# weekly digest

momentum

05 November 2018

## All the leaves are brown

*Alex Harvey, CFA*

> *there is an economic rationale to the seasonal bias which is arguably clearest through the supply-and-demand driven pricing lens of commodity markets*

As I drove down the country lanes of West Sussex this weekend I couldn't help but notice how the seasons had shifted, having not visited this home from home for several weeks. It seemed clear this year's autumn season was a little late coming following the Indian summer we enjoyed in Britain. Extrapolating that to the current investment climate might seem far-fetched, but what can't be disputed is that an observable investment cycle exists, and that boom follows bust as sure as summer follows winter. Economic cycles are well studied beasts and their effects are felt by all, for better or worse, legitimising their place in economic study. However, a less well understood, and often disputed phenomenon, is that of seasonality. Should we as investors be more attentive to its effects?

That seasonality exists is undeniable. A cursory glance at the forward pricing for the NYMEX[1] natural gas future shows the annual peaks and troughs that correlate to seasonal pricing for the commodity. The causality here is self-evident as prices correlate with temperature. Gold also has a well-documented seasonal bias and is a market where jewellery accounted for more than half of global demand last year, with India being one of the largest consumers of the precious metal. There is an increase in demand ahead of the annual festival and wedding season which starts in October such that in Q4 2017 gold traded at a small premium in India over the international gold price as a result[2] .

> *Inflation has been shown to have a seasonal bias with US consumer prices tending on average to rise in the first half of the year and fall in the second*

What is evident above is that there is an economic rationale to the seasonal bias which is arguably clearest through the supply-and-demand driven pricing lens of commodity markets. When observing price returns on financial assets such as equities, bonds and currencies the dynamics are different, yet seasonality pervades these markets as well. Inflation has been shown to have a seasonal bias with US consumer prices tending on average to rise in the first half of the year and fall in the second. Market implied 'breakeven' rates – the difference between nominal and inflation linked bond yields – attest to this effect such that this seasonal bias is priced in; there is no arbitrage. There is an observed Yen effect through March largely attributed to Yen repatriation ahead of the Japanese fiscal year end. Conversely the currency is seasonally weakest through the end of the calendar year, coinciding neatly with the so called 'Santa rally' and 'January effect'. As a perceived safe-haven currency this might be expected.

> *Assigning order to something unordered gives us false comfort in understanding its behaviour. We risk mistaking cause for effect*

In equities and credit there is some evidence of seasonality, but we should be cautious of fitting patterns to series of returns, as our human behavioural biases tend us to do. Assigning order to something unordered gives us false comfort in understanding its behaviour. We risk mistaking cause for effect. The recent equity sell-off was a repricing triggered by higher treasury yields; it wasn't an 'October effect'. Technicals and timing are important considerations but as long-term investors we prefer to focus on valuations and fundamentals and believe it is important to stay invested through the cycle, with seasonal variation forming part of the investment weather which we know will blow in but is difficult to time or profit from. Thinking any different would be California Dreamin'.

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[1] The New York Mercantile Exchange

[2] Source: The World Gold Council (gold.org) – 'Gold demand trends full year2017', 6th Feb2018

# Market Focus

- Global indices rose in the week
- US employment data remains robust
- Brent crude fell 5.3% to $72.8 per barrel
- Gold ended the week 0.2% higher at 1232 per ounce

## US

- Nonfarm payrolls rose a stronger-than-expected 250,000 in October, versus 200,000 expected, while the unemployment rate held steady at 3.7%. Average hourly earnings reached 3.1% compared with a year ago
- 10-year Treasury yields rose 13.7 basis points, attributed to the strong nonfarm payrolls report boosting sentiment on the US economy
- US indices snapped their recent losing streaks with the FANG index up 2.79%, NASDAQ Composite Index up 2.65% and the Dow Jones Industrial Average up 2.36%
- October was the S&P 500's worst month since 2011, falling 6.94%, although rebounded this week up 2.42%
- The Russell 2000 index of small-cap US firms rose 4.32%, its best week since February

## UK

- As expected the Bank of England kept the Bank Rate unchanged at 0.75% and highlighted greater financial market uncertainty about future developments in the European Union withdrawal process
- FTSE 100 finished the week 2.23% higher, while UK Gilts fell 0.3%

## Europe

- Eurozone growth slowed to 0.2% on quarter in the three months to September 2018, following 0.4% in the previous quarter and missing expectations of 0.4%
- The Italy manufacturing Purchasing Managers' Index (PMI) fell to 49.2 in October, falling below the 50-point level separating expansion from contraction. This is its first month of contraction since August 2016
- European Stoxx 600 had its worst month since January 2016, down 5.63%, although rallied 3.33% this week

## Rest of the World/ Asia

- China's main stock market indexes and the yuan rallied on dissipating fears about the US-China trade war following a report that President Trump wants to reach a deal with China's President Xi Jinping when they meet at the G20 summit in Argentina later this month
- The yuan notched its biggest two-day advance in more than 11 years on Thursday and Friday, after hitting its weakest level in more than a decade versus the US dollar earlier in the week
- Shanghai Composite Index rose 3.0% for the week, closing at 2,676
- The China Caixin service PMI for October fell to 50.8 from 53.1 in September
- The Bank of Japan kept its ultra-easy monetary policies unchanged; maintaining the short-term interest rate at minus 0.1% and leaving the 10-year government bond yield target at around 0.0%
- Nikkei 225 Stock Average rallied 5.0% for the week, closing at 22,243

**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 02 November | Month to date | YTD 2018 | 12 months |
| **Developed markets equities** | | | | | |
| United States | USD | 2.4% | 3.1% | 3.0% | 7.0% |
| United Kingdom | GBP | 2.1% | 0.9% | -4.4% | -2.2% |
| Continental Europe | EUR | 3.3% | 2.5% | -4.1% | -6.8% |
| Japan | JPY | 3.9% | 4.4% | -6.9% | -5.6% |
| Asia Pacific (ex Japan) | USD | 6.4% | 6.5% | -11.6% | -9.2% |
| Australia | AUD | 3.3% | 2.1% | -0.2% | 2.9% |
| Global | USD | 2.8% | 3.1% | -1.6% | 1.6% |
| **Emerging markets equities** | | | | | |
| Emerging Europe | USD | 1.6% | 3.0% | -10.2% | -6.2% |
| Emerging Asia | USD | 5.7% | 7.4% | -13.1% | -11.4% |
| Emerging Latin America | USD | 2.3% | 3.9% | -1.5% | 0.2% |
| BRICs | USD | 6.0% | 7.7% | -10.3% | -7.9% |
| MENA countries | USD | 0.6% | 0.7% | 7.3% | 9.1% |
| South Africa | USD | 7.3% | 8.8% | -24.5% | -11.8% |
| India | USD | 5.5% | 3.8% | -11.1% | -9.2% |
| Global emerging markets | USD | 6.1% | 6.6% | -12.1% | -9.4% |
| **Bonds** | | | | | |
| US Treasuries | USD | -0.4% | -0.7% | -2.6% | -2.6% |
| US Treasuries (inflation protected) | USD | -0.6% | -1.0% | -3.0% | -2.1% |
| US Corporate (investment grade) | USD | -0.6% | -0.8% | -4.0% | -3.4% |
| US High Yield | USD | 0.0% | 0.2% | 1.1% | 1.2% |
| UK Gilts | GBP | -0.3% | -0.7% | -1.0% | 0.1% |
| UK Corporate (investment grade) | GBP | -0.4% | -0.5% | -2.0% | -1.0% |
| Euro Government Bonds | EUR | 0.2% | -0.2% | -0.7% | -1.2% |
| Euro Corporate (investment grade) | EUR | -0.2% | -0.1% | -0.9% | -1.4% |
| Euro High Yield | EUR | 0.3% | 0.4% | -1.1% | -1.7% |
| Japanese Government | JPY | -0.1% | -0.2% | -0.4% | -0.1% |
| Australian Government | AUD | -0.5% | -0.8% | 2.4% | 2.7% |
| Global Government Bonds | USD | -0.6% | -0.5% | -3.5% | -2.2% |
| Global Bonds | USD | -0.6% | -0.5% | -3.6% | -2.3% |
| Global Convertible Bonds | USD | 1.6% | 1.9% | -2.6% | -2.9% |
| Emerging Market Bonds | USD | 0.5% | 0.5% | -6.2% | -6.7% |

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

| Asset class/region | Currency | Currency returns | | | |
|---|---|---|---|---|---|
| | | Week ending 02 November | Month to date | YTD 2018 | 12 months |
| **Property** | | | | | |
| US Property Securities | USD | -2.0% | -1.0% | -2.4% | -1.6% |
| Australian Property Securities | AUD | -1.9% | -2.4% | -3.8% | 0.4% |
| Asia Property Securities | USD | 3.6% | 2.2% | -9.2% | -7.2% |
| Global Property Securities | USD | 0.4% | 0.6% | -5.6% | -2.5% |
| **Currencies** | | | | | |
| Euro | USD | 0.1% | 0.0% | -5.3% | -2.3% |
| UK Pound Sterling | USD | 1.0% | 1.2% | -4.2% | -0.7% |
| Japanese Yen | USD | -0.5% | -0.7% | -0.5% | 0.8% |
| Australian Dollar | USD | 1.6% | 1.7% | -8.0% | -6.8% |
| South African Rand | USD | 1.3% | 1.6% | -13.6% | -2.5% |
| Swiss Franc | USD | -0.4% | -0.2% | -3.0% | -0.4% |
| Chinese Yuan | USD | 0.8% | 1.0% | -5.5% | -4.0% |
| **Commodities & Alternatives** | | | | | |
| Commodities | USD | -1.3% | -0.8% | 1.3% | 4.9% |
| Agricultural Commodities | USD | 1.4% | 1.3% | -2.4% | -3.6% |
| Oil | USD | -5.3% | -5.8% | 8.9% | 20.1% |
| Gold | USD | 0.2% | 0.5% | -5.7% | -3.5% |
| Hedge funds | USD | 0.8% | 1.1% | -3.9% | -3.2% |

Source: Bloomberg.

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