



Investment Letter – Q2 2016

"In a progressive country change is constant. Change is inevitable." Benjamin Disraeli, 1867 speech on the Reform Bill

We find ourselves in a new post-Brexit world. Politicians from all sides in the UK are jockeying for position, and for once the press is almost certainly right in describing these events, occurring as they are on an almost daily basis, as momentous. There has been an extraordinary amount of analysis with inevitably not a great deal of substance. But while many were still waiting for clarity, equity, bond and currency markets had already moved to reflect the new normal.

Going into the 23rd June, we expected, along with many other investors, a Remain vote to be the most likely outcome. However, prior to the vote we had felt that the risks to developed equity markets were skewed heavily to the downside. For this reason, we had positioned ourselves very cautiously for a number of quarters, to reflect our concerns around anaemic global growth and the ongoing ability of loose monetary policy to stimulate productivity gains. Fundamentally, we believed that traditional fixed income markets were overvalued, and were underweight many of the major developed equity markets. We had diversified our currency exposure considerably, as well as increasing our cash holding to allow us to take advantage of any negative market movements.

We had also introduced a holding of gold into the portfolios. A traditional safe haven asset that has performed disappointingly for years, the precious metal has had something of a revival this year. Gold is often considered a physical commodity currency, a store of value in the most basic sense, and the value of this kind of currency compared to ever-depreciating paper forms has increased. Much like insurance on a car, gold does nothing for long periods of time – that is, until something bad happens. At this point, having paid for something in the hope of never needing it, its value suddenly becomes clear. And as volatility buffeted the markets in the aftermath of the Referendum vote, it was investments like this that performed. Our active investment style allowed us to trade around troughs and peaks to achieve good entry points or take profits. We were pleased to see that our decisions not only protected our clients' capital, but in fact served to drive strong positive performance over the first two days after the vote and into the end of June. We intend to maintain our positioning until better opportunities are presented by the market.

However, our positive results this quarter should not overly influence an assessment of us any more than any potentially less inspiring results in the future. Instead, we encourage all of our clients to focus on our long-term view, the consistent execution of our investment philosophy and the alignment of our interests to those of our clients. We have no external shareholders who may have different motivations to our clients. And when it comes to our investment strategy, we practise what we preach: all employees and partners of Lincoln invest their own money into the same investment strategies as our clients. These characteristics are what drive our long-term results, which remains our primary objective.

At this juncture it seems worthwhile to revisit our core philosophy. We believe that asset allocation is the key determinant of long term success, and do not get overly influenced by short term results, either good or bad. We continue to look for managers who, like us, run the majority of their own personal assets in their funds; for these managers, performance and prudent risk management are the key drivers of their decision making process. We maintain a balanced portfolio of assets for all of our clients, in the knowledge that some holdings will only perform in scenarios that we may not expect to play out. During times of stress, we reorganise portfolios, taking opportunities to rebalance positions by putting money to work in areas that we continue to favour long term but that in the short term have been overlooked by other investors.

Investors' fear drives uncertainty about the future. It is this uncertainty that creates turbulence in markets. We need only look at the gating of a number of the largest UK commercial property funds for the perfect example of how uncertainty can affect investments – often in areas that one might not have expected. For our clients, we have always advocated that illiquid investments like Property and Private Equity should be managed on an Advisory basis, with the liquidity terms of the investment structure matching those of the underlying. The gating of these funds, driven by an inability to accurately reflect what the correct price should be, confirms our view that a closed ended fund where there is no access to liquidity is a more suitable method of owning these types of assets and we will continue to recommend this to our clients.

In the new post-Brexit world, this kind of investment pothole is becoming more likely. Now, even more so, is the time when dependable advice is needed.

Fred Hervey
Chief Investment Officer