



Ruffer LLP

- Manages a **multi-asset real return strategy** for MLC, since 2009
- Manages \$18 billion, across the company, as at 30 June 2011
- Origins dating back to 1994
- Employs 131 professionals
- Based in London, UK

Ruffer LLP only manages one mandate across its entire client base, aiming to preserve capital in any year, regardless of market conditions, and generate returns ahead of cash. It has followed this single philosophy since the firm started in 1994.

Why has MLC chosen Ruffer?

Ruffer runs a long only multi-asset, real return mandate for MLC with a focus on prudently growing wealth over a full market cycle whilst limiting downside risk. They do this by focussing not on what can go right, rather what can go wrong; which is well aligned with our strategy's long-term real return focus.

The portfolio is likely to include shares, debt securities, cash, commodities and foreign exchange exposures.



Jonathan Ruffer
Chief Executive

Philosophy on investing

Ruffer has an objective of preserving capital over any one year horizon and generating long-term returns ahead of the return on cash. Their prime philosophical belief is to focus not on what can go right, rather what can go wrong; which is well aligned with a capital preservation based objective. They aim to take the timing risk out of the portfolio so that it will have enough things going well in the good times whilst ensuring enough protection to preserve capital in the bad times. They never 'short-sell' stocks, rather they implement a clean and transparent 'long-only' based approach to investing.

Investment process

Ruffer's investment process involves a mixture of bottom-up and top down research. Ruffer believe that the blending of a top-down asset allocation and bottom-up stock selection approach increases portfolio efficiency by breaking down an artificial barrier in the processes of most managers of diversified portfolios. Ability to do this successfully is rare.

The top down themes provide an 'umbrella' beneath which the stock selection goes on. However, the information flow is not all one way - some top-down themes are first identified by the bottom-up focussed analysts. Ruffer will tend to pick themes ahead of the rest of the market. In part, this comes from their longer time frame and patience as investors.

Good stock selection is critical together with the way in which they build in risk control. It is not enough for the top down research to identify a theme; they also need to know which stocks to buy. Once they have identified a theme they 'follow a track', looking at which sectors and then companies are likely to benefit.

Ruffer is entirely index unaware. They focus on assets that fulfil absolute, not relative objectives.

Portfolio construction

Looking through a full market cycle, the portfolio may tend to exhibit a 50/50 average growth/defensive asset mix, though this will deviate intra-cycle. The defensive assets are held for capital protection and the growth assets to generate returns. The mix is broadly diversified in every regard except for stock specific risk. Ruffer will tend to hold around 35 stocks. Each asset in the portfolio has a key role to play, particularly in terms of how it behaves compared to other assets.

Ruffer has two teams involved in the investment management process: the bottom up research team and the top down asset allocation team. They do not have any committees – they focus instead on working as a team. Their small size means that they are able to adopt a flexible approach – also both teams hold and express strong views, this is important in ensuring that an appropriate balance is maintained.

The Research Meeting is the forum for exchanging ideas. Once modelling has been completed and reports prepared (typically 2–10 pages) analysts present their stock recommendations to the Investment Meeting. They must explain how it fits with the top down view, or if it doesn't why it still makes sense. The discussion that goes on at this meeting determines whether the stock makes it into the portfolios – where it does, the stock is implemented across all portfolios as appropriate.

Investment people

Ruffer is an independent business owned by team members and former employees. Ruffer has always regarded the quality of their staff as fundamental to the service they offer clients and they seek to recruit and retain colleagues with institutional quality experience. Brief biographies of the members of the investment team and other key staff are below.

JONATHAN RUFFER Chief Executive

Trained as a stockbroker and barrister before moving into private client investment management in 1980, with Dunbar Fund Managers. Formerly Chief Investment Officer of Rathbone Bros plc, in 2001 became an independent non-executive director of Electric and General Investment Trust PLC. He established Ruffer Investment Management in 1994.

HENRY MAXEY Chief Investment Officer

Joined Ruffer in 1998 after graduating from Oxford University with a first class honours degree in economics and management. He is a CFA charterholder and co-developed CF Ruffer Investment Funds. He became Chief Executive Elect in March 2010.

JANE TUFNELL Director

Worked at County NatWest where she ran more than £300 million of smaller companies funds including the County Smaller Companies Investment Trust and the County Smaller Companies Exempt Fund. She joined Ruffer as one of its founders in 1994.

TREVOR BRADLEY Investment Director

Joined Mercury Asset Management (now part of BlackRock) in 1992 and spent 8 years managing UK pension fund portfolios, leaving in 2000 to join McKinsey & Co as a consultant to investment management and financial services companies. Joined Ruffer in 2005.

DAVID BALLANCE Investment Director

Previously International Equities Head at Rothschild Private Management, prior to which he was European Equities Head at Rothschild Asset Management. He graduated from Oxford and worked for Allied Dunbar Asset Management as Senior Investment Manager before moving to Threadneedle Investment Managers Ltd as Head of European Equities. He joined Ruffer in 2006 and is co-manager of the CF Ruffer Total Return Fund.

STEVE RUSSELL Investment Director

Started as a research analyst at SLC Asset Management in 1987, where he became Head of Equities in charge of £5bn of equity funds. In 1999 he moved to HSBC Investment Bank as Head of UK and European Equity Strategy, before joining Ruffer in September 2003. He became a non-executive director of JP Morgan Fleming Continental Investment Trust in 2005 and is co-manager of the CF Ruffer Total Return Fund.

PETER WARBURTON Economist

Previously worked as a Research Officer at London Business School, a lecturer at Cass Business School and Chief Economist at Robert Fleming Securities. He published *Debt and Delusion* in 1999 and in 2000 co-founded Rhombus Research, an independent research company. He joined Ruffer in 2002.

TREVOR WILD Research Director

Worked for BZW from 1983 where he led a number of successful research teams, joining Commerzbank in 1999 to begin his career as a Portfolio Manager. In 2005 moved to Lehman Brothers as Managing Director of the Long Term Value Fund. Joined Ruffer in 2008.

MARY McBAIN Investment Director (Asia)

After graduating from Oxford University in 1985, started work at Invesco MIM as a fund manager on the Asian team. After leaving Invesco in 1990, she spent many years living and working in Asia, for GK Goh Securities, Apollo Investment Management and Ballingal Investment Advisors. She joined Ruffer in 2006 and manages the CF Ruffer Pacific Fund.

TIMOTHY YOUNGMAN Investment Director (Europe)

Moved into European equity research in 1985, after a period with McKinsey & Co and at Manchester Business School. He moved from Savory Milln to S.G. Warburg in 1988, and then to an independent research boutique in 1999, before joining Ruffer in January 2003. He manages the CF Ruffer European Fund.

KENTARO NISHIDA Investment Director (Japan)

After obtaining a BEcon in Japan and studying Russian in Moscow he worked as an interpreter in both Russia and the UK. He moved into equity sales in 1988 for James Capel & Company Limited and then SG Warburg Securities in 1989. He joined Ruffer in 2008 to concentrate on Japanese Equities.

Stock story

A small, but key, protective asset in the portfolio is the 2055 index-linked gilt (an inflation-linked, UK government bond).

The 2008 credit crisis was a hugely deflationary event; the collapse and rescue of banking systems precipitated a severe recession in western economies. So why is Ruffer holding an inflation-linked security, especially one that is already expensive? (The real yield on the stock is only 0.6%, compared to a long-run average of 2.3% for long-dated index-linked gilts.)

The answer reflects the determined responses and efforts of governments and central banks to avoid *deflation*, with the consequent risk of *inflation* resulting instead. In the United States, Chairman of the Federal Reserve, Ben Bernanke, had written widely of the steps required in future crises to avoid the deflationary impact of a financial collapse like that the US suffered in the 1930s. Central to the response would be to maintain substantial negative real interest rates (interest rates below inflation) and increase the money supply through 'quantitative easing' – in 2002, Bernanke wrote 'The US government has a technology, called a printing press (or its electronic equivalent) that allows it to produce as many US dollars as it wishes at no cost'. The United Kingdom has similarly introduced quantitative easing (£200 billion worth) and reduced interest rates to 0.5%. Inflation (RPI) is now 5.1%.

Negative real interest rates are a strong palliative to the pain of excessive borrowing. For example, if I borrow \$1 million from you at 5% interest, but inflation is 10%, I may be able to invest it in my business to generate \$100,000 over a year, however I am only required to pay you \$50,000 interest at the year end. This leaves you \$50,000 worse off in real terms, since you also need \$100,000 to maintain your wealth in line with the rate of inflation. Therefore the

borrower (me) has every incentive to avoid default and maintain interest payments, since all the time that he does, the burden of the \$1 million debt is passing from the borrower to the lender (and in turn the saver). This incentive helps avoid defaults and their deflationary consequences (eg. business closures and unemployment).

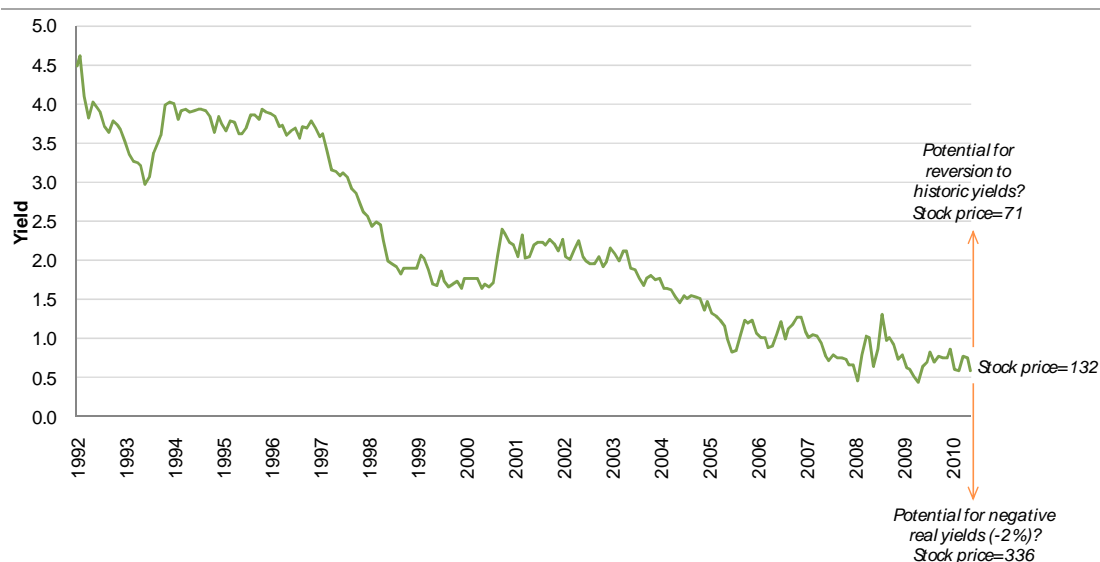
The danger of negative real interest rates (and printing money) is that the low rewards for savers and rising inflation can lead to a loss of confidence in a currency. This does not need to be on the scale of Zimbabwe, but when a population loses confidence in paper money and seeks to own tangible assets instead (a house perhaps?), the velocity of money around the economy increases, driving prices higher still as it circulates, chasing fewer goods.

In the scenario of a move to higher inflation, few asset classes are likely to perform well: conventional bond prices would fall, since the fixed coupons in the future will be worth less, so yields rise. Equities are de-rated, since they represent the present value of future cash-flows, which are discounted at the higher prevailing yields. Gold may perform well, as it did in the 1970s, the last time the global economy saw such inflation, but it is volatile. A more reliable means of preserving spending power as inflation rises would be inflation-linked government bonds.

In the UK, these were not available in the last period of high inflation, the 1970s, index-linked gilts being launched in 1981. With capital repayment and coupons rising in line with inflation, at a time when other assets (eg, equities) are falling it is possible that investors may pay a material premium for 'risk-free' returns that track inflation. The premium means that the investor is actually happy to accept returns that are less than inflation – the return may still be superior to the alternative of interest-earned in a bank. Technically, in this situation, index-linked gilts would have a negative real yield (ie, they yield less than inflation).

The price of the 2055 issue is particularly sensitive to its real yield, because of its long maturity (duration). The stock currently trades at 123. If real yields did move negative, to -2% say, then the stock could be expected to trade up to 336. Of course, if the yield reverts to the historic average of 2.3%, then the stock goes down, to 71. This seems to Ruffer a very attractive balance of risk and return: they can hold little enough of the 2055 issue in portfolios that it will make a material difference if inflation does take-off, but not so much that portfolios are hurt by its poor performance if there is a reversion to a disinflationary environment, in which case the loss should be more than offset by the performance Ruffer would expect from equities in an environment of strong growth and low inflation.

Real yield on UK government 30 year index-linked bond (stock prices for 2055 bond)



Source: Bloomberg

In an uncertain world, where certain central banks have sought to counter deflation with severely negative real interest rates and quantitative easing, a modest holding in an inflation-protected security, such as the 2055 index-linked gilt, provides sensible insurance against a misjudgement by authorities that they can later tame inflation when the need arises.

This stock may no longer be included in Ruffer's portfolio as their view may have changed since this document was prepared.

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