

weekly digest

momentum

Week ending 09 October 2016

global investment management

Styles are in fashion

There are a number of different ways that investors look to outperform the stock market. Investment Factors (or styles) are one example of this. Some Factors are well known, widely understood and their investment merit is intuitive whereas knowledge of other styles is today the preserve of investment professionals and their value proposition is more obscure. While there are a vast array of technical definitions of these different Factors, at their heart is a common purpose; namely to generate more efficient returns than the broad market; to generate more return for a given amount of risk. These Factors have historically been the preserve of active managers, but the evolution of smart beta strategies is resulting in a greater number of passive style exposures for investors.

The most widely known and innately understandable investment style is Value. Anyone who has browsed a sale rail in a shop innately understands the attractiveness of bagging a bargain and valuation strategies attempt to do just that. We investors inevitably try to intellectualise it a little by referring to investing in assets whose market price is below their intrinsic value, but the principle is the same. Ultimately stocks that are trading cheap should – eventually – be recognised as such as the rerating in price from a discounted to a 'normal' level is the reward that valuation driven managers invest for.

The Growth and Momentum styles look to identify stocks that are coming into favour for reasons such as positive growth in profitability for the firm or simply recent upticks in the price of that stock which tend to persist as others jump on the bandwagon. While valuation strategies are very price sensitive Growth and Momentum Factors are concerned more about where prices could go rather than entry price.

The Quality factor searches for companies that have a sustainable and relatively secure income stream and a history of growing that revenue effectively. These stocks generally have low capital intensity and a lot of intellectual property such as brands. Firms that fit in the Quality style tend to be well established and are certainly well managed. Quality managers tend to be unconcerned about slightly overpaying for a stock as long as it fits their stringent characteristics. These firms are often thought of as 'compounders' whose value grinds up almost regardless of the investment cycle or the business cycle. While they are not truly immune from such market forces, one would expect a quality company to be well placed to weather difficult trading periods and as a result, all things being equal, they should be less sensitive to market downdrafts than other styles.

Clearly as the number of Factors that are identified grows, the possibility of cross over from one to another increases, which risks a concentration of risks in a portfolio that is on the face of it well diversified between differently labelled styles. As ever the devil is in the detail and research effort is required to identify styles that are genuinely complementary to a portfolio. This research effort is key given even well-established Factors often have differences in their definitions depending on the practitioner. Furthermore some of the styles have long standing histories both in terms of their academic credibility but also in terms of live operation whereas others are still very much in their infancy.

Ultimately for us the key virtue of combining different investment Factors is that they provide diversification of returns drivers to the portfolio. Each of these styles is expected to beat the market over the cycle but often the returns profiles of these styles are lumpy with long periods of underperformance being followed by rapid outperformance when the style is in favour. As Outcome Based Investors, that sort of return profile is unacceptable to us because we focus on making the journey to the outcome as palatable as possible. The good news for us is that because these styles are trying to do different things, they tend to do well and badly at different times. This allows us to create a diversified basket of style specific strategies that should preserve their various inherent tailwinds while reducing the volatility of the returns series to create a more efficient returns profile. The other good news for our clients, is that while style based investing may be in vogue today, we have been investing on this basis for the best part of two decades. A wider appreciation of Factor investing is welcome for us as it is likely to result in wider knowledge of this investment philosophy and should result in the growth of strategies available that are seeking to generate the required style return. It is then up to us to identify which strategies will be successful.

The Marketplace

- Sterling vs USD lowest since 1985, whilst UK equities reach record highs
- US economy adds 156,000 jobs in September
- Dollar rises as expectations converge on December rate hike
- ECB rumours trigger rise in global bond yields
- In commodities, oil rises and gold falls

Market Focus

UK

- Pound sterling fell to a 31-year low against the dollar last week, declining by 4.2% over the week to reach USD 1.24. Deutsche Bank analysis of year-to-date performance of 148 world currencies finds sterling joint 142nd from the bottom.
- On Thursday night a 'flash crash' occurred when the currency fell over 6% in a matter of minutes during a period of trading when market liquidity was at its lowest. Sterling reached lows of USD 1.18 before quickly recovering to USD 1.24. The cause is yet to be determined with computer algorithms, triggering of stop-loss orders, options contracts expiring and 'fat finger' errors all highlighted as potential culprits.
- The pound's weakness helped UK equities to a weekly gain of 2.2%, with indexes for large and mid-cap stocks reaching all-time highs.

US

- The September payroll figures showed 156,000 jobs were added throughout the month. This was slightly below the 170,000 forecast but still reflected relatively well on the health of the labour market. The unemployment rate also rose one-tenth to 5.0%, attributed largely to an increase in the labour market participation rate from 62.8% to 62.9%.
- The figures seemed to support most market analysts' expectations for the next base interest rate rise to occur in December; implied market probability stands at 64% at time of writing.
- This reduction in uncertainty amid unpredictable eco-political conditions in Europe helped the safe haven dollar to a 1.2% weekly rise against a basket of other currencies.

Europe

- A news story on Tuesday, citing unnamed officials from the European Central Bank, claimed that their bond-buying QE program could be wound down ahead of the program's scheduled March 2017 end.
- Investors reacted by selling government bonds, despite attempts by ECB spokespeople to dispel the speculation. Global government bond prices fell 1.7% over the week, including 1.1%, 1.7% and 0.8% falls for European government bonds, UK gilts and US Treasuries respectively, with the majority of movement occurring on Tuesday and Wednesday.

Commodities

- The rise in the US dollar index and suspected profit taking after its 18.4% year-to-date rise weighed on gold, with prices falling 4.5% over the week to USD 1,257 per ounce.
- Oil continued to rise after OPEC's initial agreement to curb production, and was also helped by an unexpected three million barrel drop in US crude oil inventories (for the week ending September 30th). Brent crude prices rose 5.8% over the five days to USD 51.93 per barrel.



Asset class/region	Currency	Currency returns			
		Week ending 07 October	Month to date	YTD 2016	12 months
Developed markets equities					
United States	USD	-0.6%	-0.6%	6.6%	9.6%
United Kingdom	GBP	2.2%	2.2%	16.9%	15.5%
Continental Europe	EUR	-0.5%	-0.5%	-4.2%	-1.8%
Japan	JPY	2.1%	2.1%	-10.9%	-7.5%
Asia Pacific (ex Japan)	USD	0.9%	0.9%	13.3%	11.6%
Australia	AUD	0.6%	0.6%	6.9%	10.0%
Global	USD	-0.7%	-0.7%	4.8%	5.7%
Emerging markets equities					
Emerging Europe	USD	2.0%	2.0%	17.0%	3.6%
Emerging Asia	USD	1.2%	1.2%	14.3%	10.7%
Emerging Latin America	USD	3.2%	3.2%	36.5%	20.8%
BRICs	USD	2.5%	2.5%	19.4%	11.4%
MENA countries	USD	0.0%	0.0%	-3.5%	-11.6%
South Africa	USD	-1.4%	-1.4%	21.2%	-1.9%
India	USD	1.0%	1.0%	10.1%	4.9%
Global emerging markets	USD	1.3%	1.3%	17.5%	10.1%
Bonds					
US Treasuries	USD	-0.8%	-0.8%	4.5%	3.5%
US Treasuries (inflation protected)	USD	-0.6%	-0.6%	7.0%	5.2%
US Corporate (investment grade)	USD	-0.5%	-0.5%	8.7%	7.7%
US High Yield	USD	0.5%	0.5%	15.6%	11.7%
UK Gilts	GBP	-1.7%	-1.7%	12.8%	12.1%
UK Corporate (investment grade)	GBP	-1.9%	-1.9%	11.6%	12.3%
Euro Government Bonds	EUR	-1.1%	-1.1%	5.3%	5.7%
Euro Corporate (investment grade)	EUR	-0.4%	-0.4%	5.6%	6.4%
Euro High Yield	EUR	0.3%	0.3%	7.3%	7.5%
Japanese Government	JPY	-0.3%	-0.3%	5.1%	6.1%
Australian Government	AUD	-1.2%	-1.2%	5.7%	5.3%
Global Government Bonds	USD	-1.7%	-1.7%	8.9%	7.2%
Global Bonds	USD	-1.3%	-1.3%	7.8%	6.2%
Global Convertible Bonds	USD	-0.6%	-0.6%	2.5%	2.5%
Emerging Market Bonds	USD	-0.4%	-0.4%	15.3%	14.5%

Source: Bloomberg



Asset class/region	Currency	Currency returns			
		Week ending 07 October	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	-5.3%	-5.3%	4.9%	7.7%
Australian Property Securities	AUD	-4.2%	-4.2%	5.9%	8.5%
Asia Property Securities	USD	-2.2%	-2.2%	7.3%	5.6%
Global Property Securities	USD	-4.3%	-4.3%	6.2%	7.1%
Currencies					
Euro	USD	-0.3%	-0.3%	3.2%	-0.3%
UK Pound Sterling	USD	-4.2%	-4.2%	-15.6%	-18.8%
Japanese Yen	USD	-1.5%	-1.5%	16.9%	16.6%
Australian Dollar	USD	-1.0%	-1.0%	4.1%	5.2%
South African Rand	USD	-1.2%	-1.2%	11.4%	-3.1%
Swiss Franc	USD	-0.6%	-0.6%	2.6%	-0.4%
Chinese Yuan	USD	-0.5%	-0.5%	-3.0%	-5.1%
Commodities & Alternatives					
Commodities	USD	0.6%	0.6%	9.9%	-5.5%
Agricultural Commodities	USD	0.0%	0.0%	-0.3%	-4.0%
Oil	USD	5.8%	5.8%	39.3%	1.2%
Gold	USD	-4.5%	-4.5%	18.4%	9.7%
Hedge funds	USD	0.1%	0.1%	1.2%	0.1%

Source: Bloomberg

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