Quarterly Investment Outlook

4th Quarter 2016 September 2016

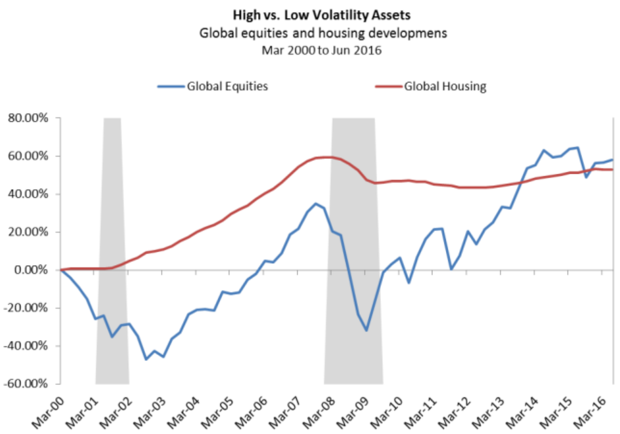
ameliora
WEALTH-MANAGEMENT

Advisor‘s Commentary

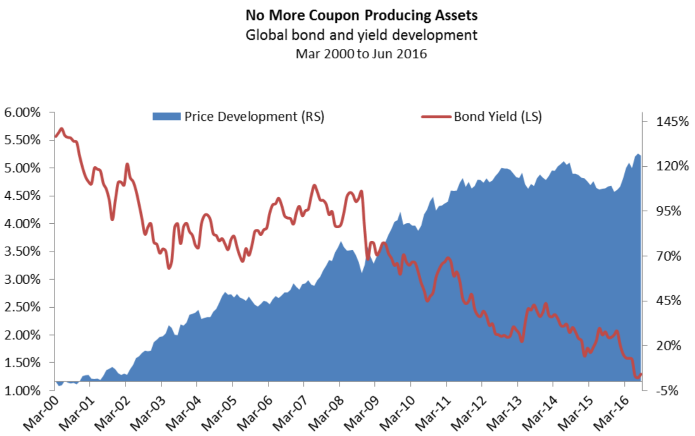
The market's disgust with volatility is rather intriguing. The idea that high price-fluctuating assets are risky and value destructive, and low volatility ones are safe and profitable, is quite perplexing. Think housing and mortgage financing. With real estate, where transaction volume is large and infrequent, prices move less than more commonly traded assets such as equities. Hence real estate is deemed more of a safe investment than stocks. And when it is safe it is also safe to obtain maximum amounts of leverage to acquire the real estate asset. As house prices moderately grow the return on equity increases exponentially making for a great levered investment. A house with an equity down payment of 20% with the remaining 80% financed will return 50%on equity for every 10% price increase in property value – assuming house prices keep rising. During the financial crisis global property prices fell by ca 9%, a marginal loss compared to a roughly 50% fall in equity markets. However, the loss on a 20% equity down payment was closer to 45%. Since the nadir of the crisis global equities have increased by ca 150% whereas global property values have increased by approximately 5%, or a 25% return on equity. Clearly, the "risky" asset was a better investment.

Volatility is in the eye of the beholder and at times it is certainly unpleasant, however without meaningful volatility there would be no asset re-pricing. For every unit of price increase, the future asset return diminishes rendering the asset more and more overvalued. Eventually, a particularly deemed "safe" asset would need to be revalued translating into higher than anticipated volatility. The magnitude of risk, i.e. volatility, effectively increases as the perceived asset quality increases.

As of late we have witnessed a subdued environment measured by volatility. Accommodative monetary policies have assisted the appraisal of various asset classes, particularly developed nations' bonds. The valuation of bonds have reached a level where the purpose of fixed income investing is becoming obliterated as hardly any coupon income is achievable.

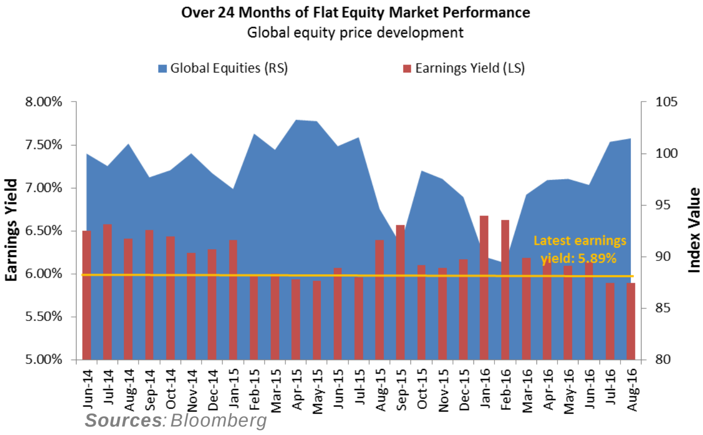


Sources*: International Monetary Fund, Bloomberg, Federal Reserve Bank of St Louis. Grey area indicates recessions.*



Sources*: Bloomberg*

So far this year, "riskier" assets such as equities, credits, and commodities have moved upwards in conjunction with "safe haven" bonds. A rather pleasant development, but also a concern with regards to portfolio construction as when such diverse assets converge it creates more unbalanced portfolio allocations. As usual, financial commentaries are quick to point out that this symbiotic relationship must abruptly end because risky asset valuations (read equities) are too stretched and there is only downside risk from here. Yet, dementia is common among financial pundits as they seem to forget that the total return from global equities over the last two years have been pretty much 0%, essentially dead money, and that the earnings yield remain stubbornly flat at around 6%, which is quite attractive in our opinion.



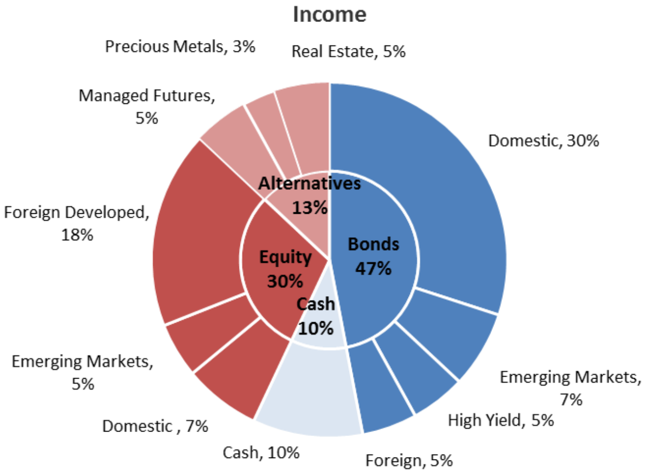
Sources*: Bloomberg*

It is inevitable that we will experience elevated asset volatility at some stage. The recent positive price developments between heterogeneous assets can easily reverse and then polarize asset price pressures downwards. Diversified portfolios will in such scenarios struggle somewhat, but normally tight correlation between different asset classes tend to be short term in nature. Over time this will diverge and asset price dispersion will yet again evolve after a period of re-pricing.

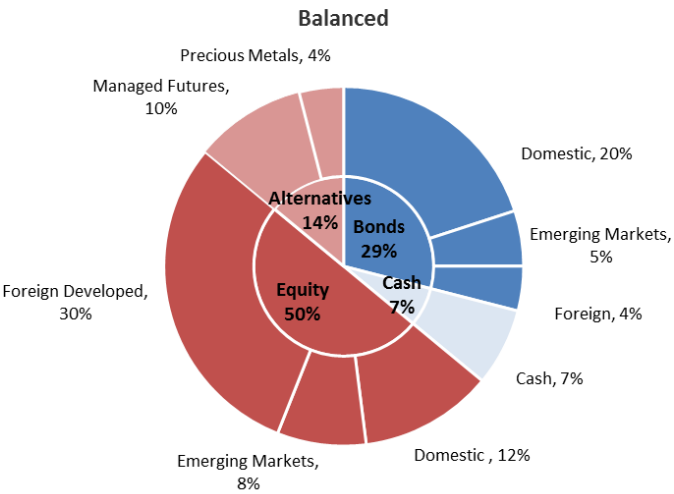
Within our investment strategy allocations, we are effectively "reverse" laddering our bond portfolios by reducing duration but at the same time enhancing the income distribution capabilities. Additionally, we have allocated more capital to diversified and liquid investment strategies such as managed futures that typically benefit from elevated volatility regimes.

Our investment strategy allocations are shown below.

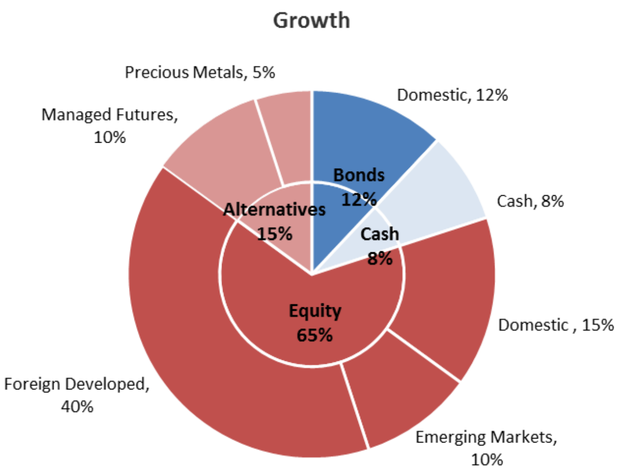
Asset Allocations



Tactical Positioning Relative Weights vs .Benchmark %		
	Income	Asset Class
	5	Cash
Bonds	-18	Domestic
	7	Emerging Markets
	5	High Yield
	-5	Foreign
Equity	-13	Domestic
	5	Emerging Markets
	8	Foreign Developed
Altern.	2	Managed Futures
	3	Precious Metals
	1	Real Estate



Tactical Positioning Relative Weights vs .Benchmark %		
	Balanced	Asset Class
	4	Cash
Bonds	-15	Domestic
	5	Emerging Markets
	0	High Yield
	-6	Foreign
Equity	-13	Domestic
	8	Emerging Markets
	17	Foreign Developed
Altern.	0	Managed Futures
	0	Precious Metals
	0	Real Estate



Tactical Positioning Relative Weights vs .Benchmark %		
	Growth	Asset Class
	5	Cash
Bonds	-8	Domestic
	0	Emerging Markets
	0	High Yield
	-5	Foreign
Equity	-23	Domestic
	10	Emerging Markets
	20	Foreign Developed
Altern.	1	Managed Futures
	0	Precious Metals
	0	Real Estate

***Source**: Ameliora Wealth Management as of 13th September, 2016*

***Note**: Tactical asset allocations are subject to change without notice and represents investment strategies in USD. Tactical positions (over-/underweight) are deviations from strategic benchmark weights*

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