

Weekly Digest

Week ending 2 July 2017

Investing for a net gain

As today marks the start of a fortnight's tennis at the Wimbledon championship, it seems apt to look at parallels we can draw between the championship and investing.

The surface changes – you need to adapt your game – Wimbledon's grass is a living surface and as a result it changes substantially over the course of the tournament. The ball in early matches will skid more whereas by the end of the tournament the ground is firmer and the ball bounces more. A player who is unable to adapt to these incremental changes as the tournament progresses will not win. While markets are not alive, they are always evolving and an investment manager who does not adapt their approach in the face of an ever changing landscape will likely be unable to achieve long term, sustainable returns. While the manager of the core portfolios actively seek out investment managers who have a clear philosophy and process that they do not waver from, the application of subtle details must have sufficient flexibility and pragmatism built in to ensure that a manager is not caught out by evolving conditions.

Every point counts – The 2010 Men's singles match between Isner and Mahut took over 11 hours across three days. There were no fewer than 138 games in the final set which Isner won 70 games to 68. In such an epic match it would have been all too easy for either of the players to give up mentally or to coast but tennis is a sport that punishes such lapses because until a match is mathematically won it can be turned around point by painstaking point. That dogged spirit, attention to detail and need for constant focus is also applicable to investments. Once a holding is in a portfolio it would be easy for an investor to get comfortable with it and to take its presence as a given. However, if a holding is not regularly assessed from first principles (as an asset that is not held in the portfolio would be) the rationale for the holding can gradually, imperceptibly, degrade and a portfolio can become home to sub optimal and potentially risky positions. An investor should regularly appraise holdings and potential holdings from first principles to check that the rationale for purchasing a holding in the first place still holds true today.

Winning at the loser's game – to paraphrase Charles D Ellis' excellent book – average tennis players should stop trying to hit

winners and focus on getting the ball back over the net because the chances are their opponent will eventually lose the point by hitting a dud shot. In elite tennis it is different because both players are capable of hitting winners and therefore that is their aim rather than avoiding losing. For investors it is an important lesson to not be over confident and to favour consistency over trying for glamorous winners that can go spectacularly wrong. We must be acutely aware of our limitations and create a process with sufficient checks, balances and robustness as so to minimise the potential impact of these inherent shortcomings.

Don't let rain stop play – Centre court had a roof installed for the 2009 championships. This enables play to continue regardless of the famously changeable English summer weather. The roof is essentially a hedge. The preference is for an open court, but the organisers have a roof to provide protection should the less preferred outcome (inclement weather) happen. In investment portfolios we invest for the base case but we do not want to build fickle investment portfolios that only work in that one scenario. As a result the managers have positions in portfolios that provide a hedging role. Government bonds, for example, are expensive but they still provide an effective event risk hedge. Similarly, while they believe that equity markets remain the most important source of portfolio returns in the foreseeable future, valuations are through fair value and the market seems somewhat complacent. As a result the portfolio managers have bought some put options in the portfolios, where possible, to reduce susceptibility to potential market downsides whilst keeping exposure to potential market gains.

Wildcards don't often win but surprises do happen – with the exception of Goran Ivanišević's popular win in 2001 lowly ranked players tend not to win grand slams. Likewise, in investments, it pays to do detailed research to identify the managers and the strategies that give the best chance of achieving the required goal. Choosing investments without the necessary quality of research introduces elements of randomness into the selection process that reduces the chance of consistently picking winners. From time to time the manager will be surprised by an outsider such as Goran but on the whole they believe their process effectively directs them to the best managers and investment opportunities.

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The Marketplace

- Oil prices climb around 5% last week
- Volatility makes a comeback moving to 10.9 on the VIX index
- Global equities trading near record highs
- Technology stocks under pressure with continued sell offs
- Central banks adopt a hawkish tone around fiscal tightening

Market Focus

US

- C.~175,000 workers added to the payroll in June pointing to a healthy labour market
- The S&P 500 Index was down -0.6% on the week, it's worst since April mainly on tech sector sell offs
- The Dow Jones was down -0.2%
- Bonds steadied after yields rose across global markets. Treasuries up 16bps on the week to 2.3%, the steepest gain since March
- GDP for the first quarter revised to 1.4% from 1.2% on the back of increased consumer spending. Estimates were as low as 0.7% in April

UK

- Theresa May gets through her Queen's Speech facing down a challenge to abolish the 1% cap on public sector wage increases, though political pressure is still mounting
- 10yr Gilts rose 22.6bps to 1.3% during the week
- Manufacturing fell below forecast during June. PMI (Purchasing Manager's Index) at 54.3. Factory orders the lowest in 11 months. PMI data on services due this Wednesday.

- Chancellor Philip Hammond will use his speech to the CBI to strike a more conciliatory tone to British business which has so far appeared side-lined in Brexit negotiations
- A delegation from the City of London is due to head to Brussels with a secret blueprint for a post Brexit free trade deal for financial services
- UK Equities fell 1.4% over the week
- BoE mulls interest rate rise amid inflation fears

Europe

- Euro maintains its position as the strongest performing major currency this year
- Continued sell offs in European bonds
- 10yr Bunds rose 21.2bps to 0.47%
- Manufacturing pace goes from strength to strength. PMI climbs to 57.4 in June from 57 in May.
- Mario Draghi gave a speech last Tuesday to central bankers, indicating a potential curb on the European Central Bank's asset-buying program
- DAX falls -3.2% and the CAC40 -2.8% on the week

Asia

- Japan's TOPIX rises on growing manufacturing confidence. Ruling party loses the Tokyo Metropolitan Assembly election. The market reaction has been muted so far.
- Nikkei closes -0.4% on the week
- Hang Seng closes the week up +0.4%
- China opens its USD9 trillion bond market to foreign institutional investors for the first time.
- Chinese manufacturing exceeded estimates.

James Klempster (CFA) & James Jones

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Asset Class/Region	Currency	Currency returns			
		Week ending 30 June 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-0.6%	0.6%	9.0%	17.2%
United Kingdom	GBP	-1.4%	-2.5%	4.6%	16.7%
Continental Europe	EUR	-2.4%	-2.2%	8.7%	21.1%
Japan	JPY	0.1%	3.0%	7.4%	32.2%
Asia Pacific (ex Japan)	USD	0.2%	1.8%	19.8%	25.0%
Australia	AUD	0.3%	0.2%	3.2%	14.1%
Global	USD	-0.4%	0.4%	10.7%	18.2%
Emerging Market Equities					
Emerging Europe	USD	1.3%	-0.5%	3.8%	18.6%
Emerging Asia	USD	-0.2%	1.7%	23.2%	27.9%
Emerging Latin America	USD	2.2%	0.7%	10.1%	15.0%
BRICs	USD	0.1%	0.7%	16.8%	25.4%
MENA countries	USD	0.1%	3.1%	4.1%	14.0%
South Africa	USD	-2.0%	-3.8%	8.0%	10.2%
India	USD	-1.2%	-1.3%	22.6%	21.0%
Global Emerging Markets	USD	0.1%	1.0%	18.4%	23.7%
Bonds					
US Treasuries	USD	-0.7%	-0.1%	2.0%	-2.5%
US Treasuries (inflation protected)	USD	-0.8%	-1.0%	0.9%	-0.7%
US Corporate (investment grade)	USD	-0.6%	0.3%	3.8%	2.3%
US High Yield	USD	0.3%	0.1%	4.9%	12.7%
UK Gilts	GBP	-2.2%	-2.0%	0.2%	-1.1%
UK Corporate (investment grade)	GBP	-1.5%	-1.1%	2.3%	5.5%
Euro Government Bonds	EUR	-1.4%	-0.5%	-1.0%	-3.3%
Euro Corporate (investment grade)	EUR	-0.8%	-0.6%	0.6%	1.3%
Euro High Yield	EUR	-0.2%	0.3%	4.2%	9.7%
Japanese Government	JPY	-0.4%	-0.3%	-0.4%	-4.3%
Australian Government	AUD	-1.2%	-1.1%	2.4%	-0.9%
Global Government Bonds	USD	-0.5%	-0.2%	4.1%	-4.4%
Global Bonds	USD	-0.1%	0.2%	4.5%	-1.7%
Global Convertible Bonds	USD	-0.5%	-0.4%	6.9%	7.8%
Emerging Market Bonds	USD	-0.6%	-0.4%	6.3%	3.7%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-1.2%	2.0%	2.0%	-3.1%
Australian Property Securities	AUD	-4.9%	-6.3%	-6.0%	-10.6%
Asia Property Securities	USD	-0.8%	-0.4%	15.8%	14.5%
Global Property Securities	USD	-0.8%	1.0%	8.0%	4.0%
Currencies					
Euro	USD	1.9%	1.6%	8.5%	2.8%
UK Pound Sterling	USD	2.3%	0.9%	5.3%	-2.3%
Japanese Yen	USD	-0.9%	-1.5%	4.1%	-8.2%
Australian Dollar	USD	1.3%	3.3%	6.7%	3.0%
South African Rand	USD	-1.1%	0.7%	4.8%	12.8%
Swiss Franc	USD	1.1%	0.9%	6.2%	1.8%
Chinese Yuan	USD	0.8%	0.8%	2.7%	-1.8%
Commodities & Alternatives					
Commodities	USD	4.4%	-0.4%	-5.8%	-3.6%
Agricultural Commodities	USD	4.9%	3.4%	1.4%	-1.5%
Oil	USD	5.2%	-4.8%	-15.7%	-3.5%
Gold	USD	-1.0%	-2.2%	7.8%	-6.0%
Hedge funds	USD	-0.1%	0.3%	2.7%	6.1%

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