

Play it again TAM

The idea that the future is unpredictable is undermined every day by the ease with which the past is explained. Everything makes sense in hindsight, a fact financial pundits exploit every evening as they offer convincing accounts of the day's events. And we cannot suppress the powerful intuition that what makes sense in hindsight today was predictable yesterday. The illusion that we understand the past fosters overconfidence in our ability to predict the future. Thinking, Fast and Slow by Nobel Memorial Prize winner in Economics, Daniel Kahneman (2011).

It is perhaps understandable that it is usually only the most successful fund managers who have the courage to stand up and say that they have absolutely no idea where markets will be in 3 months time. Indeed, such honesty often fosters even greater confidence in the individual making the confession on the dubious logic that, should markets stop being irrational, the current strategy must surely be perfectly suited to a more normalised market that everyone can make sense of. Of course, things are rarely so straightforward and, as we all know, markets can stay irrational longer than someone betting against them can stay solvent.

And so it is with the current markets which have seen dramatic moves in the last few weeks. The TAM investment team has reiterated the negative view on Gilts for some time, but the most recent weakness has been as a result of a single comment made by Federal Reserve Chairman that may, at a stretch, mean an early tapering of quantitative easing measures. Now that the sound bite-hungry media has picked up and run with this in the headlines, the threat of early tapering appears to have been adopted as a foregone conclusion. However, what Ben Bernanke actually said was in response to a highly leading question. If one chooses to ignore the context, the quote itself appears more dramatic than was intended: "If we see continued improvement and we have confidence that that is going to be sustained, then we could in the next few meetings take a step down in our pace of purchases."

One could argue that the quote should start with an enormous "if" and is nothing more than a statement of the obvious. But that doesn't matter a bit. Markets are down 10% from their peak and so any attempt to read between the lines opens oneself up to being labelled a pedant. A bit like pointing out that Humphrey Bogart is misquoted in Casablanca because he only ever said "Play it, Sam". But we digress…The UK 10-year Gilt yield has risen dramatically from the lows in early May but looks to have stabilised now at around 2.10% which was about as far as the market felt it could push it back in February. As before, the TAM investment team could make a further long term bear case for higher yields from here but the reality is that the market is not going to get there in a straight line in this market. Gilts are far more influenced by their US Government counterpart Treasuries and, for now, the global markets are waiting to see if there is a policy response from Ben Bernanke who will speak again following this week's Federal Reserve meeting. Ironically, despite him being at the centre of all economic debate, he won't be attending G8 himself because the two meetings clash. Nevertheless, he does have the option to throw the markets a dovish comment to restore order and his aides will also give further details on their own forecasts for GDP, inflation and employment. If these numbers are revised lower, the early-tapering crowd can book their summer holidays and forget about it until 2014.

At TAM, we must weigh up our long term view of Gilts against the reality of short term markets. From our perspective, Gilts have moved in the right direction even if the latest sell off has been described by some as a profit taking looking for an excuse. But there remains significant margin for policy error and we are mindful of what happened to markets in August 2011 when the re-emergence of the Greek Sovereign debt crisis was made far worse by poor policy decisions.

The resulting headlong rush into Gilts went further and faster than anyone expected. Today, the circumstances are different but the technical extremes reached by bonds and equities forces us to play this game again and make a balanced decision in the best interests of the longer term performance objectives because we must accept the reality that the current markets are fraught with any number of

problems that could flare up over something that catches nervous markets by surprise. The TAM investment team has, therefore, decided to move to a more neutral stance to protect the absolute and relative performance built up in the last 15 months and, indeed, year to date.

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