

Weekly Digest

Week ending **02 April 2017**

Said the bee to the hummingbird

In the time it takes for the Amethyst Woodstar hummingbird to flap its wings, an order routed on McKay Brothers' high speed network can travel from the Chicago Mercantile Exchange's (CME) data centre in Aurora, Illinois to the BATS/Direct Edge exchange in Secaucus, New Jersey. In fact, it is more than a third quicker if the male does indeed beat its wings at the suggested 80 times per second (the female of the species manages a still commendable 70). The irony is that while the hummingbird is famous for its ability to hover motionless, McKay Brothers say they want to move data at the speed of light.

Ultra-low 'latency' – the term used to refer the time taken for the transfer of data – has been the primary tool employed in recent years by high frequency trading firms (HFTs) to harness tiny and often temporary price discrepancies across different exchanges which can be exploited by computers thousands of times per second. In an article published in the Financial Times¹ last week we were told that the round trip latency today on the McKay Brothers' 'microwave route' is only fractionally slower than the predicted theoretical lowest latency of just under 8 milliseconds (125 flaps per second for the ornithologists amongst you).

Although you may know little about this type of 'algorithmic trading', these high volume low margin strategies now account for up to 40% of daily trading volumes in the US and have been widely blamed for momentary 'flash crashes' when markets gap sharply lower on seemingly little or no newsflow. Michael Lewis's 2014 book 'Flash Boys' provides a window into how this industry has evolved and how the pioneers stopped at nothing – literally boring through rock – to develop the most direct and fastest routes to market.

However, the current low volatility environment, coupled with something of a levelled and more populated playing field when it comes to a competitive speed advantage, means these firms are today focusing less on speed and more on developing their trading strategies; "To only have the speed without prediction is not as valuable", said Cameron Smith, president of Quantlab, a HFT company.

That may be true in theory but managers of the core portfolios would say that consistent 'prediction' is unachievable and that second guessing which direction prices will move cannot be a sustainable path to long term investment success. Indeed, these strategies are very much trading oriented and not investment led (and to be fair many would not purport them to be). Rather than trying to predict short term market returns, the managers prefer to play the longer game which they know increases the probability of long term success in achieving your investment goals. By constructing robust multi asset portfolios they can be increasingly confident over time that the portfolios' returns are likely to fall within the desired range, for a targeted level of risk. With limited visibility over the short term direction of markets, the managers prefer to use price volatility as an opportunity to further improve the probability of reaching the required goal, and by being a patient investor they are able to take advantage of more subtle distortions in risk premia that take longer to realise.

Perhaps in five or 10 years a trade might be able to round trip from Chicago to New Jersey in 5 milliseconds – the wingbeat of the humble bumblebee no less – but if you prefer more certainty over your future investment goals the portfolio managers think it's best to hum a slower tune.

1. 'Race for speed among Algo traders hits peak', March 30th 2017 <https://www.ft.com/content/6961129e-14fa-11e7-80f4-13e067d5072c>

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The Marketplace

- Strong finish to Q1 for equity markets
- US Q4 GDP growth revised upwards
- UK triggers Article 50
- China raises short term interest rates
- Euro area inflation below expectations in March

Market Focus

US

- After a minor correction in the week before last, US equities rose 0.8% last week to record a positive 0.1% return for March.
- Positive news included an upward revision of the Q4 2016 GDP growth number: from +1.9% to +2.1%, annualised. Personal consumption expenditure experienced the largest adjustment: up 0.5 to +3.5% annualised. This came after the US consumer confidence index rose 9.5 points to 125.6 on Tuesday; its highest level since December 2000.

Europe

- The headline euro area Consumer Price Index report showed consumer prices rising less than expected, at an annual rate of +1.5%, down from an annualised rate of +2.0% in February. The core rate, which excludes items like energy costs and food, also fell from +0.9% to +0.7%, its joint lowest level since April last year.
- The euro fell 0.9% on the day of the release, and finished the week 1.0% down versus the US dollar at USD 1.065.
- Continental European equities rose 1.5% for the week. Supporting economic data included German unemployment falling to 5.8%, a record low, as well as retail sales rising 1.8% in February, beating expectations of +0.7%.

- On Wednesday Sir Tim Barrow, the UK's Permanent Representative to the European Union, delivered a six page letter signed by UK Prime Minister Theresa May that documented the UK's intention to leave the EU and marks the official start date of the two year exit process.
- Markets were largely unchanged following the forewarned event, while it is unlikely that detailed negotiations will begin before June.
- UK equities fell 0.1% last week, while sterling rose 0.4% against the dollar, to USD 1.25.

Emerging Markets

- On Saturday the People's Bank of China increased interest rates on overnight, seven day, and one month loans to 3.3%, 3.45%, and 3.8%, respectively. The loans are aimed mainly at small and medium sized financial institutions.
- The March Purchasing Manager Index data out of China showed both the manufacturing and non-manufacturing indexes rising, by 0.2 and 0.9 points respectively, to 51.8 and 55.1.
- Despite this the Shanghai Composite index fell 1.0% on the day and 1.4% over the week.
- In South Africa equities fell 8.4% last week, while the South African Rand fell 7.2% against the US dollar, to ZAR 13.58. This followed the dismissal of nine cabinet members, including the Minister of Finance, by South African President Jacob Zuma. The governor of South Africa's central bank warned on Thursday that Mr Zuma's confrontation with his Finance Minister threatened to undermine the fight against high inflation levels.

Oil

- Brent crude oil prices rose 4.0% over the week to USD 52.83 per barrel. Valuations were buoyed by growing expectations that OPEC countries will extend their production cut past the current June deadline, as well as news that Libya, a member of OPEC, has curbed shipments from its largest oil field.

Alex Harvey (CFA) & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 31 Mar. 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.8%	0.1%	5.9%	16.4%
United Kingdom	GBP	-0.1%	1.2%	3.8%	23.5%
Continental Europe	EUR	1.5%	4.3%	6.9%	17.9%
Japan	JPY	-1.1%	-0.6%	0.6%	14.7%
Asia Pacific (ex Japan)	USD	0.2%	3.1%	12.8%	18.2%
Australia	AUD	2.0%	3.3%	4.8%	20.5%
Global	USD	0.5%	1.1%	6.4%	14.8%
Emerging Market Equities					
Emerging Europe	USD	-1.4%	1.7%	1.4%	11.3%
Emerging Asia	USD	-0.4%	3.3%	13.4%	18.0%
Emerging Latin America	USD	-0.4%	0.6%	12.1%	23.3%
BRICs	USD	-0.6%	1.7%	11.6%	23.4%
MENA countries	USD	0.4%	-0.3%	1.1%	12.9%
South Africa	USD	-8.4%	-0.3%	4.4%	8.1%
India	USD	1.6%	6.4%	17.8%	22.5%
Global Emerging Markets	USD	-1.1%	2.5%	11.4%	17.2%
Bonds					
US Treasuries	USD	0.0%	0.0%	0.7%	-1.5%
US Treasuries (inflation protected)	USD	-0.1%	0.0%	1.4%	1.5%
US Corporate (investment grade)	USD	0.1%	-0.2%	1.2%	3.3%
US High Yield	USD	0.9%	-0.2%	2.7%	16.4%
UK Gilts	GBP	0.8%	0.4%	1.6%	6.9%
UK Corporate (investment grade)	GBP	0.6%	0.2%	1.8%	9.3%
Euro Government Bonds	EUR	0.3%	-0.6%	-1.5%	-1.7%
Euro Corporate (investment grade)	EUR	0.4%	-0.4%	0.3%	2.5%
Euro High Yield	EUR	0.2%	0.0%	1.8%	9.0%
Japanese Government	JPY	-0.1%	-0.1%	-0.5%	-1.4%
Australian Government	AUD	0.4%	0.5%	1.3%	1.4%
Global Government Bonds	USD	-0.2%	0.1%	1.4%	-3.5%
Global Bonds	USD	-0.2%	0.1%	1.3%	-2.3%
Global Convertible Bonds	USD	0.3%	0.8%	3.8%	4.2%
Emerging Market Bonds	USD	-0.3%	0.3%	3.8%	7.4%

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Asset Class/Region	Currency	Currency returns			
		Week ending 31 Mar. 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	0.8%	-2.5%	0.7%	1.9%
Australian Property Securities	AUD	1.3%	0.6%	-1.1%	1.3%
Asia Property Securities	USD	-1.8%	0.8%	9.1%	10.3%
Global Property Securities	USD	0.0%	-0.7%	3.7%	3.5%
Currencies					
Euro	USD	-1.0%	0.8%	1.7%	-6.0%
UK Pound Sterling	USD	0.4%	1.0%	1.5%	-12.7%
Japanese Yen	USD	-0.4%	0.6%	5.1%	1.1%
Australian Dollar	USD	0.3%	-0.4%	6.2%	-0.1%
South African Rand	USD	-7.2%	-2.2%	2.1%	10.1%
Swiss Franc	USD	-1.0%	0.3%	1.9%	-3.8%
Chinese Yuan	USD	0.1%	-0.2%	1.1%	-6.2%
Commodities & Alternatives					
Commodities	USD	1.5%	-2.9%	-1.7%	12.4%
Agricultural Commodities	USD	-1.1%	-3.2%	-0.3%	2.0%
Oil	USD	4.0%	-5.0%	-7.0%	33.4%
Gold	USD	0.1%	-0.5%	8.5%	1.4%
Hedge funds	USD	0.2%	0.0%	1.7%	6.2%

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