

weekly digest

Week ending 30 October 2016

global investment management

Goals, Gilts and Goblins

The last day of October conjures up images of spooky spirits and grinning pumpkins. For many equity investors though, October's reputation for being more 'trick' than 'treat' perhaps inspires even greater fears. Some of the largest falls in equity markets have often come during the month: think 1987 or 2008. However, this seems to be more coincidental, rather than anything more sinister. Indeed global equities are only down 0.6% so far this month in local currency terms; it seems that like Halloween, there's not really much to be afraid of beyond the superficial. A wicked twist on this theme has taken place this year, however. That portion of portfolios that may have been expected to provide the most protection in a choppy month - government bonds - has actually proved to be the most ghastly. In the UK, for example, yields on ten-year Gilts have risen by 52 basis points so far in October, contributing to a decline of 4.2% for the UK government bond index.

These recent moves in bond markets globally highlight some real risks for investors, and go beyond spurious, autumnal return patterns. To be clear, however, we do not define risk as volatility; all returns will come with volatility which should in fact be welcomed to the extent that it creates investment opportunities. Rather, at Momentum we aim to help clients reach their financial goals, and not reaching those desired outcomes is the real risk to investors. Although we cannot fully control this risk, we can take steps to manage it. We broadly seek to do this in three ways.

Firstly, we seek high diversification in portfolios. As the cliché goes, there are no free lunches, but when investing diversification is as close to one as you will get. Genuine diversification requires a thorough understanding of underlying return drivers and how each investment might be expected to react under different market and economic conditions. Without this insight you will likely end up with a poorly diversified portfolio – one which is vulnerable to unnecessary drawdowns, despite on the face of it having exposure to multiple asset classes and investment holdings.

Secondly, it is critical to have a full understanding of what you're investing in. And if it's too complex don't invest. Whether you are selecting specific companies or investment managers who do that for you, it's imperative to fully understand what your holdings bring to the portfolio. We ensure that we understand the characteristics of the managers and assets that we invest in, from obvious style tilts to much more subtle biases. There are no shortcuts to achieving this understanding, but history often provides some guidance. Without this knowledge it makes it much harder to construct a truly robust, diversified portfolio and it increases the likelihood of nasty surprises.

Thirdly, invest with a margin of safety: even the best investment can be undone by the wrong valuation. We recognise that a 'one size fits all' approach doesn't work, so we invest in managers that have a wide range of approaches to valuing assets. Ultimately, however, our decision to invest in an asset class is driven by our own long-term valuation based approach to allocating capital. By focusing on asset classes that have at least reasonable valuations, while avoiding the most expensive areas, we believe we tilt the odds in our favour.

A lack of true diversification and overvaluation means that it is likely that the majority of investors probably have more risk in their portfolios than they appreciate. In both cases bond markets have arguably been the biggest culprits. Historically high-grade bonds provided meaningful diversification benefits, but they no longer have the same capacity for this, as around a quarter of developed market sovereign bonds now trade on negative yields. At Momentum we are increasingly looking beyond traditional asset classes and considering certain liquid alternative strategies, such as market neutral or risk premia funds. We are also considering gold, for its capacity to act as a potential hedge against tail risks. These alternatives should help smooth the path of returns and reduce the chances of nasty surprises when our investors review their account valuation. After all, we recognise that volatility does become a true form of risk when it causes an investor to sell out at the bottom - at which point achieving their goals becomes nigh on impossible.

The Marketplace

- US and UK Q3 GDP surprise to the upside
- FBI reopen Clinton email investigation; US markets falter
- Global bond yields continue to rise
- Europe shows signs of recovering economic activity
- Unsuccessful OPEC meeting sparks oil price fall

Market Focus

Global

- Sovereign bonds continued their sell-off throughout the week as prices declined and yields rose. Increasing expectations of a looming rate hike by the US Federal Reserve, and increasing speculation over the tapering of central bank QE programs seemed to be the main factors behind the moves.
- European Central Bank President Mario Draghi argued on Tuesday that achieving higher market rates “requires a focus on policies that can address the root causes of excess saving over investment - in other words, fiscal and structural policies.”
- Yields on 10-year Treasuries, bunds, and gilts rose by 9, 16, and 21 basis points respectively over the week. With respective yields now at 1.86%, 0.17% and 1.26%.

US

- A broadly positive week for US data was topped off with figures showing that the economy grew by 0.7% (or 2.9% annualised) over the third quarter – its fastest quarterly growth in two years and above the forecast for 2.5% annualised growth. A 10.0% annualized rise in exports was the main driver of the print.
- The GDP growth print was somewhat overshadowed by the FBI announcing that it was reopening its investigation into Presidential Candidate Hillary Clinton’s email account and use of a private server. The news sent US equities 0.3% lower on Friday, bringing their weekly loss to 0.7%.

Europe

- UK Q3 GDP grew 0.5% over the quarter, beating economist’s average forecast of 0.3%. On a yearly basis, GDP was 2.3% higher versus expectations of 2.1%. GDP has now grown for fifteen consecutive quarters.
- Meanwhile, the Purchasing Managers Index (PMI) readings for the Eurozone, a good proxy for general economic activity in the area, showed that the manufacturing and services PMIs both rose higher than forecasted, resulting in the composite PMI index rising 1.1 points to 53.7 versus 52.8 expected (with readings above 50 representing expansion).
- Despite this, UK and Continental European equities fell 0.3% and 0.8% over the week.

Commodities

- The price of Brent crude oil fell by 4.0% last week to USD 49.6 per barrel. This was predominantly due to OPEC discussions on Friday, which reportedly ended in deadlock with disputes over country level quotas as well as Russia’s oil minister on Tuesday saying that production cuts aren’t “an option for us.” Prices are down a further 2.9% at time of writing, over reports that non-OPEC countries had similarly unsuccessful negotiations on Saturday.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

Andrew Hardy (CFA) & Oliver Bickley



Asset class/region	Currency	Currency returns			
		Week ending 28 October	Month to date	YTD 2016	12 months
Developed markets equities					
United States	USD	-0.7%	-1.8%	5.3%	3.3%
United Kingdom	GBP	-0.3%	1.5%	16.1%	12.9%
Continental Europe	EUR	-0.8%	0.6%	-3.1%	-5.1%
Japan	JPY	2.0%	5.3%	-8.1%	-8.0%
Asia Pacific (ex Japan)	USD	-1.4%	-1.8%	10.3%	6.2%
Australia	AUD	-2.7%	-2.8%	3.3%	3.5%
Global	USD	-0.6%	-1.9%	3.5%	0.7%
Emerging markets equities					
Emerging Europe	USD	0.3%	0.9%	15.8%	2.5%
Emerging Asia	USD	-1.2%	-1.3%	11.5%	5.6%
Emerging Latin America	USD	0.0%	9.3%	44.6%	30.8%
BRICs	USD	-1.4%	1.0%	17.7%	10.2%
MENA countries	USD	2.6%	2.4%	-1.2%	-5.5%
South Africa	USD	-0.4%	-3.6%	18.5%	-4.1%
India	USD	-0.4%	0.1%	9.2%	4.0%
Global emerging markets	USD	-0.8%	0.1%	16.1%	7.5%
Bonds					
US Treasuries	USD	-0.6%	-1.4%	4.0%	3.1%
US Treasuries (inflation protected)	USD	-0.5%	-0.7%	7.0%	5.9%
US Corporate (investment grade)	USD	-0.8%	-0.9%	8.2%	6.7%
US High Yield	USD	-0.5%	0.7%	15.9%	10.5%
UK Gilts	GBP	-1.9%	-4.2%	9.9%	8.9%
UK Corporate (investment grade)	GBP	-1.3%	-3.7%	9.5%	9.5%
Euro Government Bonds	EUR	-1.3%	-2.2%	4.1%	2.9%
Euro Corporate (investment grade)	EUR	-0.6%	-0.8%	5.2%	4.8%
Euro High Yield	EUR	-0.1%	1.0%	8.1%	6.7%
Japanese Government	JPY	-0.1%	-0.4%	5.0%	5.7%
Australian Government	AUD	-0.5%	-2.2%	4.6%	3.7%
Global Government Bonds	USD	-1.0%	-3.7%	6.6%	5.1%
Global Bonds	USD	-0.7%	-2.9%	6.1%	4.5%
Global Convertible Bonds	USD	-0.4%	-1.7%	1.4%	-0.6%
Emerging Market Bonds	USD	-1.2%	-1.9%	13.5%	11.1%

Source: Bloomberg



Asset class/region	Currency	Currency returns			
		Week ending 28 October	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	-3.6%	-7.3%	2.7%	2.5%
Australian Property Securities	AUD	-3.9%	-9.2%	0.4%	-0.5%
Asia Property Securities	USD	0.2%	-1.7%	8.0%	3.8%
Global Property Securities	USD	-2.2%	-6.0%	4.2%	2.3%
Currencies					
Euro	USD	0.9%	-2.3%	1.2%	0.6%
UK Pound Sterling	USD	-0.3%	-6.1%	-17.3%	-20.1%
Japanese Yen	USD	-0.9%	-3.2%	14.9%	15.6%
Australian Dollar	USD	-0.1%	-0.8%	4.3%	6.8%
South African Rand	USD	1.1%	-0.7%	11.9%	-0.8%
Swiss Franc	USD	0.6%	-1.7%	1.5%	0.7%
Chinese Yuan	USD	-0.2%	-1.6%	-4.1%	-6.1%
Commodities & Alternatives					
Commodities	USD	-0.6%	0.7%	10.0%	-2.9%
Agricultural Commodities	USD	1.2%	3.6%	3.3%	0.3%
Oil	USD	-4.0%	1.3%	33.3%	1.3%
Gold	USD	0.7%	-3.1%	20.2%	10.3%
Hedge funds	USD	-0.4%	-0.4%	0.8%	-1.1%

Source: Bloomberg

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