momentum

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The long and short of Liquid Alternatives

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The growth of the liquid alternatives market has been significant in recent years and this has made it more accessible to a much wider range of investors. These strategies are often known as the "hedge funds for Main Street" due to various factors such as greater transparency, daily liquidity and lower fees. However, most of these strategies have failed to live up to expectations, with mediocre performance, particularly in 2018. In a year when equity markets fell, have they failed to provide the desired diversification, and should this be terminal for one's investment?

"These strategies are often known as the "hedge funds for Main Street""

The mistake made all too often by investors is to think of liquid alternatives as an outright hedge against market declines, rather than as a 'diversifier'. If you are bearish on stocks, then you want to be short and not 'alternative'. You should invest in alternatives because you believe they can deliver positive expected returns over time and provide diversification to traditional assets, hence be uncorrelated with your existing portfolio. This is particularly important for outcome base investment solutions as it would enhance the probability of achieving the objective whilst making the journey more palatable. An asset being uncorrelated simply means it is no more likely to go up when equity (risk assets) markets go down, as it is to go down when risk assets go up.

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As with all investments, one of the key questions to consider is what to do when the going gets tough. When these strategies struggle we should ask what is to come and not what's gone before; is this period of weak performance likely to persist? There is no simple answer here, but we should start by considering if the core thesis remains intact. Performance is part of this, but it is not the only component. We believe that short term performance - particularly where this performance is within statistical tolerance - is not in and of itself a sufficient reason to divest.

Investors need to ask questions like has the process changed? Has a key individual left? Has there been a change to the way the strategy is articulated? You need to reconsider the reasons that convinced you to invest in the first place. For example, if you believe that factors such as value, momentum and quality work over the long term, then it might be sensible to hold on during difficult times. For a strategy with a target volatility of circa 10%, you are going to lose money from time to time: note that most strategies do not preclude negative returns over say 12 months. When we look across the universe of alternative managers, we find that in 2018 most suffered moves that were big but within expectations. Although short term performance can be painful, ask yourself if it is really "off-the-chart" or is it within the expected bounds that happens on occasion. This should give one some comfort to stay invested.

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Investment returns are almost never linear (and if they were, this should be a warning sign in itself). Until now performance has been broadly within expectations hence in isolation this is not reason to change one's thesis. This doesn't mean hold on regardless: if the situation (the investment rationale) changes we need to change our mind. Ongoing monitoring remains key. This sector is however far from being homogenous and one can expect a wide dispersion of returns between different strategies. Liquid alternative managers are not one and the same, so it is critical to have blend of managers to mitigate single strategy risk.

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Market Focus

- UK PM May's Brexit Withdrawal Agreement rejected for a third time
- Q4 US growth revised lower
- Brent crude advanced 2.0%, ending the week at $68.4 per barrel
- Gold prices fell 1.5% to $1293 per ounce

US

- Revisions to fourth-quarter GDP showed the US economy grew 2.2% in the quarter, down from the previous estimate of 2.6% and leaves full-year growth at 2.9% for 2018
- Core PCE index, the Federal Reserve's preferred measure of inflation, rose 1.8% in January from a year earlier, easing to its weakest level in 11 months
- US Treasuries returned 0.4% last week with the yield on the 10-year Treasury falling 3.4 basis points to 2.41%
- US equities advanced 1.2% on the week

Rest of the World/Asia

- US officials reported progress in trade talks with China last week. Chinese equity markets posted mixed returns, with the benchmark index ending the week down 0.4%
- In Japan, parliament approved a record fiscal 2019 budget of ¥101.46 trillion. In terms of data, the unemployment rate fell to 2.3% in February from 2.5% in the prior month and industrial production picked up in February
- Turkey's benchmark stock index fell 6% on the week amid renewed volatility in the lira as the government directed the country's banks, ahead of the local elections, to withhold lira liquidity from the offshore swap market in an attempt to prevent the lira from falling sharply

UK

- On Friday MPs rejected Theresa May's EU withdrawal agreement on the day the UK was due to leave the EU. The government lost by 344 votes to 286, and PM May has until 12th April to seek a longer extension to the negotiation process to avoid a no-deal Brexit on that date
- Earlier in the week MPs voted on a series of indicative votes, and all eight alternative Brexit proposals were rejected by parliament. Further indicative votes on a way forward are scheduled to take place on Monday 1st April
- In terms of data, on an annual basis, UK Q4 GDP growth was revised upwards to 1.4% from the preliminary estimate of 1.3%
- UK manufacturing PMI rose sharply to 55.1 in March from 52.12 in February. Manufacturers stockpiling around Brexit uncertainty seen as a big driver of the move
- Following the turbulent week for British politics UK large-cap equities rose 1%, supported by a weaker pound. The British pound depreciated 1.6% against the US dollar

Europe

- On Wednesday, ECB President Draghi said the European Central Bank could further delay any plans to raise interest rates and may look at measures to mitigate the side-effects of negative interest rates warning that risk to growth were on the rise
- Germany's unemployment rate hit a new record low of 4.9% in March and retail sales rose on the month in February
- In France, the final GDP growth for 2018 was revised up to 1.6% from 1.5% previously
- Continental European equities rose 1.2% on the week

Past performance is not indicative of future returns.
Source: Bloomberg, returns in local currency unless otherwise stated.

Currency returns					
Asset class/region	Currency	Week ending 29 March	Month to date	YTD 2019	12 months
Developed markets equities					
United States	USD	1.2%	1.9%	13.5%	8.8%
United Kingdom	GBP	1.0%	3.2%	9.4%	7.6%
Continental Europe	EUR	1.2%	1.9%	12.4%	4.0%
Japan	JPY	-0.5%	0.1%	7.7%	-4.4%
Asia Pacific (ex Japan)	USD	-0.1%	1.5%	11.5%	-3.4%
Australia	AUD	-0.2%	0.7%	10.9%	12.1%
Global	USD	0.7%	1.3%	12.5%	4.1%
Emerging markets equities					
Emerging Europe	USD	-1.6%	-1.4%	7.8%	-7.2%
Emerging Asia	USD	-0.3%	1.8%	11.1%	-6.7%
Emerging Latin America	USD	1.3%	-2.5%	7.9%	-6.7%
BRICs	USD	0.7%	2.5%	14.0%	-3.5%
MENA countries	USD	0.5%	2.1%	7.9%	7.4%
South Africa	USD	1.0%	-1.7%	4.4%	-18.0%
India	USD	1.3%	10.1%	7.9%	9.4%
Global emerging markets	USD	-0.1%	0.8%	9.9%	-7.3%
Bonds					
US Treasuries	USD	0.4%	2.0%	2.2%	4.3%
US Treasuries (inflation protected)	USD	0.1%	1.9%	3.3%	2.7%
US Corporate (investment grade)	USD	0.5%	2.5%	5.1%	4.9%
US High Yield	USD	0.3%	0.9%	7.3%	5.9%
UK Gilts	GBP	-0.7%	3.5%	3.6%	3.9%
UK Corporate (investment grade)	GBP	-0.1%	2.6%	4.6%	3.8%
Euro Government Bonds	EUR	0.1%	1.8%	2.5%	2.0%
Euro Corporate (investment grade)	EUR	0.3%	1.4%	3.2%	2.3%
Euro High Yield	EUR	0.4%	1.1%	5.3%	1.8%
Japanese Government	JPY	0.2%	0.9%	1.7%	2.3%
Australian Government	AUD	0.4%	2.2%	4.1%	8.4%
Global Government Bonds	USD	-0.2%	1.4%	1.8%	-1.0%
Global Bonds	USD	0.0%	1.4%	2.3%	-0.3%
Global Convertible Bonds	USD	-0.7%	-0.4%	5.6%	-1.2%
Emerging Market Bonds	USD	0.4%	1.1%	6.2%	2.6%

Source: Bloomberg. **Past performance is not indicative of future returns.**

Currency returns					
Asset class/region	Currency	Week ending 29 March	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	1.2%	3.1%	15.9%	19.2%
Australian Property Securities	AUD	0.6%	6.0%	13.9%	20.3%
Asia Property Securities	USD	0.8%	6.1%	15.3%	9.1%
Global Property Securities	USD	1.0%	3.9%	14.5%	10.4%
Currencies					
Euro	USD	-0.7%	-1.4%	-2.0%	-8.7%
UK Pound Sterling	USD	-1.6%	-2.1%	1.9%	-7.3%
Japanese Yen	USD	-0.7%	0.5%	-1.0%	-3.9%
Australian Dollar	USD	0.2%	0.0%	0.8%	-7.5%
South African Rand	USD	0.4%	-2.4%	-0.2%	-17.9%
Swiss Franc	USD	-0.1%	0.2%	-1.3%	-3.9%
Chinese Yuan	USD	0.1%	-0.3%	2.5%	-6.1%
Commodities & Alternatives					
Commodities	USD	-0.6%	0.1%	9.0%	-2.7%
Agricultural Commodities	USD	-2.4%	-1.0%	-2.1%	-10.2%
Oil	USD	2.0%	3.6%	27.1%	-2.7%
Gold	USD	-1.5%	-1.7%	0.9%	-2.2%
Hedge funds	USD	-0.1%	0.0%	2.8%	-3.1%

Source: Bloomberg. Past performance is not indicative of future returns.

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