



LETTER TO INVESTORS

Binary vs. broad-path thinking

Events over the last few months have reminded us that the world does not always run according to the consensus. Political, social or economic developments can demand a change in overall direction. Sector-specific problems may require a policy response.

So we have to continue to look for future “inflection points” which could profoundly change the investment environment. It is possible to identify several of these well in advance – for example, the Italian constitutional reform referendum and the U.S. elections in November. Other inflection points could give less notice of their arrival.

The identification of such inflection points is an essential undertaking. They allow us to assess potential effects and contagion channels from them.

There is, however, a temptation to see these inflection points as essentially binary – a fence that we will either jump or fall at. But is this really the case?

Consider for example the Brexit referendum. On paper, this was a truly binary event – an unexpected result delivering an outcome with high associated economic and investment risks. But after an initial sell down, most markets stabilized, at least temporarily: the binary event did not generate a binary market outcome.

In fact, future inflection points are more likely to be gates to get through, rather than fences to bring us down. Some gates will be wider than others: markets may give more leeway, for example, to economic data points than to political surprises. This is something we need to take into account when managing portfolios.

Past performance is not indicative of future returns. Readers should refer to the explanatory notes at the end of this document.