VIEWS FROM THE DESK (VFTD) January 2015

The futility of (weather) forecasts

Readers of last month's VFTD will recall our discussions about unpredictability. In that same piece we made reference to our upcoming outlook for 2015. Having boxed ourselves into this forecasting corner, we began collating our thoughts and were rather taken by a recent article, from the Wall Street Journal, titled "Lessons From a Year of Market Surprises" (30th December 2014). The following extract neatly sums up the dilemma we face;

'The Nobel laureate and retired Stanford University economist Kenneth Arrow did a tour of duty as a weather forecaster for the U.S. Air Force during World War II. Ordered to evaluate mathematical models for predicting the weather one month ahead, he found that they were worthless. Informed of that, his superiors sent back another order: "The Commanding General is well aware that the forecasts are no good. However, he needs them for planning purposes."'

Mr. Arrow's story illustrates how people gain a sense of comfort from predictions and – to quote further - *admitting that the future is unknowable is just too frightening.*

At Affinity, we regularly remind ourselves of two very important things; 1) managing assets is a long term assignment and, 2) forecasting is extremely difficult. In this context, sticking to what is probable and shaping investment strategies around this is what *we* need for planning purposes. With this in mind, what do we view as "probables" moving into 2015?

- **Taps on**: Japan is firmly committed to QE and the evolution of the ECB's version will continue. As importantly, the Fed will not liquidate their bond portfolio and China is focused on loosening policy. Consequently, financial markets will remain supported by central bank activity.
- **Snakes and ladders**: There will be winners and losers from the sharp fall in the oil price. For some Emerging Market nations, the negative consequences will be severe – e.g. Venezuela, Russia; by contrast, the likes of India and Turkey will see their economies benefit. For consumers, particularly in the States, there will be a significant energy dividend boosting spending. Estimates suggest US households will enjoy savings of c.$100bn; this coinciding with rising wages as the employment market tightens.

- **Gloves off**: Headlines around the political landscape, ahead of this year's UK General Election, will grow in number. The on going debate about the future of Europe will intensify and the rise of extreme politics will threaten economic, political and social stability across the region.

- **Lift-off**: The Fed will, for the first time in 9 years, raise interest rates. This is contributing to US dollar strength, as global monetary policies diverge.
- **Hollywood hacked** – as the recent Sony headlines illustrated, cyber attacks are on the rise and are an increasingly important issue for corporations and governments alike. Their cost to the global economy is currently estimated to be c.$575bn a year, a figure set to surge as increasingly sophisticated hacks damage both trade and international relations.

We should caveat the above, with a health warning regarding consensus "probable" views. Last year the risks of such unanimity were best illustrated by the market's call on US Treasuries. Everyone expected (10 year) yields to move upwards towards 3% and positioned accordingly. Few were long duration, but those who were enjoyed a stellar return, with 30 year USTs delivering c.26%. Once again, as we entered the New Year, the market remained convinced yields would rise, with speculative shorts on the US T-note tripling to unprecedented levels. The first few days have not been kind to these positions, as a key technical level was breached to the downside (2.00%) and the yield touched 1.885%.

To help manage short-termism and acknowledging the flaws of near-term forecasting, our readers will know we anchor most investments to super secular trends. To recap, we utilise five themes, shaping the world as we know it today; Smart Technology, Demographics, Access to Finance, Protectionism & Geopolitical Instability and Tail Risks & Complexity. Each of these is creating powerful and - in the case of Demographics – very reliable and predictable forces. These result in a range of opportunities being fashioned for investors with a sufficiently long investment time horizon.

In conclusion

No prediction is worth following unless you know whether the forecaster is reliable. To return to that WSJ article, it asks why '*so many people seem to complain that the weather forecast is inaccurate even as they bet a chunk of their life savings on a prediction from an investing pundit whose track record isn't even traceable?'*

Whilst we don't claim to be much use at forecasting the weather; Affinity's three year track record now enables others to assess our investment management capabilities.

Julia Warrander and Russell Waite

Performance of discretionary strategies

Income Strategy (£)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-0.66**	**1.62**	**0.49**	**0.37**	**1.18**	**0.08**	**-0.42**	**1.24**	**-0.04**	**0.36**	**1.32**	**-**	**5.65**	Composite
2013	**1.75**	**0.60**	**0.75**	**0.91**	**-0.24**	**-2.35**	**1.28**	**-0.49**	**-0.06**	**1.40**	**-0.34**	**0.64**	**3.85**	Composite
2012	**2.44**	**1.95**	**-0.46**	**-0.34**	**-1.42**	**1.82**	**1.98**	**0.55**	**0.83**	**0.34**	**0.61**	**0.48**	**9.30**	Model

Income Strategy ($)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-1.51**	**2.43**	**0.61**	**0.88**	**0.93**	**0.87**	**-0.88**	**0.43**	**-1.82**	**-0.20**	**0.47**	**-**	**2.17**	Composite
2013	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-0.03**	**0.97**	**0.94**	Composite

Real Return Strategy (£)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-0.63**	**2.19**	**0.33**	**-1.26**	**2.05**	**-0.04**	**-0.55**	**1.71**	**-1.04**	**0.59**	**1.91**	**-**	**5.29**	Composite
2013	**2.63**	**1.80**	**0.72**	**0.15**	**1.23**	**-2.25**	**1.51**	**-1.45**	**0.32**	**2.11**	**-0.65**	**0.48**	**6.68**	Composite
2012	**3.17**	**3.15**	**-0.32**	**-0.87**	**-3.31**	**1.63**	**2.20**	**1.00**	**1.46**	**-0.56**	**0.92**	**0.07**	**8.34**	Model

Real Return Strategy ($)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-1.14**	**3.23**	**-0.07**	**-0.85**	**1.41**	**0.86**	**-1.30**	**0.62**	**-2.02**	**-0.19**	**0.67**	**-**	**1.11**	Composite
2013	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1.35**	**0.90**	**1.33**	**3.61**	Composite

Growth Strategy (£)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-1.19**	**2.68**	**0.06**	**-1.87**	**1.89**	**0.11**	**-0.45**	**1.92**	**-1.11**	**-0.82**	**1.35**	**-**	**2.50**	Composite
2013	**3.49**	**2.06**	**0.91**	**-0.32**	**1.50**	**-2.97**	**2.18**	**-2.28**	**0.61**	**2.53**	**-0.97**	**0.57**	**7.36**	Composite
2012	**3.57**	**3.13**	**-0.44**	**-1.23**	**-3.98**	**1.85**	**2.16**	**0.60**	**1.84**	**-0.28**	**1.03**	**0.45**	**8.72**	Model

Equity Growth Strategy ($)

%	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD	Based on
2014	**-3.26**	**4.87**	**-0.84**	**-1.61**	**2.22**	**2.41**	**-1.31**	**0.94**	**-2.21**	**-1.33**	**0.76**	**-**	**0.37**	Composite
2013	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**0.66**	**1.96**	**2.64**	Composite

Last month's composite performance numbers are currently being calculated and may be provided on request.

The performance detailed above is for illustrative purposes only and reflects the returns across Affinity Private Wealth's Income, Real Return and Growth model strategies, net of 0.95% management fees.

This does not constitute investment advice and past performance should not be viewed as an indicator of future performance.