



Ruffer LLP

East Sussex Pension Fund

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31 May 2016



Overview of Ruffer

Portfolio performance

Current portfolio

Outlook

Appendix

Started in 1994; a single investment approach: absolute return

One service on offer – discretionary investment management

£18.2 billion of assets under management for private clients, charities and pension funds

224 people; partnership structure – owned by directors and staff

Two investment objectives defining 'absolute returns'

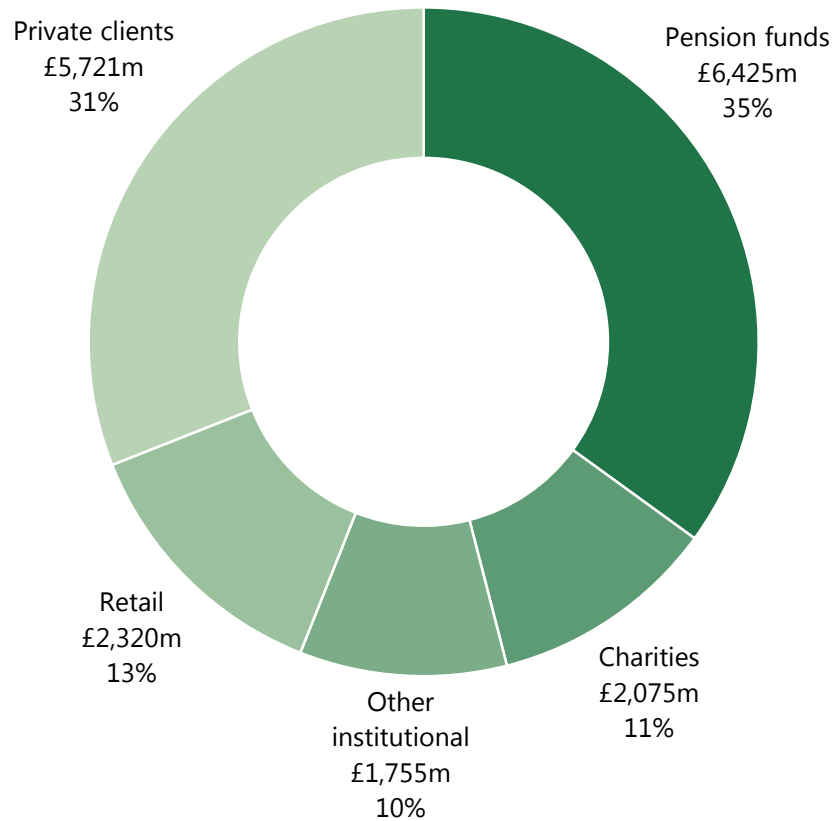
- not to lose money on a rolling 12 month basis
- grow funds at a higher rate than would be achieved by depositing them in cash

Unbenchmarking investment approach

- all conventional asset classes; global equities and bonds, currencies, funds
- active asset allocation and focused stock selection
- derivative use where appropriate

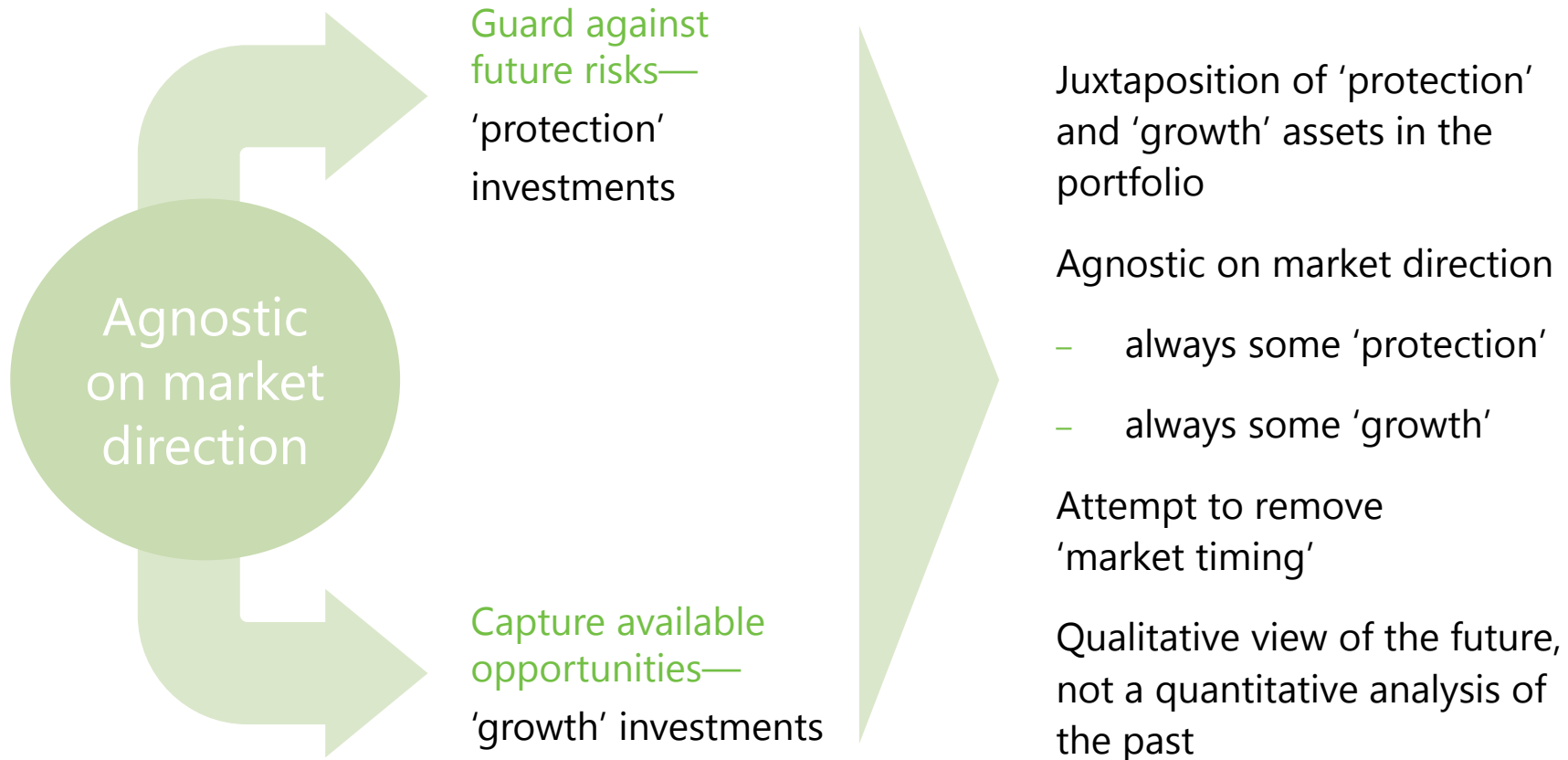
# Current assets under management

Ruffer LLP assets under management, March 2016 (£18.2 billion)



£950 million managed for  
nine local authority  
pension schemes

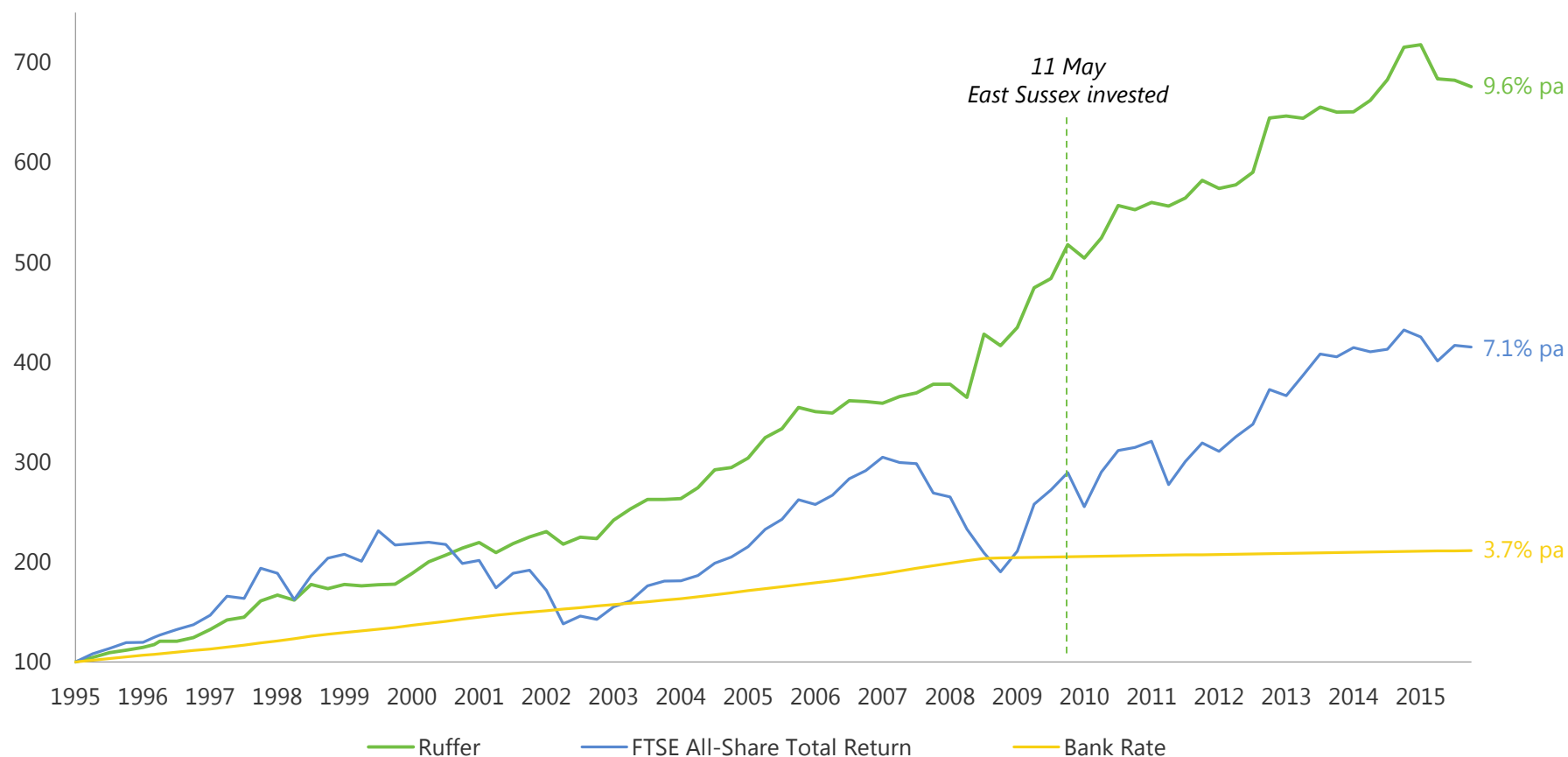
# Constructing an absolute return portfolio



# Long-term performance



## Ruffer performance versus Bank of England Bank Rate and FTSE All-Share Index 1995–2016



Source: Thomson Datastream, Ruffer. Cumulative performance 30 June 1995 to 31 March 2016, in pounds sterling. Performance data is included in the appendix. All figures include reinvested income. Ruffer's representative portfolio is an unconstrained segregated portfolio following Ruffer's investment approach. Ruffer performance is shown after deduction of all fees and management charges. Please note that past performance is not a reliable indicator of future performance. The value of the investments and the income from them can go down as well as up and you may not get back the full amount originally invested. The value of overseas investments will be influenced by the rate of exchange. Calendar quarter data has been used up to the latest quarter end and monthly data thereafter.

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# Performance of the portfolio

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## Portfolio value £

Initial investment received in ten instalments	192,325,000
Value as at 31 Mar 2016	240,346,620
Current value (22 Apr 2016)	244,984,530

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## Performance (net of all fees) to 22 Apr 2016 %

Cumulative performance (since inception, 11 May 2010)	+29.4
Annualised performance (since inception, 11 May 2010)	+4.4

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# Long-term performance



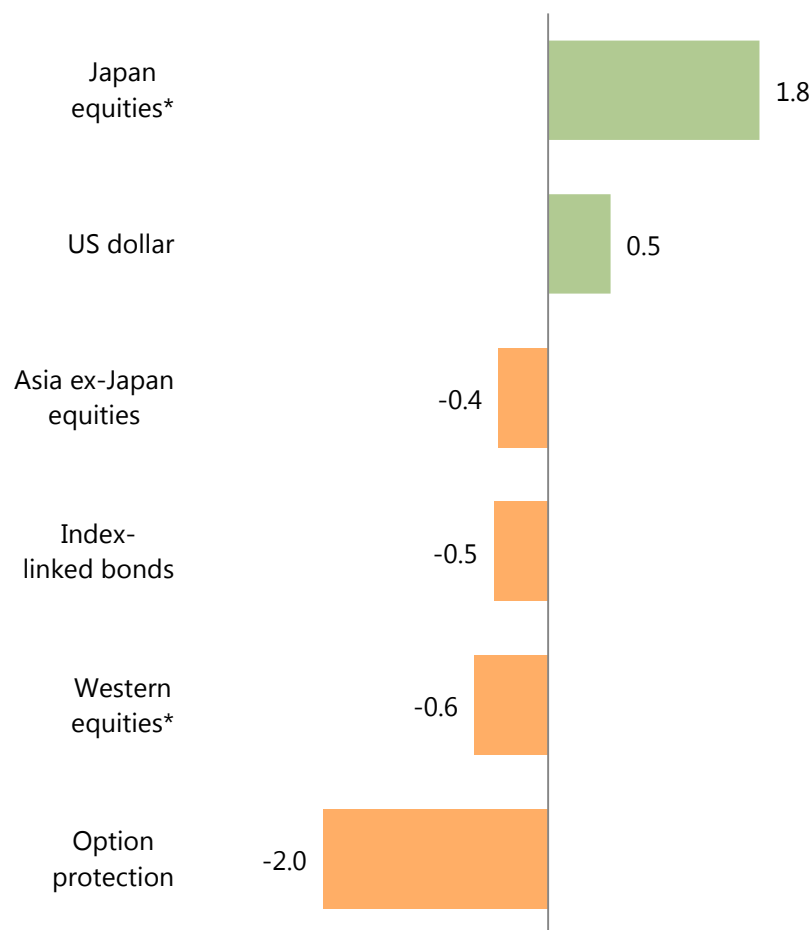
East Sussex Pension Fund	*%	Main contributions
2010 (from 11 May)	+6.2	Good performance as equities benefitted from further QE and improving economic data. Gold and index-linked bonds also gained.
2011	+1.0	Small positive return was pleasing in a year in which global equity markets fell sharply. Positive contributions from defensive stable growth companies and index-linked bonds, partially offset by falls in gold mining equities.
2012	+1.5	Disappointing year in which gains in global equities were largely neutralised by declines in the value of the index-linked bonds, gold and options.
2013	+13.5	A very strong year as Japanese equities rose sharply following the announcement of a large monetary and fiscal easing programme and other equities also gained from continued QE. Gold and gold mining equities weighed.
2014	+5.9	A satisfactory year given the backdrop of extremely volatile markets driven by geopolitical concerns and worries over the end of QE in US. UK index-linked bonds and Asian equities were the major positive contributors.
2015	-2.5	Disappointing year even though markets were broadly flat. Strong returns in the first half of the year were lost in a very weak third quarter when China devalued. This triggered sharp falls in equity markets, particularly in Asia. Fear of a US rate hike weighed on bonds.
2016 (to 22 Apr)	+1.5	Encouraging start given a convulsive beginning to the year. Equity markets and commodities plummeted in January on renewed China fears. Supportive central banks helped markets to rebound. Gold rose sharply.
Total return inception to 22 Apr	+29.4	

# Since last meeting: one strong year, one weak

	*%	Main contributions
Strong	Q3 2014	+2.6 Good quarter as portfolio benefitted from foreign currency exposure when sterling wobbled on Scottish referendum fears. UK index-linked bonds and Japanese equities also helped.
	Q4 2014	+4.3 Portfolio rose sharply as Japanese equities were boosted by strong earnings and low inflation helped to push up bond prices benefitting long-dated index linked bonds. End of US QE helped US dollar assets.
	Q1 2015	+4.0 Strong quarter as portfolio benefitted from equity markets hitting new highs and many bond yields hitting multi century lows. The US dollar exposure further enhanced returns.
	Q2 2015	+0.2 The portfolio held its ground in a difficult quarter in which both global equities and bonds fell sharply. Options and good equity selection offset losses elsewhere.
Weak	Q3 2015	-5.7 Very weak quarter as equity markets plummeted after China devalued. Japan was particularly hard hit. Bonds and gold also fell on concerns about a US rate rise. Options helped in August but retreated in September.
	Q4 2015	-0.7 Portfolio rebounded in October as Japan and other markets rallied. Equities then retreated with cyclical worst hit. Losses in options and index-linked bonds also weighed.
	Q1 2016	-0.4 Extremely volatile. Equities and commodity prices fell sharply on renewed China fears before rebounding somewhat after central bank support. Gold and index-linked bonds offset some losses.
Recovery?	Q2 2016 (to 22 Apr)	+1.9 Indications that the US central bank will be cautious about raising interest rates and will take into consideration conditions in the rest of the world supported equities, particularly cyclical.

# Key performance contributions in 2015

## % contribution to portfolio return 2015



■ Japan ended the year the best of the major stock markets, gaining 10% despite a late summer sell-off. Equities were supported by monetary stimulus, increasing profits and improved corporate governance

■ Following a strong run in the US dollar we took profits and hedged back most of the US exposure into sterling early in the year

■ Hong Kong listed securities were hit by turmoil in China – sharp falls in Chinese equities and then the renminbi devaluation in August

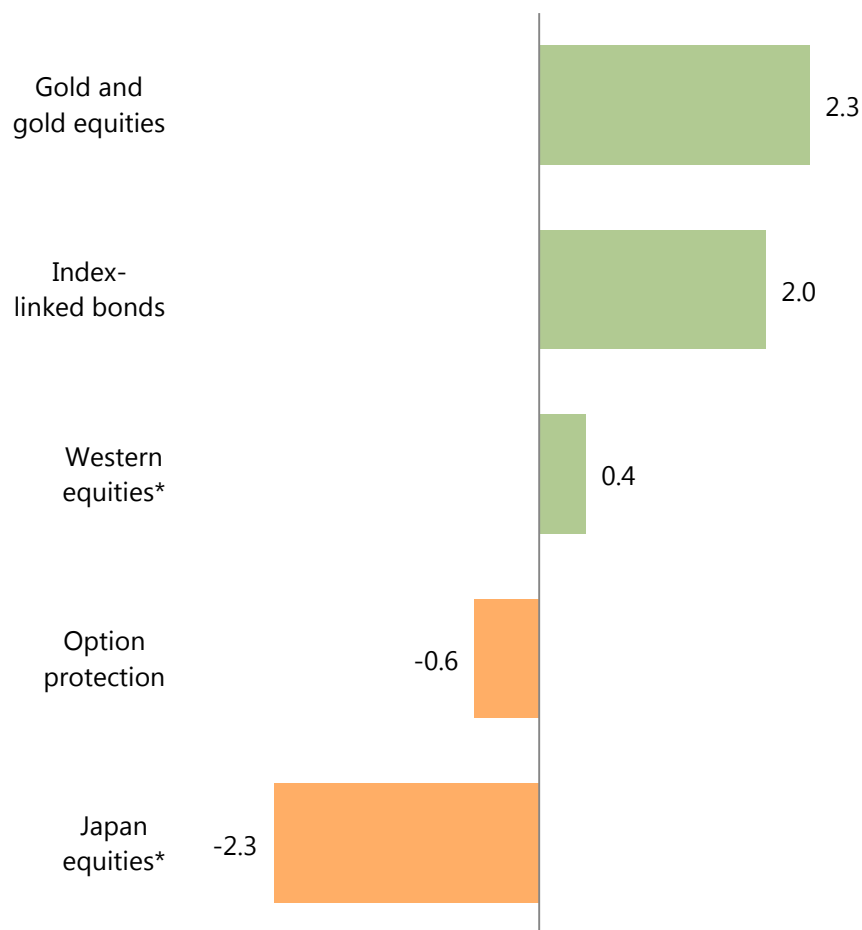
■ The long-dated bonds suffered as bond yields rose as markets prepared for the Fed finally lifting interest rates, which happened in December. Inflation expectations also fell amid falling oil prices and economic growth concerns

■ The divergence in performance between stable growth and cyclical equities has reached historically extreme levels. The portfolio's shift to more economically sensitive shares proved early and hit returns

■ Option protection was a cost as positions guarding against a severe fall in markets lost value as equity and bond markets ended the year broadly flat

# Key performance contributions in 2016

## % contribution to portfolio return to 22 April



■ The prospect of ever-more-negative rates in developed markets increased the relative attraction of gold (which will only ever yield zero). Gold mining shares have done even better due to cheap valuations and efforts to cut costs

■ Index-linked bonds have performed well so far this year, with yields falling globally and, more recently, inflation breakevens widening helping index-linked bonds to outperform conventional bonds

■ Equity markets were volatile over the quarter, falling by over 10%. They then recovered much of the losses when central banks turned more supportive. Some cyclical shares started to gain ground

■ The volatility options appreciated during the panic in January, but as markets recovered, the fall in volatility and also Japan's move to negative interest rates meant options were a negative over the quarter

■ Japan was hit early in the year largely on its proximity to China's troubles. The yen rose as a safe haven and this hurt the stock market. The problem was exacerbated late in January when the Bank of Japan introduced negative rates which hit financials hard

Overview of Ruffer

Portfolio performance



Current portfolio

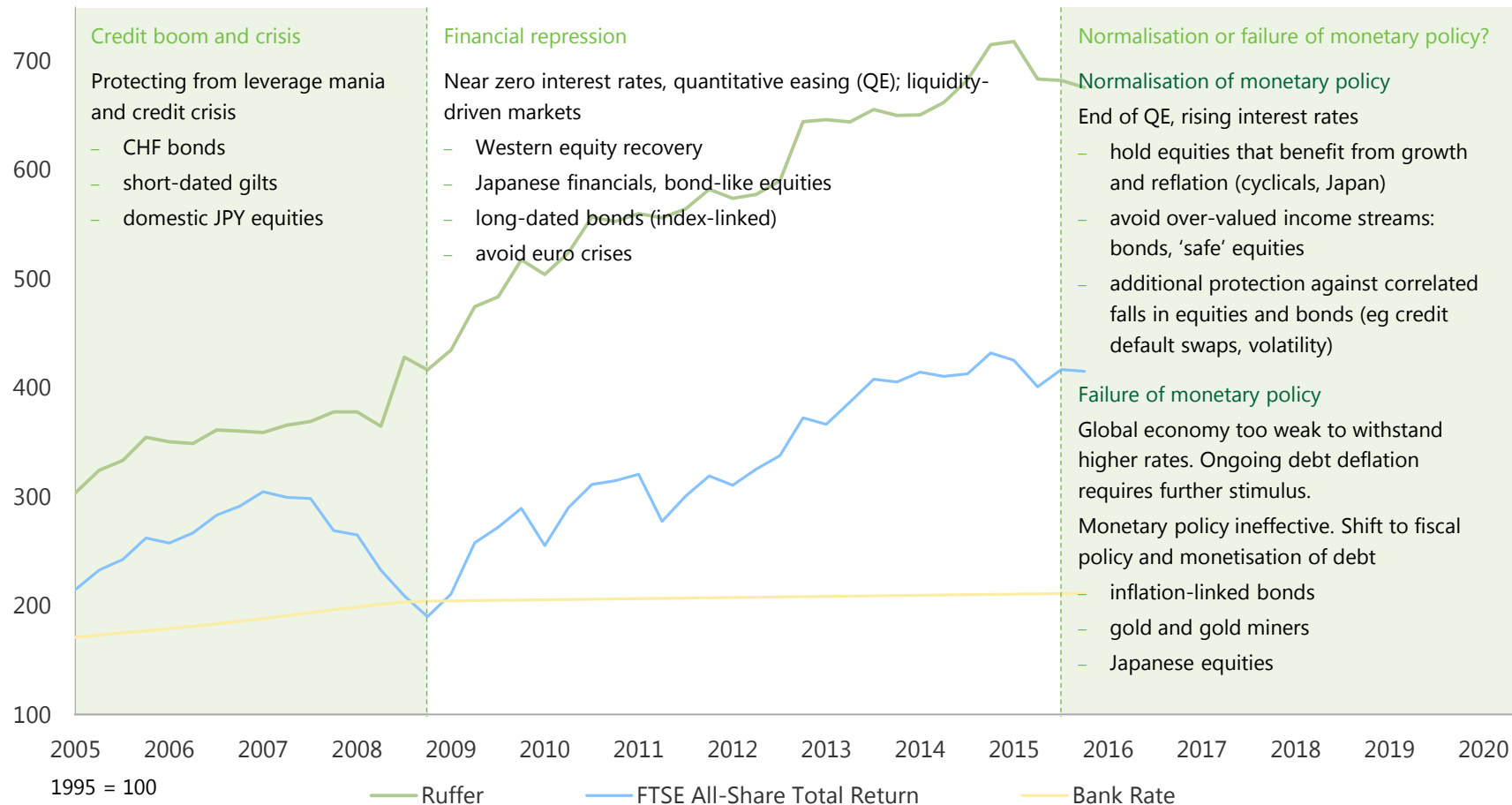
Outlook

Appendix

# We face the normalisation or failure of monetary policy



## Ruffer's absolute return strategy across different stages of the economic cycle



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## Equities

### Global equities

Monetary intervention by central banks boosted equity markets with abundant liquidity. The US has taken the first step towards normalisation.

Equities with stable cashflows are popular and close to peak valuations. Cyclical are cheap and unloved. We hold the latter.

### Japan

After nearly two decades of deflation the imperative for monetary stimulation is greatest in Japan. We expect fiscal stimulus too. In addition, Japanese companies are benefitting from years of cost cutting and restructuring. They are also adopting more shareholder friendly policies.

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## Index-linked bonds

### Excess levels of global indebtedness

Global debt has grown by over 5% pa since the credit crisis outpacing economic growth of 3% pa and leading to an increase in the debt burden.

The solution is for the authorities to achieve negative real yields by holding interest rates below the rate of inflation. This erodes the outstanding value of debt – at the expense of savers. In this environment we expect the index-linked bonds to appreciate sharply providing vital protection.

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## Offsets

### Swaptions, volatility, and protection against a sharp rise in credit spreads

The distorting effects of QE and ultra-low interest rates have resulted in equities and bonds moving together driven by liquidity - thus breaking their traditional offsetting relationship.

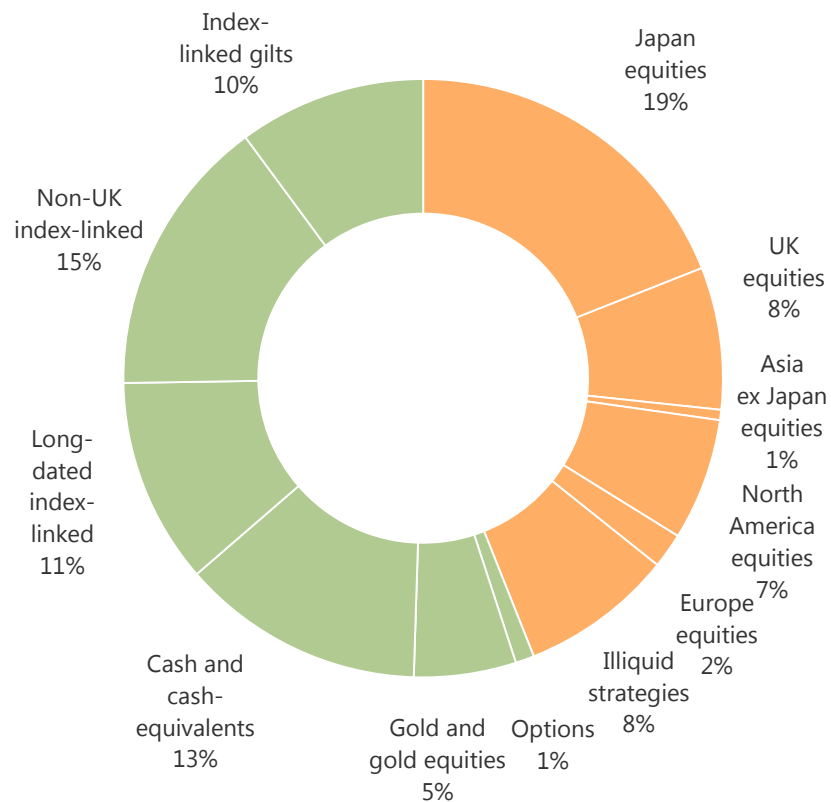
We have had to look to other financial instruments in order to achieve adequate protection. These are options on rising yields (swaptions), volatility and credit spreads. However, these investments are uncomfortable to hold in periods of only moderate volatility as, unlike conventional assets, time works against investors. But we regard them as necessary for the scenario we most fear: a major correction in both bond and equity markets.

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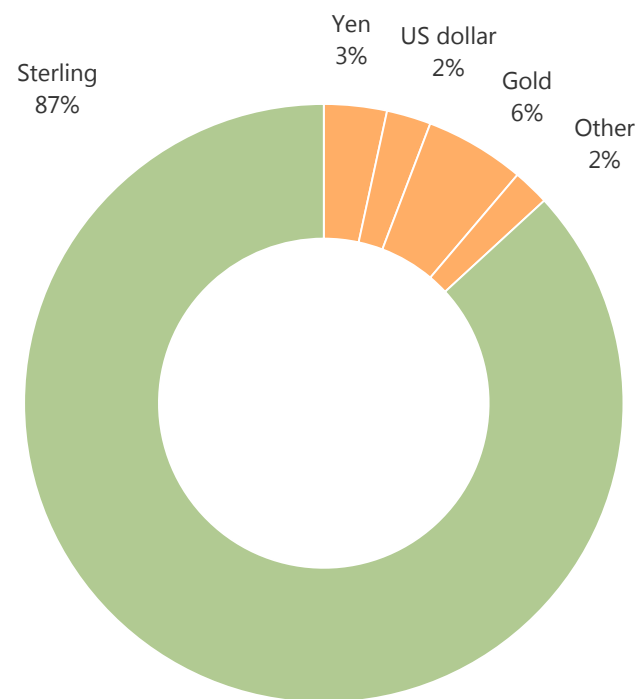


# Current portfolio structure

## Asset allocation



## Currency allocation



Top 5 equity holdings	% of fund
ORIX	2.5
Sony	2.4
Rakuten	2.3
Royal Bank of Scotland	2.1
ExxonMobil	1.8

Stocks selected by the research team

- 32 analysts
- fundamental research

Unconstrained, 'best-ideas'  
stock selection – not index tracking

Portfolios built with conviction

Overview of Ruffer

Portfolio performance

Current portfolio

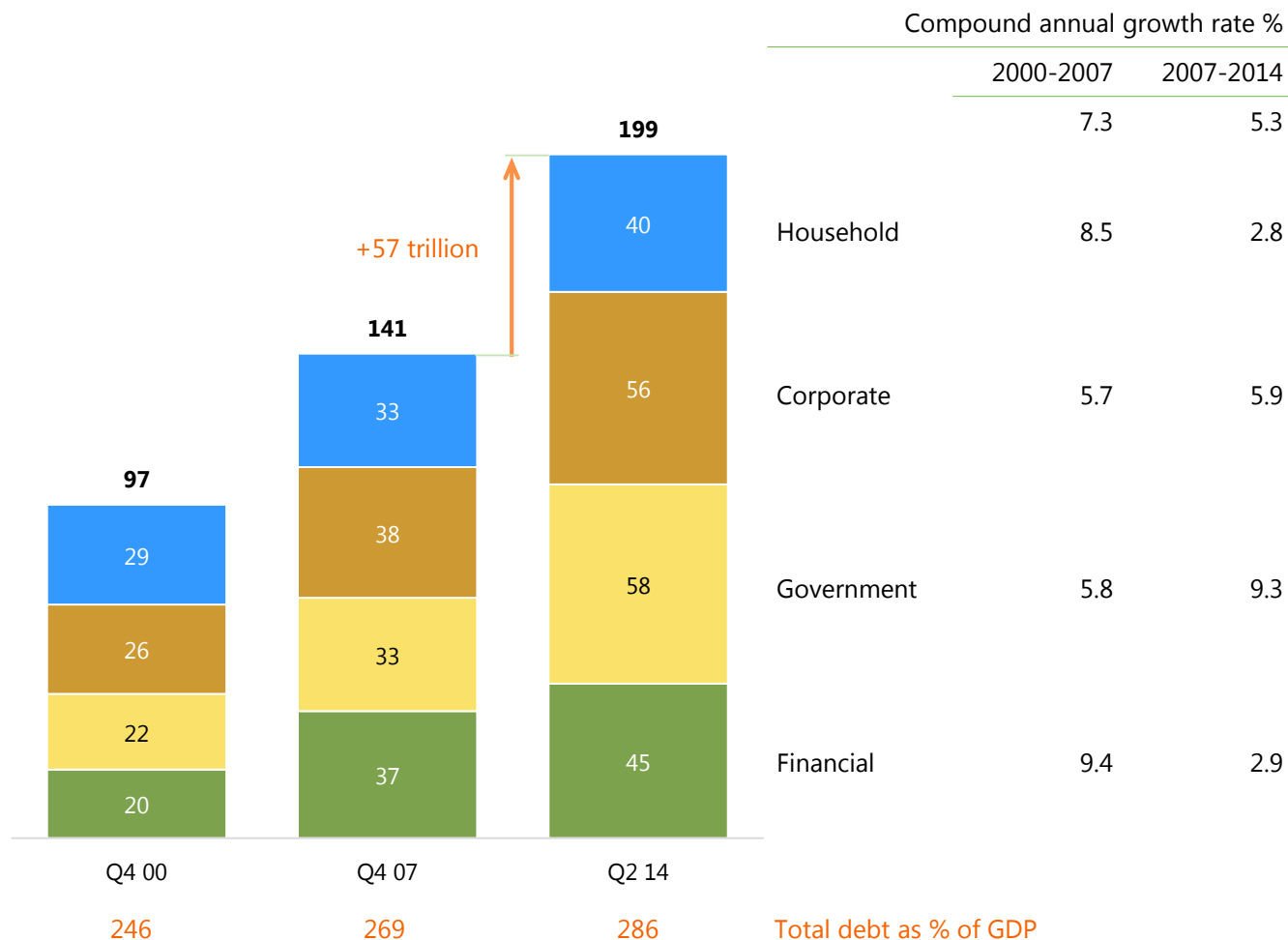


Outlook

Appendix

# Global debt has increased

Global stock of debt outstanding by type, \$ trillion, constant 2013 exchange rates



# Markets remain vulnerable to deflationary shocks

## Policy uncertainties in Q1 2016

### Jan 2016 – the concerns

#### The Chinese renminbi

Would Beijing want or be able to limit capital outflows and bring the currency under control?

#### The barrel of oil

What would stop the oil price from falling further and what was the sharp fall telling us about global growth?

#### Central bank policy

The Federal Reserve's members forecast four rate hikes in 2016; would they ignore the problems a strong dollar posed to the rest of the world? How would other central banks respond?

### What we now know

The People's Bank of China moved to stabilise the renminbi ahead of Chinese New Year, calming the market.

The price collapse is starting to reduce current and future supply.

The Bank of Japan, the ECB, and the People's Bank of China all eased monetary policy; the Federal Reserve has now reduced its guidance to two rate rises in 2016.

# The drumbeat for 'helicopter money' grows louder



## Quotes supporting fiscal policy and monetising debt

'When monetary policy alone is inadequate to support economic recovery or to avoid too-low inflation, fiscal policy provides a potentially powerful alternative - especially when interest rates are stuck near zero'

Ben Bernanke, former US Federal Reserve Chairman

'But if our problem is inadequate nominal demand, there is one policy that will always work. If governments run larger fiscal deficits, and finance this not with interest-bearing debt but with central bank money, nominal demand will undoubtedly increase.'

Lord Adair Turner, Former Head of the FSA

'A helicopter drop means that the ECB would print and distribute money to citizens directly. If it were to distribute, say, €3,000bn or about €10,000 per citizen over five years, that would take care of the inflation problem nicely.'

Wolfgang Munchau, Financial Times

'A more radical proposal still would be to remove the zero lower bound constraint entirely by abolishing paper currency.'

Andy Haldane, Bank of England

'If dropping interest rates to zero was Unorthodox Policy #1, and QE was Unorthodox Policy #2, then it seems very possible that helicopter money will be Unorthodox Policy #3.'

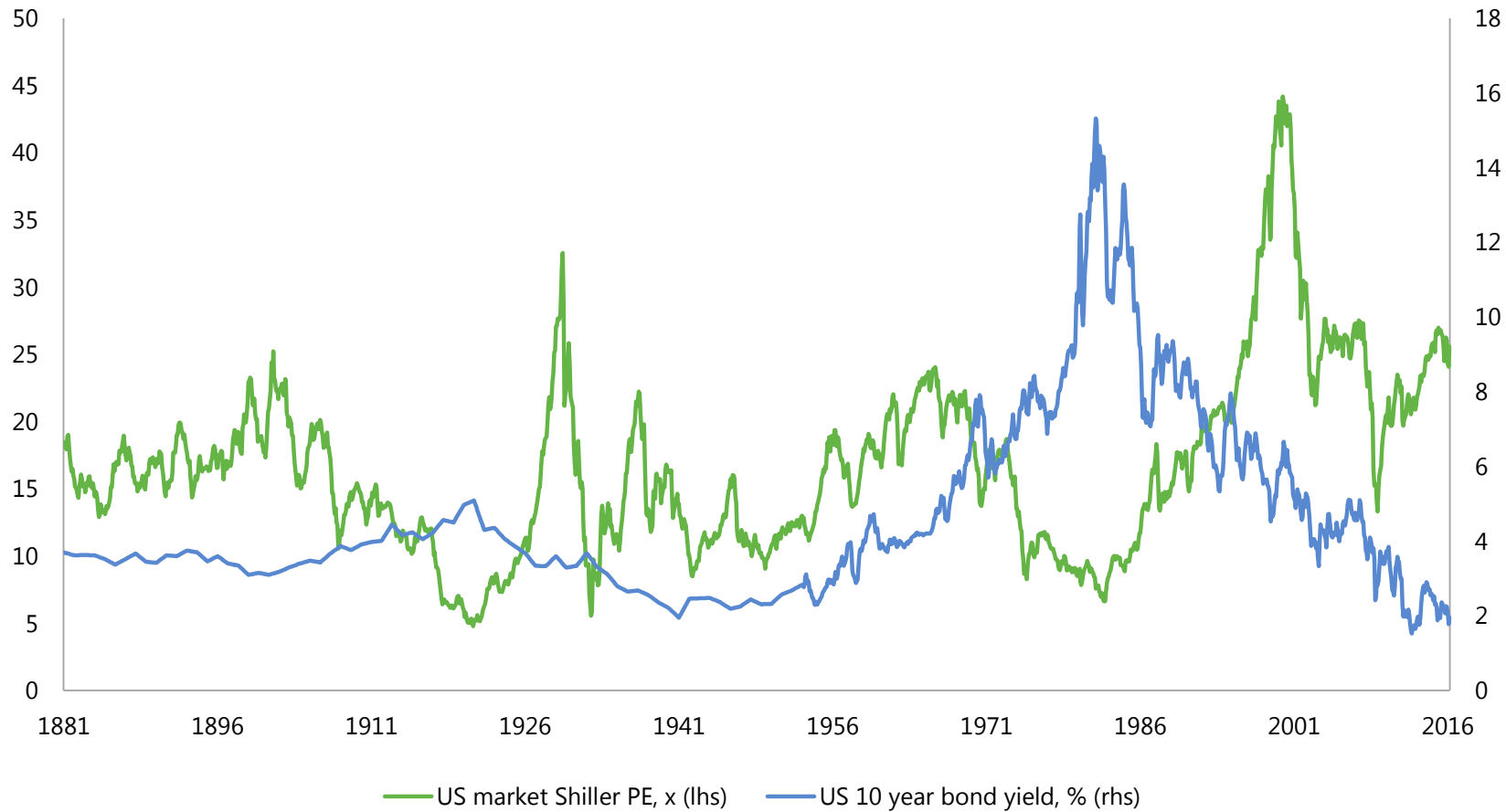
Ray Dalio, Founder Bridgewater Associates

'One option would be for the Bank of England to be given a new mandate to upgrade our economy to invest in new large scale housing, energy, transport and digital projects; quantitative easing for people instead of banks.'

Jeremy Corbyn, Leader of the UK Labour Party

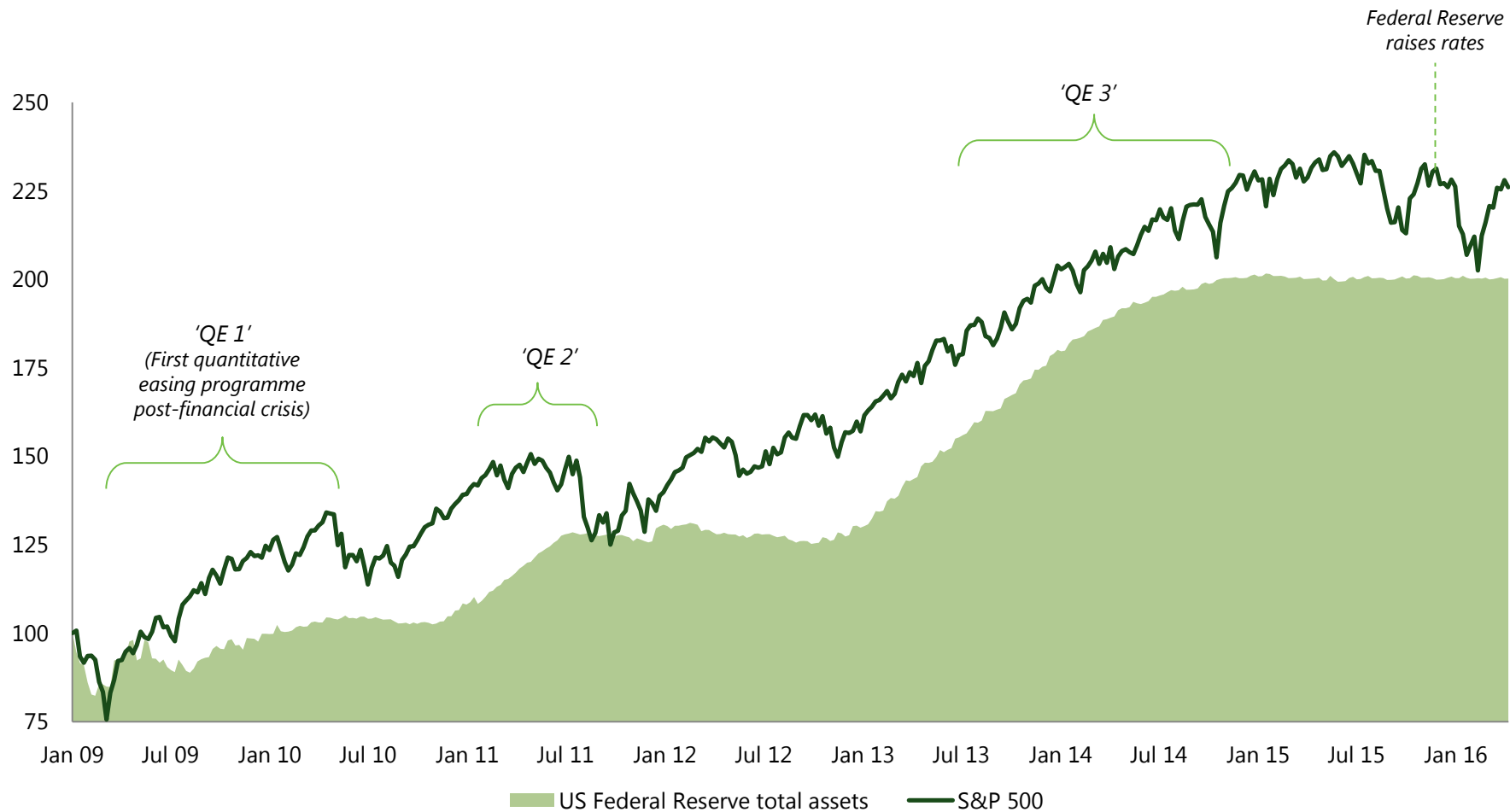
# Asset markets in general, and safe assets in particular...

...are stretched



# What will rate rises do to asset prices?

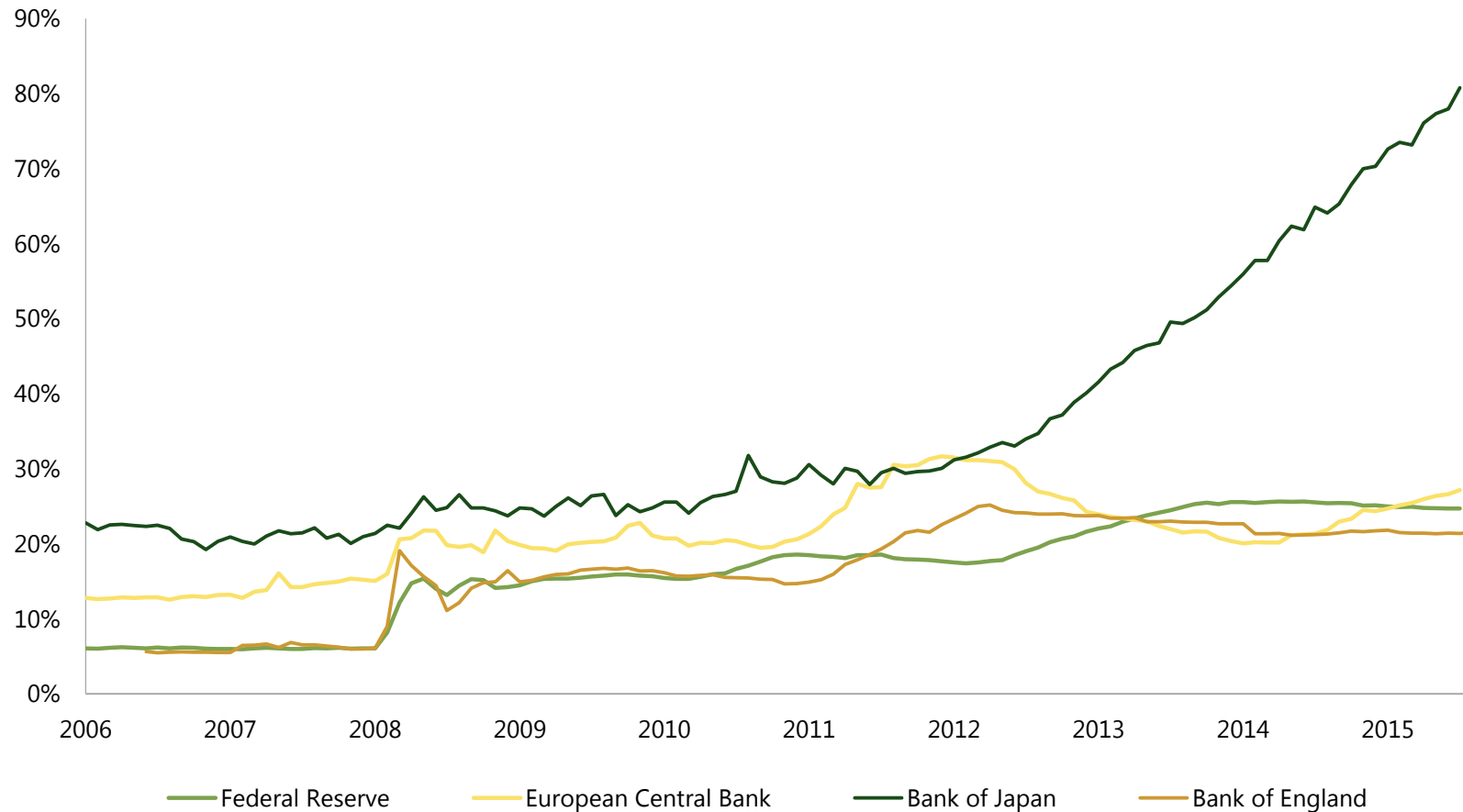
## Quantitative easing (US Federal Reserve total assets) and asset prices (S&P 500)





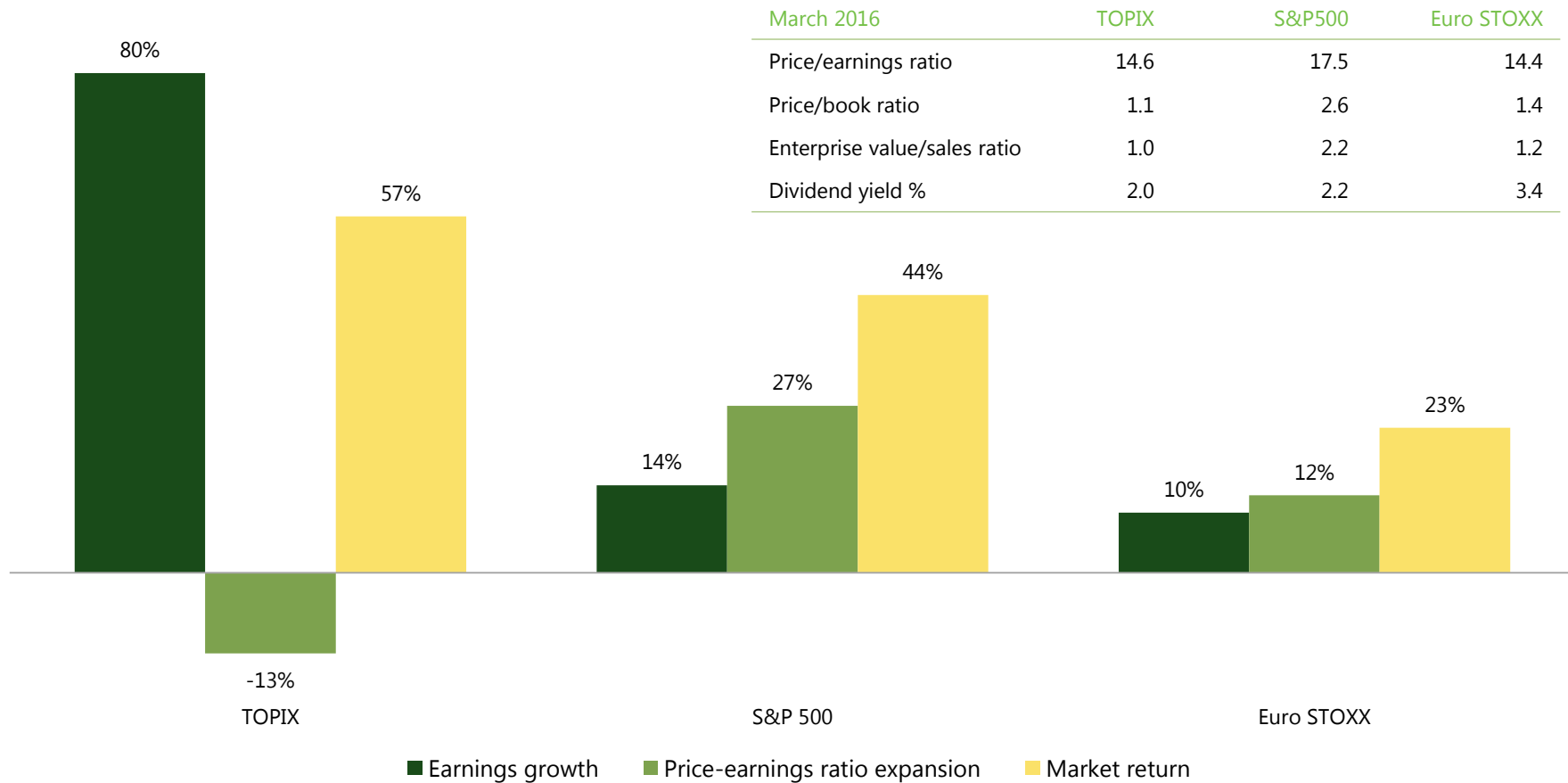
# The Bank of Japan has cut rates and continues QE

## Central bank assets as % of GDP



# Japanese valuations remain undemanding

Earnings growth, P/E expansion, stock market return since Abenomics started (Dec 2012-Mar 2016)



# Underperformance by cyclical value shares...

...is at extreme levels

Absolute performance (£, base=100)

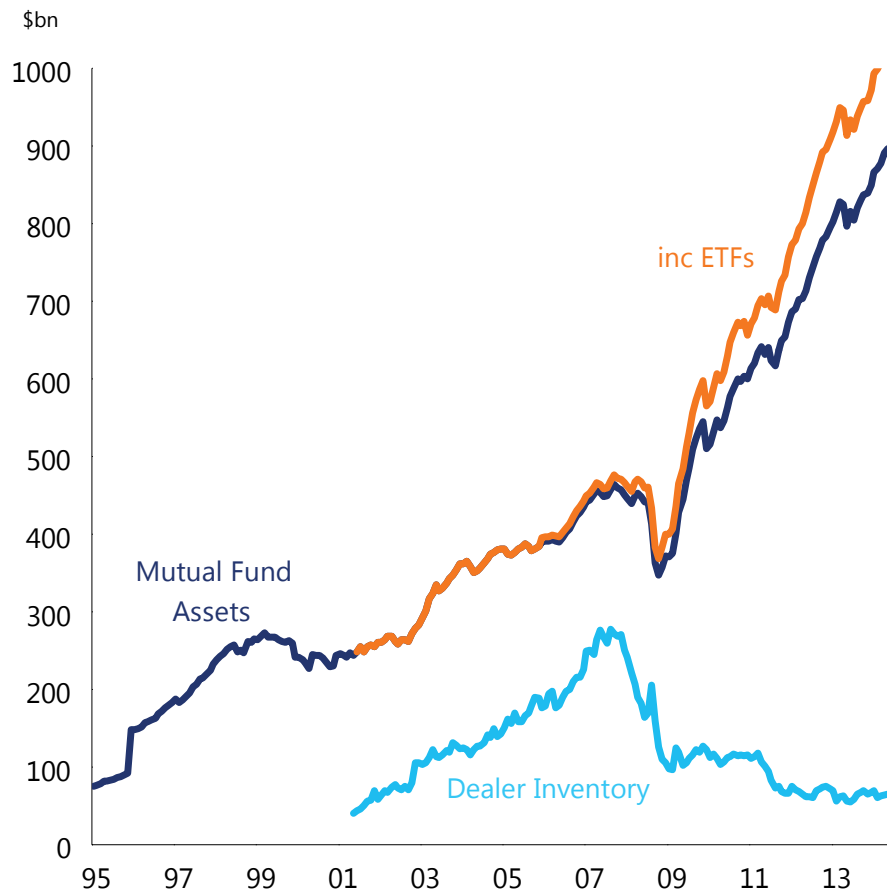


Relative performance (£, base=100)



# Liquidity in fixed-income markets is likely to be pressured *R U F F E R*

## Bond mutual fund assets versus dealer inventory

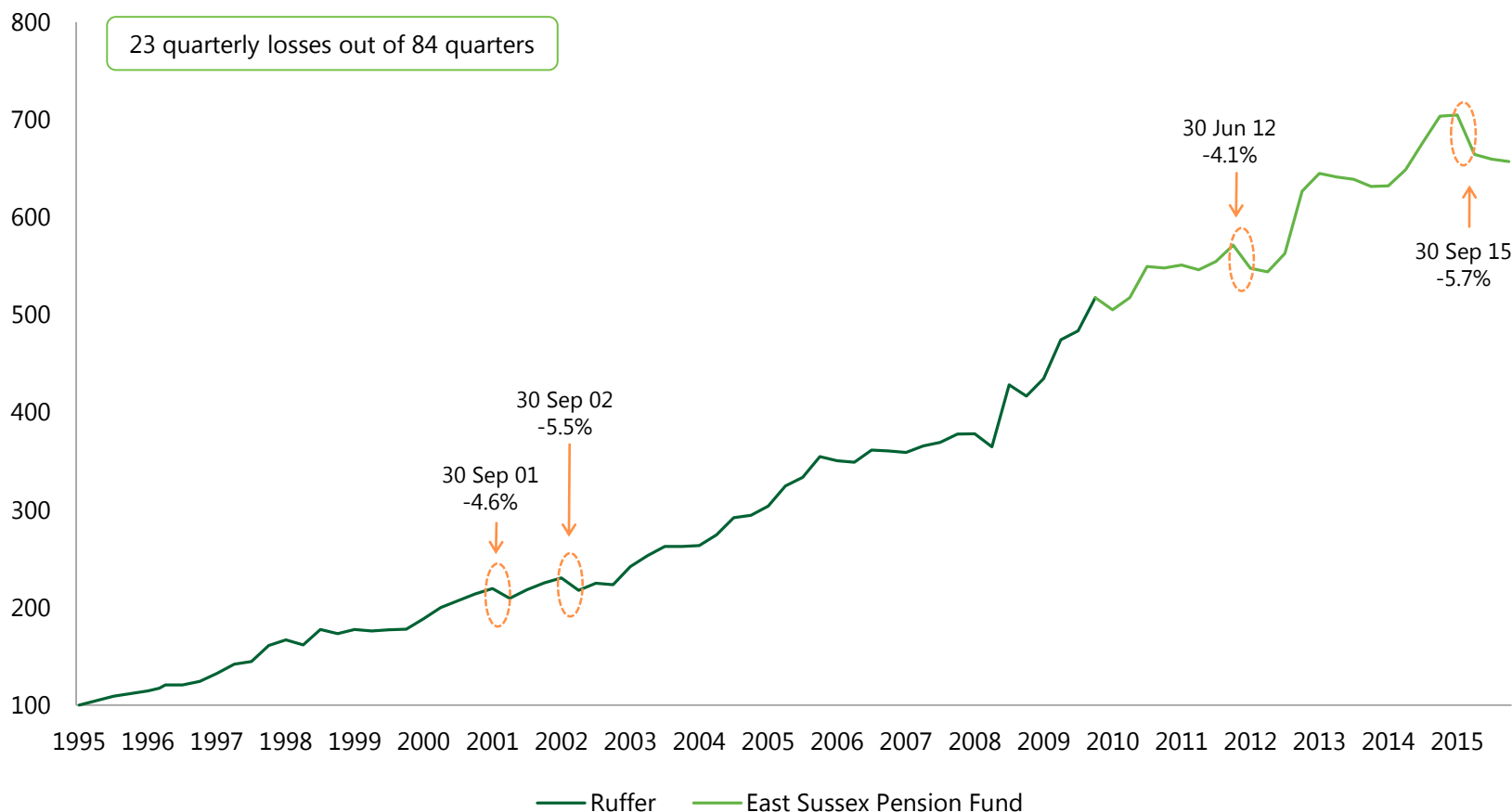




## Appendix

# Long-term performance – quarterly losses

## Risk defined by capital loss – four largest calendar quarterly drawdowns 1995–2016



Source: Ruffer. Cumulative performance of representative portfolio from 30 June 1995 to 30 June 2010 and East Sussex Pension Fund portfolio from 30 Jun 2010 to 31 March 2016, in pounds sterling. Performance data is included in the appendix. All figures include reinvested income. Ruffer's representative portfolio is an unconstrained segregated portfolio following Ruffer's investment approach. Ruffer performance is shown after deduction of all fees and management charges. Please note that past performance is not a reliable indicator of future performance. The value of the investments and the income from them can go down as well as up and you may not get back the full amount originally invested. The value of overseas investments will be influenced by the rate of exchange. Calendar quarter data has been used up to the latest quarter end.

Bernard Connolly, the prominent former European civil servant, expelled from the EU for writing 'The Rotten heart of Europe', and now an economic commentator, has an *idée fixe*. It carries the snappy cachet 'intertemporal disequilibrium', which is a hoity-toity (or possibly Irish) way of articulating the fact that if you eat tomorrow's cake today, you'll go hungry tomorrow. It is a helpful insight, which chimes with our constant refrain of a coming inflation: put the two together, and you have Connolly's 'cause' and Ruffer's 'effect'; eat tomorrow's lunch, and tomorrow will be the poorer for it. The instrument by which we will become poorer is inflation with nominal returns very considerably below the rate of inflation.

Investors who seek to keep safe in this world are faced with the footballer's 'game of two halves'. The double-helpings of cake in the short term make the economic profile fatter than its long-term average – later, the outlook is for leaner times than would otherwise be the case.

In this first half, there is both opportunity and danger – and the clearer the opportunity, the sharper the danger. Companies with steady cash flow which are managing to show some growth have share prices which have been steadily and unexcitingly making progress. We now own few of these high quality companies, having sold them much too soon. We did so because the safety and quality of such businesses does not make for a safe investment if the stock prices are over-valued, and we believe they are.

The same is true of well-researched smaller companies where skilful stock pickers have been able to identify the characteristics for corporate prosperity and have been rewarded by rising share prices, and correspondingly expensive ratings. We have participated in this, but at the periphery, not as a core part of the portfolios.

We have comparatively little money in equities, slightly over one-third of portfolios, which is towards the lowest percentage we have ever held. We have a geographic bias towards Japan, which was good until the middle of last year, but has since been hit by its proximity to China, and by policy decisions in Japan itself. We think they will be reversed, which is why we retain this position. As a theme we hold 'value' stocks, seemingly the worst place to be, full of company and industry-specific risk, and if there is only to be a short day in the sun, why spend it under the shade of becalmed ratings? The answer is that a change of investment

climate invariably brings with it a change of market leadership, and the discomfiture of 'quality' should create appetite for 'value'.

The markets are nervous and volatile, evidenced by the sharp fall, and equally sharp recovery in the last quarter. Some of this is technical. Sharp rallies make it expensive being a bear – although there is a great deal of bearishness about. That's scarcely a surprise. The United States may soon be run by an outsider. Europe is overwhelmed by refugees and terror, and the fear that the German anchor may not be the force for stability that it has hitherto been. Britain flirts with Brexit. All this leaves a window for absolutist regimes in Russia, China and the Middle East to wax strong. The Central Banks fear – rightly – that they can do nothing if economies turn down, but at the moment they are OK: the US is growing at between 2% and 2.5% per annum, Britain about the same but slowing, Europe less, but growing and Japan too. This is not the rebound to recovery that they yearn for, but nor is it the crisis that the doomsters expect daily.

The decisive factor appears to be the markets themselves. While they hold up, or recover sharply after each fall, confidence holds up as well. It is hard to feel that the world is broken when asset prices are high – even a chronic lack of income in an income-less world seems manageable if the capital value of the assets is buoyant.

For this reason, the direction of the markets might be the decisive factor in determining the course of the economy. It is well known that market downturns act as a harbinger of bad economic news – but this is akin to the work of a barometer, which responds to an actuality of falling pressure which announces the storm. This time it could be the cause – we are in deflationary conditions, and the true enemy is, as always in deflation, a lack of confidence: a fall in markets, not followed by a bounce, could shock everyone into seeing how deflationary the conditions have become.



The unconventional – some would say desperate – measures which the Central Banks have introduced since 2009 have bought time – but they have not brought a solution to the deflationary trend which has rolled inexorably onward. The howitzers of the Fed with their quantitative easing, the bazookas from Japan and the *Minenwerfer* from Draghi in Europe have stabilised the world after the trauma of the 2008 credit-crunch. But these measures, which used to be regarded as inflationarily reckless, have not stopped the deflation. Traditional economic wisdom has nothing to say – have the authorities not done enough, have they done the wrong thing? Is deflation unstoppable? There are advocates for each of these views. What is clear to all in authority is that the massive amount of debt in the world and the deflationary character of the world's trade must not be allowed to combine to create a depression; as that most fatuous of Royals, King Edward VIII, remarked in the Cardiff slums, 'Something must be done'.

There is one 'solution' yet untried – direct creation of money by governments. Why hasn't it been used? Here is Roger Bootle on the subject in the Daily Telegraph. '[It] has been taboo for very good reasons. It is dangerous. The threat of inflation is obvious enough. Think of Weimar Germany or today's Zimbabwe.' It is a routine response to financial shipwreck, but, as anxiety has risen, so the taboo is breaking – first, among academics, who talk about fiscal expansion as a viable answer. Just as 'quantitative easing' was a euphemism since nobody knew whether this initiative into terra incognita would encounter dragons, so 'fiscal expansion' is a euphemism for what is more generally, if unhelpfully, known as 'printing money'. Take Russia today, in a vortex of deflationary forces – its major exports are primary goods, especially oil, which has plummeted in price, its capital is fleeing the country, business conditions are terrible – the very essence of deflation, but how is it that the baboushka suffers not deflation, but inflation when she shops? Because the currency has slumped in purchasing-power, reflected, but not caused, by a falling in value in the foreign exchange market. The same is true in Brazil, and over the last generation, most of South America. It rarely happens in first division countries – France in the late 1950s would be one example, and there is only one occasion when it has been true of all first-division currencies at the same time. That was in the 1970s, provoked by sharp rises in commodity prices and validated by strong trade unions demanding higher wages. They are almost laughably the opposite dynamics to those that obtain today. Falling raw material prices cry out 'deflation', and unions are powerless to protect the working man, whose economic retreat in all countries is

absolute. But what copper and the TUC can't do today, those weasel words 'fiscal expansion' can do – and there is now an intellectual framework for this to happen. Those who are fearful of it always go to its caricature, Weimar and Zimbabwe, but a country only has a currency which becomes worthless when it is bankrupt – it can always change direction (back to austerity) when profligacy becomes too expensive. But it is still a dangerous thing to do, and will need another bold government to follow the lead of the recently elected Trudeau government in Canada in implementing it.

For a fair while, it had looked as though we would see it first in Japan, where the evils of deflation are more absolutely understood than elsewhere, and where there is a bold and determined premier, Shinzo Abe, who has staked his reputation on beating deflation. We were aware that there was a bazooka in the offing in late January, and thought that it might be announced then – alas, Kuroda, head of the Bank of Japan was holding a gun, but by the wrong end, and in announcing negative nominal interest rates, he sparked a headlong fall in world stock markets, led down by the Japanese banks, which we own in size. What this episode has shown is how difficult it is to impose fiscal expansion (in Japan, it is the entrenched Ministry of Finance which will not countenance a radical fiscal move), but also how 'more of the same' is leading to dangerous and uncertain results, which show that monetary responses have their dangers, too. Nevertheless, we continue to believe that it will be in Japan that a fiscal expansion (and its inflationary implications) will come about.

Our conclusion is that there is bad stuff out there, but, as always, we make no attempt at timing the darkening of the sky. Those who share our fears, and have acted on them, have been massively caught out. Those who stick to momentum investment have every reason to congratulate themselves on keeping out of trouble by 'sticking to quality', but keeping out of trouble will necessitate a move away from these assets, which will require a different mind to the one that got them into the assets in the first place. We remain nervous, but we continue to believe that our holdings of inflation linked-bonds will provide the ultimate safety our clients need, although they could easily be volatile, tested by the realisation that we are staring at true deflation.

Jonathan Ruffer  
April 2016



# Regulatory performance data



## Percentage growth

From 31 March %	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
To 31 March %	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Ruffer	11.0	29.7	7.6	2.6	20.4	5.2	-0.8	17.5	12.2	20.5	1.6	4.8	10.3	24.2	6.8	5.3	10.7	0.9	10.0	-5.5
FTSE All-Share	14.9	41.2	5.3	6.5	-8.5	-3.4	-25.7	26.9	13.3	28.0	11.1	-7.7	-29.3	52.3	8.7	1.4	16.8	8.8	6.6	-3.9
Bank Rate	6.0	6.8	7.3	5.4	6.1	5.0	4.0	3.7	4.6	4.7	4.9	5.7	4.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5

Source: Thomson Datastream, Ruffer. Ruffer performance is shown after deduction of all fees and management charges, and on the basis of income being reinvested.

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## Who we are

Ruffer is a privately-owned investment management firm. We currently manage over £18 billion for pension funds, charities, companies and private clients, and employ over 200 people, with offices in London, Edinburgh and Hong Kong. We have a single investment strategy that has followed the same tried and tested investment approach since the firm started in 1994.

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## Our investment objectives

Our goal is to deliver consistent positive returns, regardless of how the financial markets perform. We define this through two investment aims–

not to lose money in any rolling twelve-month period

to generate returns meaningfully ahead of the 'risk-free' alternative of placing money on deposit

Since Ruffer started, this approach has produced returns ahead of equity markets, but with much lower volatility and risk. Over shorter time periods, if equity markets are rising, our returns are likely to be lower than those of equity indices, since we will always hold protective assets as well.

Although these are our aims there is always the chance that we may lose money because of the nature of the investments involved and it is possible that individual constituents of the portfolio lose all their value.

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## How we invest

Ruffer portfolios are predominantly invested in conventional assets, such as equities, bonds, commodities and currencies; we also will make use of derivatives. Part or all of your portfolio may be invested in Ruffer in-house funds.

At the heart of our investment approach is an asset allocation which always maintains a balance of 'greed' and 'fear' investments. Protective assets, such as bonds, should perform well in a market downturn and defend the portfolio value; those in growth, principally equities, should deliver good returns in favourable market conditions. This blend of offsetting investments reflects the prevailing risks and opportunities that we see in financial markets, rather than any pre-determined allocation. We operate without the constraints of benchmarks that institutional investors have historically been tied to.

The asset allocation is fulfilled through specific stock selections. We invest only in companies that reflect the themes we seek to benefit from in portfolios. We never simply invest in a stock market index.

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## Our investment team

Ruffer's investment team and strategy are led by Jonathan Ruffer (Chairman) and Henry Maxey (Chief Executive). They are supported by a Research Team of over 30 analysts, focussing on economic and market trends, company analysis and developing investment ideas. These are used by portfolio managers on the Fund Management Team to construct portfolios in line with the investment strategy. The average experience of Ruffer's investment team is over 15 years.

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