

# Weekly Digest

Week ending 3 July 2016

## A game plan to avoid England's mistakes

While in the midst of UEFA Euro 2016, it is a good opportunity to unpack the England football team's abject failure and to look for any positive investment lessons that can be drawn from the debacle.

**Have a good strategy and execute.** This is key. The England team looked bereft of true leadership and had no definitive strategy, formation, or game plan. It is important to be flexible when the environment necessitates it, but it must only be a means to improve the chances of achieving the desired outcome. A lack of clarity, and change for the sake of it, does not help a team (or a portfolio) gel. What is more, for investors, changes are not costless and so having a strategy in place that will generate the desired returns through a broad mix of market conditions reduces the need to chop and change a portfolio. Knowing what outcome you want to achieve at the outset helps in this regard.

**Don't underestimate the risks you don't know.** Being overconfident leaves us vulnerable to surprises. Just because you haven't considered a risk does not mean it cannot be very impactful on your portfolio. So try to consider how you can be wrong in terms of your strategy and what you can have in place to protect you should things not pan out how you expect.

**Be adaptable.** As a fund manager you are faced with a difficult decision if a strategy is not working. Stick dogmatically with what you are doing or try something new. There are times when it is right to stick to a plan but some managers cross the line from healthy persistence to obstinacy and so it is crucial to identify managers that will not change on a sixpence, but that have sufficient humility to know when to call it a day on a particular tactic.

**Alignment of incentives.** It is difficult to see why a footballer, who earns a fortune playing for his club would put his body on the line for the national team, where the direct rewards are more meagre. The same applies to investment managers. Ideally a manager would be invested in their strategy and have structures in place to ensure that their interests are aligned with their clients. If you are invested in a strategy that is not key to a fund manager's personal wealth or success then there is a risk that you are overlooked.

**Ensure the total is greater than the sum of the parts.** We are told time and time again that England have a large number of world class players in the squad. The team's value, in combination, was far less than the sum of the parts. Investors must look to do the opposite. We must always consider the totality of the portfolios we manage rather than simply populating every segment of the fund with the 'best' possible holdings. For example choosing certain bond and equity strategies may leave a portfolio overly sensitive to the oil price or an unpredictable exogenous shock that would only be apparent if a portfolio is assessed from the top down as well as the bottom up. Ultimately the key is having the right people in the right position and this is true for sport and fund management.

**Select on form not reputation.** The only guarantee for players and fund managers is that you can't buy past performance. As a result you need to select the team that you think will perform best together on the day rather than using stars that were in their heyday last season or market cycle.

## The Marketplace

- Rating agencies cut UK credit rating
- Global equity markets rebound
- European bank stock fragility continues
- Commodities record broad gains
- Mixed results in China's monthly PMI data

## Market Focus

### UK

- On Monday S&P cut its UK credit rating two notches from AAA to AA, whilst Fitch cut the UK's rating from AA+ to AA. Both agencies cited implications of the UK leaving the EU as the primary reason behind the downgrade.
- Bank of England governor Mark Carney hinted towards the use of looser monetary policy to stabilise UK financial markets. As a result the market's implied probability of a July rate cut rose to 62% (it was a mere 11% pre-referendum).
- Sterling depreciated another 3% against the dollar throughout the week, and is now down 9.9% year-to-date.

### Global

- European equity markets were boosted by the prospect of central bank stimulus following the UK referendum. Continental Europe gained 3.1%, whilst UK equities gained 7.2%.
- In the US, markets are now not expecting a Federal Reserve rate hike until October 2018, this prospect of sustained low rates helped to push US equities to a 3.3% weekly rise.

- Japanese and global emerging market equities also benefitted from the improved sentiment, with rises of 4.3% and 4.4%, respectively.

### Europe

- The Euro Stoxx Banks index lost 0.9% last week amid fears surrounding economic growth and lending conditions resulting from the 'Brexit' outcome. This leaves the index down by nearly 19% from pre-referendum levels.
- Italian banks fared worst, as reports quoting the presence of USD 401 billion of bad debts raised fears of a domestic banking fallout.

### China

- Two reports for June's manufacturing Purchasing Managers Index (PMI) came in at 50.0 (down from May's 50.1) and 48.6 (down from 49.2). A number below 50 represents contraction, thus the two reports illustrate the slowdown in Chinese manufacturing.
- The non-manufacturing PMI number rose 0.6 points to 53.7, the highest level since March. The contrasting results could somewhat illustrate China's ongoing attempts to move to a more service based economy.

### China

- The broad commodities index gained 2.6% last week: metals outperformed, with gold, silver and nickel rising 2.0%, 11.4% and 6.2% respectively. Brent crude oil rose 4.0% to finish the week slightly above USD 50 per barrel.

*James Klempster, CFA & Jonathan Adamson*

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Asset Class/Region	Currency	Currency returns			
		Week ending 1 July 2016	Month to date	YTD 2016	12 months
<b>Developed Market Equities</b>					
United States	USD	3.3%	0.2%	3.7%	2.8%
United Kingdom	GBP	7.2%	1.1%	8.1%	3.2%
Continental Europe	EUR	3.1%	0.9%	-7.2%	-11.2%
Japan	JPY	4.3%	0.7%	-18.0%	-21.7%
Asia Pacific (ex Japan)	USD	3.9%	0.6%	2.9%	-10.1%
Australia	AUD	2.8%	0.3%	1.3%	-0.2%
Global	USD	3.3%	0.4%	1.1%	-3.0%
<b>Emerging Market Equities</b>					
Emerging Europe	USD	2.0%	0.2%	10.1%	-10.9%
Emerging Asia	USD	4.4%	0.7%	2.9%	-12.0%
Emerging Latin America	USD	7.0%	0.7%	26.3%	-6.0%
BRICs	USD	4.2%	0.2%	4.7%	-16.3%
MENA countries	USD	-0.9%	0.0%	-0.8%	-18.4%
South Africa	USD	4.4%	0.8%	16.5%	-14.3%
India	USD	4.0%	1.0%	4.1%	-5.6%
Global Emerging Markets	USD	4.4%	0.6%	7.1%	-11.5%
<b>Bonds</b>					
US Treasuries	USD	0.9%	0.2%	6.0%	7.5%
US Treasuries (inflation protected)	USD	1.4%	0.6%	7.2%	5.8%
US Corporate (investment grade)	USD	0.8%	0.0%	7.7%	8.4%
US High Yield	USD	0.2%	0.0%	9.1%	1.4%
UK Gilts	GBP	2.8%	0.4%	12.6%	15.6%
UK Corporate (investment grade)	GBP	2.3%	0.8%	8.1%	10.2%
Euro Government Bonds	EUR	1.6%	0.2%	5.9%	9.3%
Euro Corporate (investment grade)	EUR	0.8%	0.2%	4.3%	5.4%
Euro High Yield	EUR	1.1%	0.5%	4.1%	3.5%
Japanese Government	JPY	0.5%	0.3%	8.1%	10.5%
Australian Government	AUD	0.3%	0.2%	6.3%	8.6%
Global Government Bonds	USD	0.8%	0.2%	10.8%	12.4%
Global Bonds	USD	0.8%	0.3%	8.6%	9.3%
Global Convertible Bonds	USD	0.9%	0.3%	-0.3%	-1.8%
Emerging Market Bonds	USD	2.7%	0.6%	12.9%	13.8%

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Asset Class/Region	Currency	Currency returns			
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<b>Property</b>					
US Property Securities	USD	4.5%	0.1%	12.9%	20.6%
Australian Property Securities	AUD	3.3%	1.1%	14.9%	18.5%
Asia Property Securities	USD	4.8%	0.1%	3.2%	-5.2%
Global Property Securities	USD	4.2%	0.3%	9.2%	10.1%
<b>Currencies</b>					
Euro	USD	0.2%	0.3%	2.6%	0.8%
UK Pound Sterling	USD	-3.0%	-0.3%	-9.9%	-15.0%
Japanese Yen	USD	-0.3%	0.6%	17.3%	20.1%
Australian Dollar	USD	0.3%	0.6%	2.9%	-1.9%
South African Rand	USD	4.1%	1.1%	6.2%	-15.9%
Swiss Franc	USD	-0.1%	0.2%	2.9%	-2.6%
Chinese Yuan	USD	-0.5%	-0.2%	-2.4%	-6.9%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	2.6%	1.0%	12.0%	-15.4%
Agricultural Commodities	USD	-0.6%	-0.7%	4.4%	-9.1%
Oil	USD	4.0%	1.3%	35.1%	-18.8%
Gold	USD	2.0%	1.5%	26.4%	14.8%
Hedge funds	USD	0.9%	0.0%	-1.0%	-5.7%

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