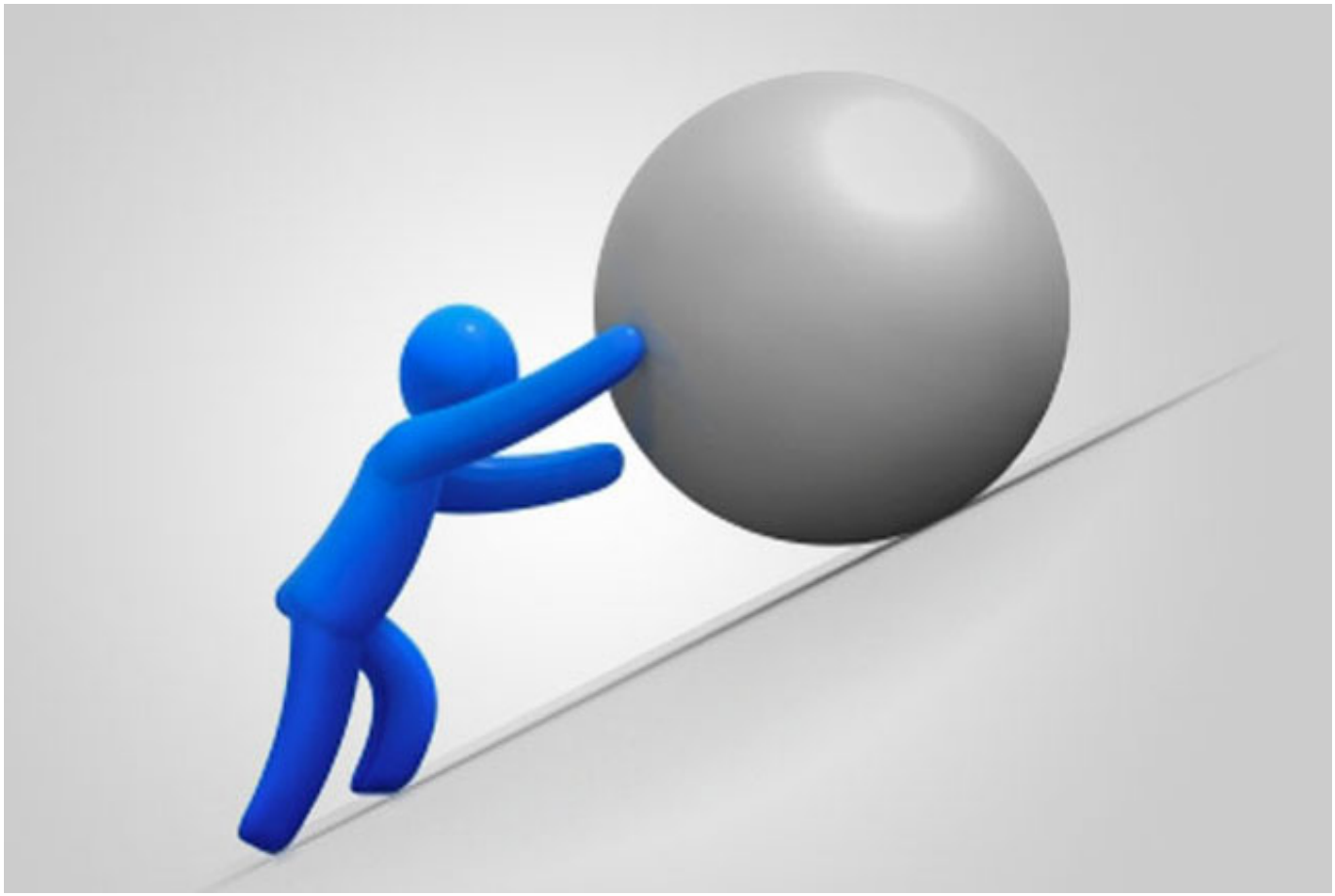


The Myth of Sisyphus

Pushing the Rock of Consensus up the Hill - the Myth of Sisyphus

"Man's futile search for meaning, unity, and clarity in the face of an unintelligible world devoid of God and eternal truths or values."

One might be forgiven for thinking that there's nothing to get too excited about in stock markets judging by the newspapers over the last week or so where upheavals in Russia, Iran and Syria have captured the headlines. One could argue that these events matter in the long term but the best long term indicator we have, the stock and bond markets, are exhibiting low levels of volatility not seen since July last year – before the latest chapter in the Eurozone crisis. Indeed, the FTSE 100 Index is up around 15% from the lows in October and within an ace of the 6,000 level without the usual fireworks or front page enthusiasm. Furthermore, conventional wisdom has it that stock market rallies are well founded on high volume yet volumes in this rally have been relatively light. For those of a short term nature, which was

just about everyone in 2011, justifying the daily grind of pushing the rock of equities up the hill is a task worthy of the Myth of Sisyphus.

We at TAM maintain a mild underweight on equities but have been happy to be keeping up with the current rally and aware of the increasing frustration of those with plenty of un-invested money on the sidelines unwilling to join the slipstream of the "new" consensus which attributes the rise in stock markets to the Long Term Refinancing Operations (LTRO) implemented by the ECB. There is ample evidence that this has been a major reason for the rally and not just in equities. Prior to the operation to provide cheap liquidity, Spanish and Italian bond yields were around 5.5% and 7% respectively compared to 4.86% and 4.96% today. The simultaneous rise of both countries Sovereign Debt is hardly surprising when one looks at ECB data from January. It shows that whilst Eurozone banks increased their holdings of government securities by a record EUR 53 billion, more than 80% of this came from Spanish and Italian banks funded by cheap liquidity at 1%. In "LTRO Part II" it was the turn of the French and German Banks to feast on the cheap money offering. Funds are not necessarily finding their way into equities or, indeed, the economy on that basis. But it does ease the pressure on the Eurozone crisis by giving banks more time to develop stronger balance sheets – creating a possibility of a return to the "risk-on trade".

During the liquidity operations carried out in the USA with QE (parts I and II) this was all unequivocally good news for equities but we seem now to be witnessing a diminishing return for the huge amounts of money being ploughed in – "less bang for a buck" – and there is a sense that the current measure only saves time for the Eurozone without solving the problem. Even Sarkozy's main opponent Francois Hollande, a self-proclaimed enemy of the financial markets, has been increasing his popularity saying that "much time has been wasted on summits of the last resort", during his visit to London last week. This message is not lost on markets, not to mention a population, seeking meaning, clarity and unity in the face of austerity measures which, for many, are quite simply baffling.
Any number of reasons could now be employed to justify a short term sell off in equities, in our view. Of the geo-political problems facing the world, perhaps the tension in Iran is the greater cause for angst in the financial markets due to the headwinds it creates for economic growth by forcing up the price of oil.

For TAM there are two very heavy rocks that could still tumble back down the hill in the form of either an abrupt slowdown in the US economy, as stimulus runs out, or a sudden realisation that there is a property bubble in China which the authorities there can't handle after all. These are both risks which carry just as much, if not more, significance than the Euro zone debacle for global equities, in our view.

Also, as the TAM investment team has built up the portfolio weighting in equities, we have been careful not to over extend into emerging markets and China. Neither of these is immune to the credit crunch in the developed world and it would be remarkable if they did not suffer some similar pain. It is inconceivable that the US and Europe will face possible years of austerity but somehow let China and emerging markets "off the hook". The historic notion of de-coupling in global financial markets is riddled with failure and we are reminded of a similar period in the 1990's where a similar debate raged over the

relative merits of Japan during a time of decline in the USA. As we have learned historically, as far as equity markets are concerned, it is an argument that enjoys only fleeting moments of popularity.

As we have pointed out in previous notes, whilst it remains a preoccupation for the media, it is folly to try to attribute a sensible reason for every short term twist and turn in the stock market. We must ignore the perceived market consensus that carries short term investment themes up the hill only to see them crash back again. We remain mindful of the raft of problems elsewhere which could undermine equities in the short term and there will be times when we must not play the games that force others in at top.

We continue to maintain a marginal underweight equity position but this has not stopped us through fund selection of adding good market value in the first two months of 2012.

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