%	We remain neutral on government bonds overall, as the inflation outlook appears subdued in the near-term. The prospect of further bond buying from the ECB is likely to keep bund yields low, which in turn should prevent yields in other markets rising too far too soon.	-
Investment Grade -3 -2 -1 **0** 1 2 3	9%	In the UK and Europe there has been a modest increase in credit spreads in 2016, but returns remain attractive in most scenarios relative to government bond markets.	-
High Yield -3 -2 -1 **0** 1 2 3	4%	High yield markets in the UK and Euro area are shielded to date from the US high yield bond market.	-
Emerging Market -3 -2 -1 **0** 1 2 3	3%	We believe that valuations are attractive and sufficient to outweigh the potential volatility caused by the Fed's rate rises.	-

Alternatives	SAA	Commentary	TAA
UK Real Estate -3 -2 -1 **0** 1 2 3	10%	Yields and rental growth of 3% should also make a useful contribution to robust total return in 2016. Valuations appear stretched in absolute terms limiting long-term returns.	-
Infrastructure -3 -2 -1 **0** 1 2 3	5%	Valuations remain full, with limited scope for disappointment, but cash flow generation is drawing fund flows.	-
Private Equity -3 -2 -1 **0** 1 2 3	6%	The asset class most correlated to the economy, in terms of risk. PE houses are expected to deliver positive returns until the economy slows markedly or credit costs rise to curtail private market activity.	-

Source: Artorius Wealth

Key: The numbers reflect a quantitative description of our tactical positions relative to the strategic benchmarks. Our Strategic Asset Allocation (SAA) solutions offer a blend of assets that over a medium terms (5-7 years) will, in our view, provided the optimal mix of returns and risk at a given level of risk tolerance. Our Tactical Asset Allocation (TAA) tilts to the SAA reflect our shorter-term cyclical views. The SAA and TAA positions reflect a medium risk sterling on-shore based client portfolio. Views are subject to change and implementation in portfolios will reflect specific client requirements.

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