The Red House

New Year Resolutions

'There is nothing either good or bad but thinking makes it so.' **Shakespeare**

It's that time of the year when the media is full of forecasts for 2012, the latest diets and New Year resolutions. For a couple of weeks the all pervading gloom of the economic news seemed to lift from the front pages as the politicians, central bankers and wise economic commentators all took time off from the dance of doom they have been enjoying over the last 6 months. But they are coming back to worry us again; politicians need crises to resolve and the news media much prefer bad news to good. The 12 days of Christmas are over, bring on the Grinches!

At TRH we are determined to resist the temptation to join the communal wallow in despondency. Here are some tips from TRH to help you see some sunshine when others forecast stormy times ahead.

1. Ignore the incessant drumbeat of the hourly announcements of the latest FTSE 100 level.

This information is of no relevance to the majority of investors and certainly not to TRH clients. Our client portfolios access the long-term returns from thousands of equity holdings in all of the major developed and emerging market economies. A fixation on hourly, daily, monthly, and even yearly returns can lead to reactions based on short term emotions which are proven to damage long-term returns.

2. Laugh (or shout!) at the soothsayers who tell us what will happen in the investment and economic world.

Rather sadly I keep an eye on what these great minds have said in the past and how their forecasts pan out. Every year the majority gets it wrong, but every year they try again. Presumably they think we've forgotten what they said twelve months earlier.

Take the 2010 Barclays Capital Global Macro Survey of more than two thousand institutional investors in the USA. Their pick for the best performing asset class in 2011 was equities (with 40% support), followed by commodities (34%) and bonds (less than 10%). The consensus prediction was a 15% gain in the US S&P-500 for the year to around 1,420. (3)

The truth turned out to be rather different. Using broad indices, bonds were the best performing asset class of the year with negative returns from commodities and equities. The movement in the S&P-500 index in 2011 was close to zero.

In case you were wondering, the UK experts do no better.

The worrying thing is that millions of investors have billions of pounds managed by these institutions using strategies based on consistently poor forecasting. TRH's investment strategy steers well clear of forecasting and attempting to time investment markets. Instead we construct our portfolios for the long term based on what the evidence tells us about the risk and return characteristics of asset classes and how they behave when blended together.

3. Remember that the past has gone.

The current news may be gloomy, but markets are forward looking and generally efficient which means that all known information is reflected in the price of a stock or bond. When risk appetites are low, the price of safe assets (such as bonds) is higher than at other times due to increased demand. Conversely, the expected reward for risk assets (such as equities) is higher during such times. By keeping their discipline and remaining invested during such times TRH clients are certain to capture this higher expected return………when it arrives.

It is only human to feel anxious about bad news. We fear loss more than we like gains. Losses within a portfolio are only losses if they are realised. TRH portfolios are designed for the long term which is why we do not tamper with our asset allocation when things inevitably change in the short term.

A tendency is to judge the effectiveness of investment strategies by looking at performances on one to five year horizons. We do this because most of us are naturally programmed to be more sensitive to short-term losses than to long-term gains. This is why much of the financial services industry and media encourage a short-term focus. This is akin to looking through the wrong end of a telescope, the thing we should be focusing on looks even further away.

TRH portfolios are selected to match each client's unique circumstances and needs. They are constantly monitored and adjusted where necessary to maintain the agreed exposure to risk and tested against all known liabilities at Annual Planning Meetings.

4. Enjoy a reduction in cost.

Transact, our platform administration providers have reduced their annual fee for the second consecutive year. The savings are as follows:-

Portfolio size	Annual Saving
£1 million	£275
£2 million	£375
£3 million	£450

Not huge numbers but should fill a few tanks of petrol or pay for an excellent meal out!

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5. Win a prize!

All the quotes on the recent newsletters have been from Shakespeare but what have they got in common? The 2 previous quotes were:

'Madness in great ones must not unwatch'd go'
'There is a special providence in the fall of a sparrow …….The readiness is all'

One of my favourite authors was Peter Bernstein who sadly died last year. He wrote 'Against the Gods - the remarkable story of risk'. A copy will be sent to the first reader who sends me the answer and promises they did not use Google!

Gareth Marr
The Red House
13 January 2012

Acknowledgements, sources and risk warnings

1. This document is intended for informational purposes only and no action should be taken, or refrained from being taken, as a consequence of it without consulting a suitably qualified adviser. Please contact The Red House (TRH) if further information is required. Any opinions or estimates contained in this document represent the judgement of TRH at this time, and are subject to change without notice.
2. Parts of this article were taken from 'Things Change' an article by Jim Parker of Dimensional Fund Adviser dated 16th December 2011.
3. Barclays Capital Investor Survey 14th December 2010.