NOWHERE TO HIDE?? IT'S NOT ASSET ALLOCATION - BUT STRATEGY SELECTION THAT MATTERS

The objective of asset allocation is to balance the risk / reward trade off with respect to the tolerance / need for our clients. In the below piece, Deputy CIO Hugh Selby-Smith follows up on our thoughts from mid-2017 and discusses the need for asset allocators to adopt strategy diversification within asset classes.

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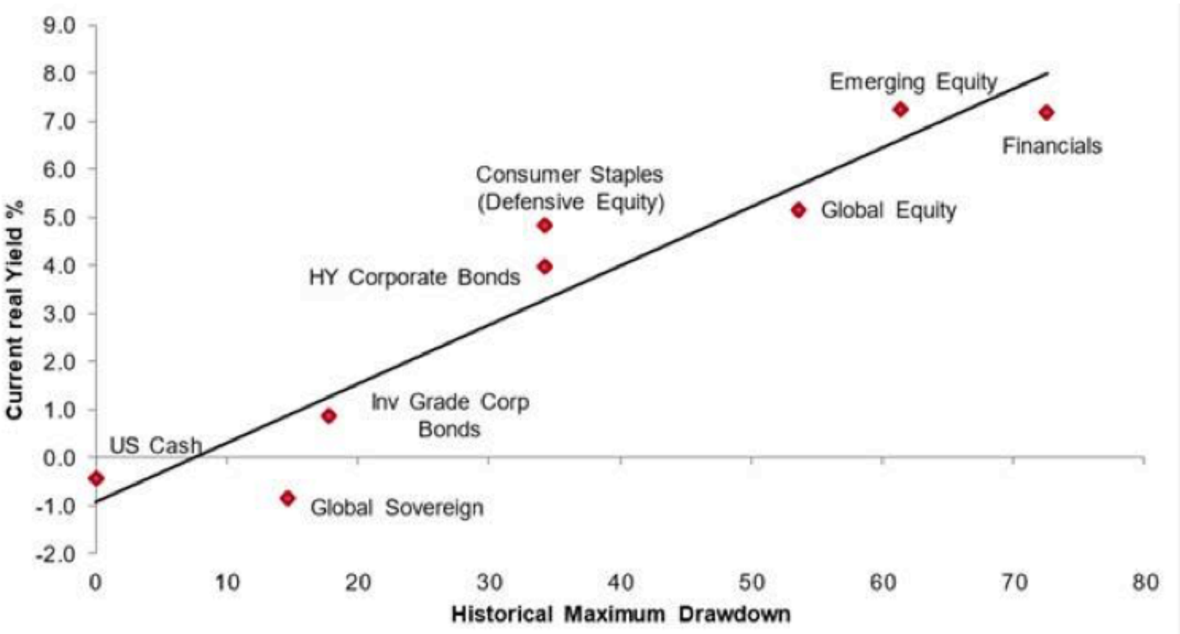
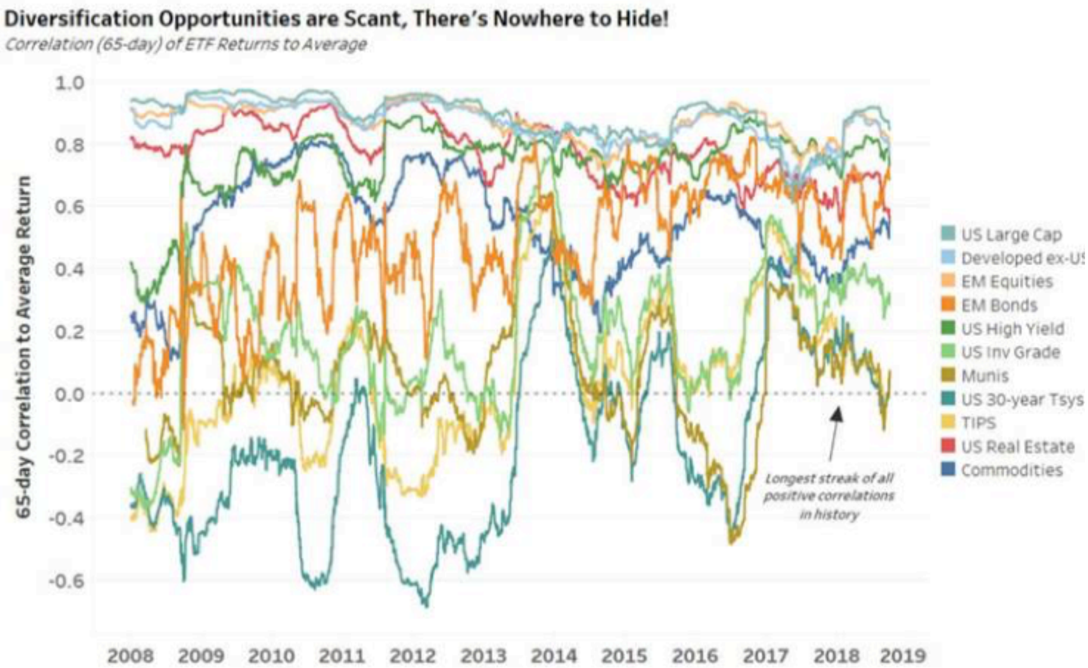
One thing we have been discussing consistently over the last year or more is the challenges facing traditional asset allocation given valuations and the symmetrical relationship between drawdown risk and the real yield on differing asset classes. This is illustrated in the chart below which we first started showing in mid-2017. Refer to our Thought Piece dated 6 October 2017 for more information.

This challenge remains as acute today.



Recent months have shown the challenge of few diversification opportunities, with every major asset class return being positively correlated in the last 65 days. So never has the lack of diversified sources of returns in client portfolios been more painful – even assuming perfect foresight (as if !!).



The following tables show how we have generated our returns over the last 12 months as I think it demonstrates the diversified nature of our returns – it's a blend of solid bottom up analytical work to select mispriced companies to invest in; generation of a significant level of income via our implementation process; and limiting market levels of risk to capture far less of market falls than we gain when markets rise.

Over the last 12 months our use of capital vs. the broader market looks as follows:

12 month make up of portfolio	Equity	Cash Backing Puts	Unencumbered Cash
Talaria	59.8%	20.7%	19.5%
Market	100.0%	0.0%	0.0%

Benchmark investors are exposed to the performance of global equities – and by extension traditional equity managers are exposed to choosing the right stocks, in the right regions, in the right sectors to try and better the low cost alternative. At its most basic then - market returns is 100% the driver of the outcome – with the variability of better or worse down to style, regional exposure, stock selection etc.

As can be seen from the below – our pre-fee returns are materially more balanced driven by: an excellent year again of stock selection; a contracted 17.4% rate of return (low by historical standards) on over 20% of our investors capital, generating a high level of income; and a much lower level of overall market risk on the money put to work giving rise to materially lower drawdowns in months like February and October so there is more money working for you in the ups. All of which add up to a more certain and better outcome.

12 month returns to 26 Oct 18 (A$)	Total 12 month Return	Mark Exposure return	Income from Implementation	Stock Selection
Talaria (pre-fees)	11.7%	4.6%	3.6%	3.5%
Benchmark	*7.7%*	*7.7%*	***0.0%***	***0.0%***

It is this greater certainty of outcomes - driven by a differentiated make up of returns - which has allowed us to generate such solid long term returns since 2005.

Summary:

In a world in which traditional asset allocation is going to be less useful going forward than in the past – and certainly will carry more risk for those getting it wrong - the answer lies in not selecting assets classes but in selecting strategies and managers who can give you a different outcome.

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