

Independent Investor

FOUNDER AND EDITOR/Jonathan Davis

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The Case For The Doubters



Those who read *Independent Investor's* Q and A with **Sebastian Lyon** of Troy Asset Management in July 2009 will be familiar with his conservative, hairshirt style of investing. At recent meetings for investors in his funds, which now include the Personal Assets investment trust, formerly managed by **Ian Rushbrook**, he updated his views on the market outlook.

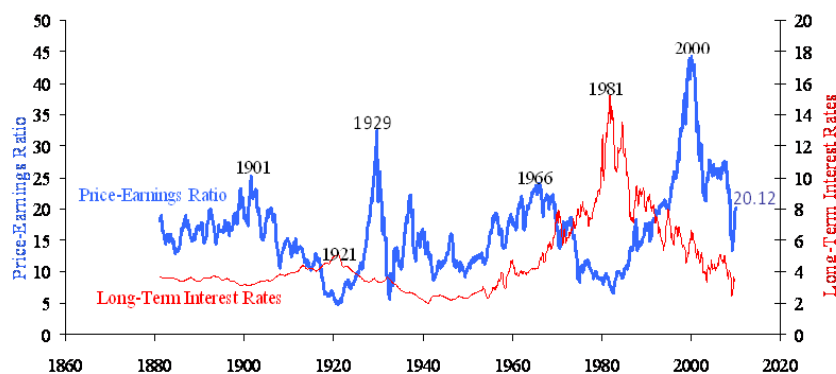
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The Case For The Doubters

These are some of the key points in his presentation:

- As a consequence of the global financial crisis, investors are now living in "a phoney world", one that is characterised by interest rates of zero and asset prices that have been seriously distorted by quantitative easing, among other things. The consequence is that few investors, even professionals, know what to think. Picking a path through this unprecedented set of conditions is like "being in a dark room looking for a black cat that isn't there";
- In Sebastian's view, the secular bear market which began in the year 2000 continues, meaning that the UK stock market is likely to follow a similar path to that of the Dow Jones index between 1966 and 1982, rising and falling within a trading range (that range, in the case of the FTSE 100 index, being 3500 to 6500);
- Most likely that means the equity market will experience one more low before a new secular bull market begins in a few years' time. The trigger for the new setback is likely to be a sustained rise in bond yields;
- The current cyclically adjusted equity market p/e ratio, though down from its peak, is still in the top quarter of historical experience and the dividend yield, following ten months of rising markets and many companies announcing dividend cuts, is "nearer poor value than good value";

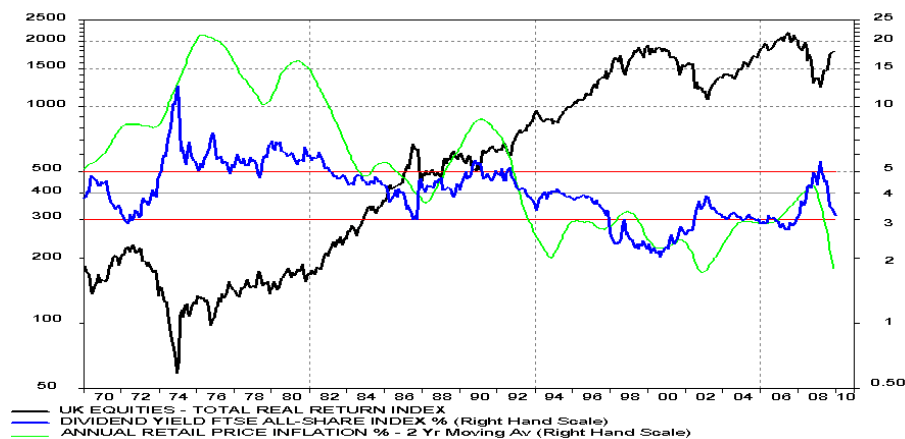


Given his mandate to preserve the real value of his investors' money, and faced with this unappealing outlook, Sebastian has been buying stocks such as Diageo and Nestle, which have impressive records of growing their dividends (sevenfold in the last 20 years in the case of Nestle);

The companies he is avoiding like the plague are those such as Cookson and British Airways, whose CEO Willie Walsh has to spend his time firefighting successive crises rather than planning for the future (BA has not paid a dividend since 2001);

Another big holding in both Personal Assets and Troy's flagship fund is gold, something that most investment trusts have never held and many investors hate. Yet gold, which J.P.Morgan described as "money and nothing else", is the ultimate store of value and the only sensible protection against inflation and policy errors in an era of fiscal excess;

Sebastian was keen to point out, finally, that despite the cautious mandate of his funds, he was by no means a "perma-bear", as his successor Ian Rushbrook had never been either. He looks forward to the time (2015?) when the secular bear market has ended, gold is no longer needed in the portfolio and the funds are able to gear up to participate in the next equity bull market. That time however is not yet here.



Comment: I am a fan of the Troy approach to fund management, not least for its emphasis on low turnover and reasonable management fees, although I think there is a serious risk that the rebound in the US economy may well surprise this year by being stronger than cautious investors such as Sebastian expect. My own portfolio includes gold and defensive equities for similar reasons to his.

This quotation from Gerald Loeb, author of a classic book on the stock market, with which Sebastian finished his presentation is also very apt: "Profits can be made safely only when the opportunity is available and not just because they happen to be desired or needed...Willingness and ability to hold funds uninvested while awaiting real opportunities is a key to success in the battle for investment survival". In other words, there is nothing wrong with staying in cash when no clear-cut opportunities for stock market profit appear to exist.

ABOUT INDEPENDENT INVESTOR

Independent Investor was set up to publish analysis and commentary on asset allocation, having particular regard to the ideas and insights of leading professional investors I have come to know and admire over 30 years of following the financial markets. The website, www.independent-investor.com, is updated regularly with notes and features as they are written. It also includes the Editor's columns in the *Financial Times* and *Spectator* and an archive of previously published material. A new version of *Independent Investor's* regular subscription-only newsletter will appear shortly.

FOUNDER AND EDITOR

Jonathan Davis, 55, is the author of three books on investment, and founder and chairman of Independent Investor LLP, an independent investment publishing company. A graduate of Cambridge University and MIT, where he studied the methods of Warren Buffett for a thesis, his areas of expertise include asset allocation, fund selection and style analysis. His early career was spent as a senior business journalist on *The Times*, *The Economist* and *The Independent*. He has been a regular columnist on the *Financial Times* since 2007 and before that wrote a weekly column for *The Independent* for 12 years. He is a Non-Executive Director of Hargreaves Lansdown plc and a Director of Agrifirma Services Ltd. Email: jd@independent-investor.com.



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