weekly digest

momentum

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No shortcuts

Andrew Hardy, CFA

Hiring managers looking to bring someone into their business or team would naturally include an interview stage for promising candidates, which may consist of several rounds of face to face questioning and assessment. Why should the process of selecting third party investment managers consist of any less? Some asset managers do not emphasise this crucial part of the investment process enough. At Momentum we believe there is no substitute for extensive interaction with third party investment teams to determine their quality. The differences between good managers and the best are often subtle and hard to uncover, but they can quickly add up.

> *"there is no substitute for extensive interaction with third party investment teams to determine their quality"*

At its heart, we believe effective manager selection is about identifying the best stewards of capital for the long term. We seek consistency of philosophy and process, continuity of personnel, conviction in decisions and focus. The benefits should be obvious, and good investment returns tend to follow, but these characteristics are so often lacking. Quantitative analysis is a vital element of the selection process, but in isolation is never sufficient. As in sport, the track record keeps the score, but tells you little about how well the game was played or if someone is likely to win next time.

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One of the most important areas for discussion in research meetings is around positions held in a manager's portfolio. Do they have a clear rationale for each one that is consistent with their philosophy? Do they understand the economic drivers and risks intimately? Does the manager understand the investment well enough or are the analysts really calling the shots? Discussing many positions, past and present, as well as why they don't hold others that would fit their style, can identify patterns of behaviour or weaknesses in the process.

It's also valuable to discuss positions that didn't work out. What went wrong and what did they learn from it? Investment managers are often characterised as gung ho and arrogant, but the reality is the best of them usually have a massive dose of humility. Investing is about taking calculated risks and some will inevitably not play out as expected.

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It's also valuable to meet with several members of the investment team on an individual basis as this different angle usually uncovers new information. For example, other team members may take a different approach from the lead manager, or they may just be less scripted and more honest about the approach.

Numerous different lines of enquiry like this, over the course of many meetings, build up a complete picture of how a strategy is managed, along with inherent risks and opportunities. This thorough approach, which leads to our team conducting over 300 meetings with third party managers per year, is crucial in enabling us to maintain conviction with managers for the long term. We are far less likely to be surprised by strategy performance or manager actions, whereas investors that don't know their underlying holdings so well are more likely to sell after a period of underperformance, which is so often detrimental to long term performance. The search for replacement managers also consumes more time; as in life short cuts usually don't pay off.

> *"the average holding period for managers in our flagship global equity strategy is over six years"*

To conclude with some data, the average holding period for managers in our flagship global equity strategy is over six years, a factor that has doubtless contributed to its top quartile performance track record over the medium and long term. Similarly, linking back to the hiring manager analogy, the average tenure of investment team members at Momentum in London is over ten years. A thorough due diligence process at all levels is working for us and our clients.

Market Focus

- Stock markets fell sharply amid escalating trade tensions
- President Trump threatened tariffs on Mexico imports
- Brent crude tumbled 6.1%, ending the week at $64.5 per barrel
- Gold prices rose 1.6% to $1304 per ounce

US

- Stocks fell sharply following President Trump's announcement, through a tweet on Thursday, that the US would impose a 5% tariff on Mexican goods unless the Mexican government stopped the flow of unauthorized migrants across the border
- The trade conflict with China appeared to deepen as the tone of trade rhetoric grew sharper on both sides
- The Fed's preferred inflation gauge, core PCE, gained 1.6% year-over-year in April after rising 1.5% in March
- US Treasuries rallied on risk aversion. 10-year yields fell -19.6 basis points, but the real action was in the front end, where 2-year yields fell -24.2 basis points for their sharpest weekly move in almost 10 years
- Credit spreads staged their worst performance of the year, widening +38 basis points
- US large-cap equities fell -2.6% on the week, the worst weekly performance of the year and was the fourth consecutive weekly decline, a streak that hasn't occurred since October 2014

UK

- The newly-formed Brexit Party, led by populist Nigel Farage, took more than 30% of the vote in the UK European elections, while the Conservatives and Labour suffered heavy losses
- The UK large-cap index fell 1.5% on the week, while UK Gilts returned 0.5%

Europe

- European equities followed the US lower, declining -1.7% on the week
- Results from the EU elections showed the major established parties suffered big losses, as liberals, Greens and nationalists gained ground
- Germany's unemployment rate rose in May for the first time in five years, to 5%, up from 4.9% in April. German Bunds rallied, though not as sharply as Treasuries, with yields dropping -8.6 basis points to a new all-time low of -0.2%
- Italian BTPs notably underperformed, with yields rising +11.6 basis points, in the face of generalised safe haven flows into bonds

Rest of the World/Asia

- The Mexican peso declined 3% against the dollar in light of an escalation in trade tensions
- China's manufacturing activity contracted more than expected in May. The manufacturing PMI fell to 49.4 from April's 50.1
- Stocks in South Africa rose 2.2%, supported by President Cyril Ramaphosa cabinet appointments in the week
- Oil prices fell amid a smaller-than-expected decline in the US crude inventories and fears of a global economic slowdown