

# Absolute Insight UK Equity Market Neutral Fund

September 2011



August was a chaotic month for risk assets including equity markets. The Absolute Insight UK Equity Market Neutral Fund returned -0.4%\* in August, a month when the FTSE All-Share index fell by 7%.

## August performance

The approach we take on the Fund is simple. We aim to make money when we have strong views on stocks and we are in an environment where stock prices are being driven by company fundamentals, while preserving capital when markets become stressed and individual fundamentals get lost in the panic.

We had observed signs of risk building ahead of the August's spike in volatility and we used the tools at our disposal to manage through the stress: 1) cut gross exposure; 2) tighten hedges – to ensure we are exposed only to risk we are comfortable with and 3) use stop-losses – to reduce the extent of any drawdown.

## Views and positioning

Our basic view of the world has not changed as we have been cautious on the global economic outlook for some time. In many cases, analyst earnings forecasts have been too optimistic and many sectors are going to see substantial downgrades. As a result we have become less cautious on areas such as consumer and defence stocks, as earnings expectations in these areas were already relatively pessimistic. We believe there is less scope for downgrades in these sectors compared to other parts of the market. An example of this is our long position

in British Aerospace hedged versus the FTSE 250 index.

Experience shows us that spikes in volatility and stock correlations invariably produce opportunities to pick up good quality stocks at attractive levels. The reason for this is simple: when the market panics, everything gets sold off whether these are the best or the worst companies. As conditions return to normal, better quality companies tend to outperform.

Opportunities were widespread but broadly fall into two areas. The first is in good quality companies with relatively defensive earnings that have fallen with the market, but should have held up better. Examples include Wincor Nixdorf where we have taken a long position versus the MDAX index. The second is to look within sectors for winners and losers. In the aerospace sector Meggitt, a company we know well, seems to have been oversold relative to Rolls-Royce so we have designed a pair-trade which should profit as this issue normalises.

## Outlook

We expect markets to remain volatile, swinging from optimism to pessimism and back again on each piece of economic data or political summit. This does not seem a supportive environment for broad-based equity

market gains. Our approach will remain unchanged aiming to deliver positive returns irrespective of equity market direction - based on stock selection to identify potential winners and losers and then combining these in a paired trade approach.

Please note the value of investments and any income will fluctuate and is not guaranteed (this may be partly due to exchange rate fluctuations). Investors may not get back the full amount invested.

This interview is available online on our audio and video library.  
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\* Source: Insight. Returns are net of fees and expressed in GBP.

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