

Asset



Our new Cash Management Service

Investment opportunities for charities

Market commentary

The benefits of wealth management

Cornelian

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A Cornelian is a semi-precious gemstone reputed to have powers to improve analytical ability and clarify perception: two qualities on which we pride ourselves.

Cornelian Asset Managers has built a reputation for excellent service and strong investment performance. The basis of our success has been the experience and quality of our team of investment managers, coupled with the inherent strengths of our investment process.

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Introducing 'Asset'

the quarterly newsletter from Cornelian Asset Managers

Jeremy Richardson
CHIEF EXECUTIVE



WELCOME TO our first edition of Asset for 2012. I recognise that there will be few readers who did not find investment markets challenging in 2011. I also know from recent discussions with our clients and professional connections that there are many who remain concerned about investment prospects for 2012. I have no crystal ball, but although we recognise the possibility of further unexpected events in the short term, I do believe that later this year investors will become increasingly confident about the action taken by governments and central banks. What I can assure readers is that all of us at Cornelian will continue to strive to achieve the investment returns and deliver the service that you rightly expect from us. As ever the investment returns we seek for our clients should be consistent with those of a prudent manager where both risk and reward are given their appropriate weighting.

Asset contains a variety of articles for our readers reflective not just of the investment services we provide but the diverse nature of our client and contact base. In this edition the guest article from Craig Gibson of AGL Wealth sheds some light on the differences between firms providing financial services and the benefits of adopting a wealth management approach.

As Marcus Brooks our Charities director comments, we do see selective value in a range of asset classes particularly over the medium to long term. However, we also recognise that clients require the comfort of standalone cash deposits outwith an investment portfolio. Following requests for enhancements to our original cash management service, and after consultation with clients and professional advisers we will launch our new Cash Management Service shortly. John Jackson's article outlines our approach highlighting the features of the service.

Finally, as we move through 2012, may I take this opportunity to wish you a healthy and prosperous year. Thank you for your continued support.

Making the most of Investment Opportunities



Marcus Brooks

DIRECTOR, HEAD OF PRIVATE CLIENTS
& CHARITIES

FOR CHARITIES with cash to invest or investment portfolios, the opportunities have never been greater even in current volatile market conditions. It is worth taking a step back and considering what exactly charities are trying to achieve with their investment portfolios. While accepting that all charities are different and have their own requirements, for many it is to maintain their capital base in real terms and for income generated from the portfolio to increase over time. In meeting these aims most charities with endowment portfolios have, in effect, an infinite time horizon because it is their intention to fulfil their purpose indefinitely. The main implication of this is that charities can afford to take more risk in their portfolios relative to a private individual or pension fund whose time horizon and therefore risk appetite may well diminish over time. This may be counterintuitive to some charities which tend to view themselves as conservative investors.

“...the opportunities for those prepared to take some risk are significant.”

From a portfolio perspective it means that charities should be able to invest a greater proportion of their funds in more volatile asset classes such as equities, corporate bonds, high yield debt and property. Over time, a luxury charities have and many other investors do not, use of a greater proportion of more volatile asset classes should produce higher returns. This is especially the case at present when so called ‘low risk’ assets such as gilts and cash may well offer low or negative returns in real terms.

In contrast the opportunities for those prepared to take some risk are significant. For example, in the UK equity market, large, global companies with strong brands and balance sheets paying

attractive dividends can be bought on reasonable valuations. Increasingly they will be seen as safe places to invest, safer perhaps even than government bond markets whilst also offering an inflation hedge. GlaxoSmithkline, Diageo, Compass Group, and Vodafone all fulfil these criteria. Most have the added advantage of significant emerging economy exposure.

Yield used to be the preserve of UK equities. However, poor equity returns over the last few years during a time in which companies globally have been growing profits, earnings and dividends and strengthening balance sheets mean that reasonable income yields (much higher than yields on cash or gilts) are available in many international companies. Charity portfolios looking for a reasonable level of income generation do not need to confine their portfolios to the UK.

As an alternative to cash or gilts charities could consider infrastructure. Secondary stage projects (built and let long term to the Government and other public bodies) offer predictable, government backed, long term cash flows, which are partially index linked. Funds investing in infrastructure and quoted on the London Stock Exchange are yielding over 5% compared to the ten year gilt yield of 2.2% (source: Reuters). The Government is currently trying to persuade investors to consider this asset class but, in fact, it has been available through these funds for six years and returns over this period have been more than acceptable. Commercial property, if held through a well diversified portfolio, offers similar advantages of long term predictable returns with an income that should keep pace with inflation.

The long term nature of Charity investment offers them the advantage over many investors of being able to take a long term view. The opportunities being thrown up by the current market volatility should ensure that charities who take that view can continue their good works for many years to come.

This article was originally published in the Scotsman, December 2011.

New challenges for a New Year!



Hector Kilpatrick
CHIEF INVESTMENT OFFICER

Market Overview

The final quarter of the year saw equity markets stage something of a rally after the very poor showing during the third quarter. Europe continued to dominate the headlines as several Governments fell, the Germans continued to play hard ball (demanding further fiscal austerity and harmonisation prior to discussing quantitative easing) and the rating agencies started to downgrade sovereign credit ratings. Furthermore, GDP forecasts for the Eurozone were cut significantly, such that the consensus forecast is now predicting a recession in the Eurozone during 2012.

None of the above really argued for a decent rally in the equity markets, however, macroeconomic releases out of the US have been consistently stronger than (previously reduced) expectations. This has resulted in US economic growth forecasts for 2012 being revised upwards.

Over the quarter, the FTSE All-Share returned +8.4%, which helped limit the damage for the full year to -3.5%. This represents a fairly remarkable performance given the scale of earnings downgrades witnessed and the dramatic loss of confidence in the banking system and the European economy.

In local currency terms, US equities continue to perform strongly (S&P 500, +9.5% (for the full year, -0.5%)), helped by encouraging macroeconomic data releases. The Japanese equity market performed poorly (Nikkei, -2.8%) as concerns heightened that the new Japanese Government would not have sufficient resolve to confront some of the country's economic problems.

Gilts continued to perform well, returning 5.0% over the quarter. This resulted in the asset class producing a return of 15.6% for the year as investors bought into the Conservative/Lib Dem deficit reduction plans. Internationally, UK Treasuries are seen as something of a safe haven. An additional quantitative easing package also helped to maintain enthusiasm of the asset class. For the year

as a whole, Corporate Bonds underperformed Gilts due to heightened risk aversion. However, performance relative to Gilts was positive during the final quarter.

The Brent oil price has risen 4.5% over the past three months (+13.3% for the full year), boosted by a tight demand/supply balance and more vocal sabre rattling from Iran.


The Gold price is down 3.7% over three months, but up 10% for the full year. The stronger US economy is forcing investors to reconsider the probability of an additional round of quantitative easing in the US in the near term and this has taken some of the shine off the asset class.

Investment Outlook

The US economy is currently surprising forecasters with its resilience. Indeed, consumer and business confidence survey results are more robust than expected, and this is being reflected in the relative performance (and valuation) of the US stock market. It is undoubtedly true that the competitiveness of the US economy has improved, however it would be wrong to think that the US economy is out of the woods.

As a result of the rigidities built into the political system and the fact that Congress and the Senate are currently controlled by opposing political parties, tough decisions on fiscal austerity are being delayed. This cannot persist *ad infinitum* but it is difficult to see how such fiscal decisions can be taken before the Presidential election in November 2012. Furthermore, housing is a significant driver of US economic activity, and HSBC has warned recently that house prices may have further to fall as foreclosure activity increases following a hiatus in the process.

The relative economic strength exhibited in the US may dissipate as the year progresses as real disposable incomes are not growing, household net wealth continues to shrink and the consumer has



A low growth, low interest rate environment should ensure decent returns for holders of investment grade corporate debt...

been spending savings in the run up to Christmas. Some of this may reverse in 2012 as the reality of fiscal austerity, post the presidential election, dawns.

On this side of the Atlantic, the Eurozone has reached a precipice. Another false move and the economies of the member states could be seriously compromised. With French (and Italian) Government bond yields rising sharply, the credibility of the European Financial Stability Fund has been questioned and, therefore, its ability to raise adequate funds has diminished. The European Union is, therefore, looking to the IMF to provide additional support. The quantum of what is available from this source has fallen short of what is being demanded by market participants. Furthermore, Germany has made its requirement that the successor of the European Financial Stability Fund does not exceed 500bn Euros explicit. Detailing an absolute level such as this may prove to be a mistake as it gives the markets something to latch on to.

Private Sector Involvement (PSI) in the Greek debt restructure is far from a done deal. Banks are being strong armed into agreeing a 50% cut to the value of their Greek Government bond holdings. However, the European Union has subsequently strongly implied that PSI would not be invoked should any other Eurozone country need to restructure its debt in the future. Understandably, private holders of Greek debt are objecting to being singled out in such a manner.

Following the December European leaders summit, Eurozone member states will look to their domestic Governments

to ratify treaty changes over the forthcoming months, in order to bring about closer fiscal integration. This, to our minds, will be exceptionally difficult to complete satisfactorily. Will Italy (amongst others) be told it has to implement austerity until it meets the Maastricht criteria of 60% net debt/GDP? This could take 20 years! Will Ireland be told to double its corporate tax rate? Even if the political classes accept this, it is highly questionable that the electorates will. Furthermore, the French economy is at a critical juncture as growth slows and their ability to meet budget deficit targets is questioned, particularly given the potential need to inject capital into ailing French banks.

Logically, the only long term solution to the Eurozone crisis is the formulation of a United States of Europe, where there is a directly elected executive, tax rates are harmonised and transfer payments can be made across boundaries. This, of course, is as far away as ever. Indeed, President Sarkozy (no doubt with one eye on the forthcoming French Presidential election) has recently ruled out greater federalism.

On the positive side, central banks of the major economies are providing significant funding support to the banking sector, which is designed to address (at least, in the short to medium term) the very serious liquidity problems the banks have. This is helping to avert an abrupt credit crunch. It is also buying time for the banks to manage their balance sheets more aggressively.

We believe it is likely that market participants will once again challenge the resolve of Eurozone leaders in the coming months, particularly, as the only solution on the table (as championed by Germany) is fiscal austerity. This is seriously diminishing the prospects for growth, which itself begets further austerity, as budget deficit targets are missed. Spain is a good example of this. The new Government has just announced further fiscal austerity measures as a result of its widening budget deficit, despite having an unemployment rate of more than 20%. Without a sustained improvement in global economic growth, the ECB will be obliged to undertake quantitative easing at some stage in the future.

With Government, consumer and bank sector deleveraging prevalent for the next couple of years (at least), an extended period of low growth, low interest rates and high unemployment is about as good as can be hoped for. This does not necessarily have to be bad news for equity markets and we certainly


believe there are many good quality, cheap, highly cash generative businesses that can win out in such a scenario.

It is encouraging to note a piece of research from the Royal Bank of Scotland, which shows that the ten largest stocks in the UK (the so called 'mega caps') have, in the past when trading at similar cheap valuations as they are today, tended to generate significantly positive average annual returns going forward. Furthermore, on 2012 numbers they are forecast to generate a dividend yield of more than twice that of the 10 year Gilt yield, despite exhibiting strong balance sheets and relatively conservative dividend payout ratios. In addition, the number of shares in issue for this group of companies has reduced by some 15% over the past ten years (because of share buybacks), whilst the amount of Government debt issued has grown substantially and is set to continue to do so for the foreseeable future. Without wanting to endorse every one of the UK mega cap stocks, I know where I would rather put my money.

We continue to favour Asian (including Japan) equity markets both in terms of the ability for policymakers to stimulate growth, and valuation. We are intrigued by the valuation of the European markets, but remain content to sit on the sidelines for now, believing that further earnings downgrades will be forthcoming. It feels difficult to believe that the US stockmarket will achieve 23% earnings growth over the next two years as the consensus suggests economic growth is likely to come in below trend for this period.

A low growth, low interest rate environment should ensure decent returns for holders of investment grade corporate debt as company balance sheets are strong. Such an economic scenario should ensure that management teams resist the temptation to make debt funded acquisitions.

Source: Financial Analytics and Bloomberg.



On the positive side, central banks of the major economies are providing significant funding support to the banking sector...

Financial Planning or Wealth Management – is there a difference?



Craig T Gibson
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IN THE EVER CHANGING world of financial services, where firms can decide what to call themselves and how they then present themselves to the public, there's not necessarily a very clear distinction between a 'financial planning' firm and a 'wealth management' firm. Often, the difference is little more than the perceived marketing distinction of the labels to certain target clients.

It is certainly true that when you get far enough up the wealth scale, it appears that the necessary knowledge and skills, and the associated tasks a wealth manager performs in their daily job, really do begin to change, and wealth management starts to represent a body of knowledge distinct from financial planning. Or at the least, representing a distinct specialisation of the field, not unlike how an orthopaedic surgeon represents a significant depth of knowledge and skills, with different job tasks, than the general practitioner physician. And in turn, the delivery of these wealth management tasks, skills, and knowledge lends itself to different business models, as well; wealth management will provide access to specialised advisers (investment, legal, taxation and international) or may include a family office that serve a relatively limited number of very high net worth clients with unique services as a business model that simply couldn't be done economically and feasibly in a financial planning firm with hundreds of clients.

The difference is really big-picture. Financial planning usually means creating a strategy for accumulating wealth for retirement and personal goals. Investment management focuses on managing financial assets with a performance level in mind. Wealth management, in comparison, considers the total net worth of a family, a couple or an individual. It weighs financial decisions in light of an investment portfolio and additional components of the financial picture such as property, insurance, a business, charitable gifting and more.

Yet it is also about paying attention to detail. Every successful professional or business owner reaches a point of delegation – there comes a point at which you can't do it all yourself. Indeed, it can be hazardous to try and keep track of every detail without help. The same goes for your finances – your investments, your taxes, your various assets.

Good wealth management helps you stay on top of things. A skilled wealth management firm pays attention to many of the financial details in your life for you. You feel confident because the wealth management firm has an ongoing relationship with you, with regular reviews and open communication.

Wealth management unites your existing advisors from different disciplines as a team. The team looks at your goals, needs and priorities to determine the right, bespoke strategy for guiding your invested assets and enhancing your net worth.

With over twenty years' industry experience each, our senior team have all worked in private wealth management divisions of major multi-national financial institutions. We are able to offer private and business clients a completely holistic approach to their wealth planning needs through a range of core disciplines. For example, we provide forensic investment analysis, critical risk profiling and wealth creation and distribution strategies. Through our internal partners we can provide business restructuring strategies, international relocation planning and personal and company taxation solutions. Our external business partners offer our clients access to property management facilities, discretionary investment management and private banking services.

When is it time for wealth management? If you have too many financial concerns, issues or priorities to address by yourself, then it is certainly time for this kind of financial care. And even if your financial life is less complex, significant wealth calls for a vigilant, ongoing management approach.

“Wealth management unites your existing advisors from different disciplines as a team.”

Cornelian's new Cash Management Service



John Jackson
DIRECTOR, CHIEF OPERATING OFFICER

AS MY INVESTMENT COLLEAGUES will point out, at current interest and inflation rates cash produces a negative real return. Nevertheless for reasons of liquidity, anticipated future purchases or through preference many of us continue to hold a sizeable portion of our assets in cash.

All too often this cash sits concentrated in one or two bank accounts, earning poor rates of interest, or a change of account is made to earn a higher rate of return only to find that the rate drops some months later. Assessing banks and comparing interest rates is time consuming. There is also a considerable amount of work and administration involved in opening and closing bank accounts. As a result, many of us fail to optimise the returns from our cash, or gain sufficient diversification.

In these uncertain times clients understandably worry about holding large

sums in one institution. The Financial Services Compensation Scheme covers deposits of £85,000 for an individual at one institution. For larger sums the need to manage risk through diversification remains as important as ever and we receive frequent requests from our clients for a service to manage their cash.

I am delighted to announce that we are launching a new Cash Management Service in March 2012.

Over the next few weeks we will be contacting all of our existing Cash Investment Management clients, informing them of the full details of this new, enhanced service.

The Cash Management information pack and application forms will be available shortly – to reserve a copy please contact Adam Paterson on 0131 240 2768 or adam.paterson@cornelianam.com

The main benefits to you of our Cash Management Service

We will do all the hard work for you

- All administration involved with opening accounts and moving cash is done by us
- We research and select the banks to be used

Risk will be managed

- Banks are assessed and monitored on an ongoing basis to ensure we are using only those with good institutional and financial strength
- All cash is placed with banks regulated in the UK
- Cash is diversified across different banks with a typical spread of around five banks

Returns will be managed

- Cash is actively managed to achieve reasonable returns depending on market conditions
- Primary focus is on management of risk and on that basis we will not necessarily obtain the highest interest rates

The service is easy to use

- All we require from you is the completion of one application form

You can view your account

- Clients can use Cornelian's secure On-Line service to see details of where cash is held
- We will provide an annual report detailing all transaction and activity, interest received and balances

The minimum amount required for the service is £100,000.

The Service will also be available to clients of financial advisers and intermediaries.

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