

Weekly Digest

Week ending 5 June 2016

Investing for an outcome

Today investors are confronted by a vast multitude of market issues, economic issues, political issues and so on. We believe that, while all of these are undeniably important, the key problem faced today is that the vast majority of people are on the hook for their own retirement and they are substantially under-saved. The age of final salary pensions is over and so the advice and investment process must focus on doing the right thing for clients: to enable them to retire with the level of wealth that they need at the time that they want to retire.

This brings us neatly to outcomes based investing. The whole purpose of this philosophy is that it shifts the investment process into alignment with the needs and desires of the ultimate client in a framework that they can understand. No one contemplates their long term savings and worries about an annualised volatility number or a Sharpe ratio, but people do understand that they need to achieve returns. The key question for the managers of our core portfolios, is whether they can deliver that without taking undue levels of risk for clients. It is about moving people away from 'accidental' returns to targeted returns, or outcomes.

There are a lot of funds today that either target a risk level or a tracking error level or a certain level of outperformance versus a particular index. All of these approaches run the risk of 'accidental' returns because the reference they make is the wrong target for the client. For example, a risk targeting fund commits to achieving a certain risk level, but does not commit to a return outcome. Funds that focus solely on tracking error worry about the potentially arbitrary performance of a market benchmark and so, again, the actual outcome is accidental. Outcomes based investing is all about investing for the client's goals and keeping the client invested on the journey to the outcome. It is about being sensible, prudent and making sure that clients fully understand risks and characteristics at the outset.

Outcomes based solutions requires investing for the right reasons for the long term. The managers of our core portfolios are firmly valuation driven and to that end they scour their investable universe for markets that offer good value – that is they are priced below their intrinsic value. They identify those that are sufficiently attractive to warrant further consideration and then they create a combination of assets that they believe will generate returns in line with the required outcome, whilst sitting within their mandated risk bands. They are relatively circumspect when they do this modelling; they do not extrapolate time series and assume that everything is going to continue in a positive growth environment indefinitely. They are much more likely to assume mean reversion which penalises data series that are getting ahead of themselves. They would much rather be a little pessimistic with respect to all asset classes and consequently be surprised on the upside rather than the downside.

They invest for the base case but they also model up and down scenarios to give them a feeling of the skew of returns that they are accepting by buying a certain asset class. They have an internally generated hurdle rate which illustrates attractiveness in the context of the amount of risk a particular position brings to the table. Risk management is an integral part of their portfolio management process. They look at what each position does to the overall risk and expected returns of the portfolio to ensure they do not overly concentrate their portfolio in terms of any idiosyncratic risks. In an environment where there is so much noise and in a world where retirement savings are a confusing necessity, they believe that outcome based investment will become increasingly popular with investors and advisers alike.

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The Marketplace

- Polls suggest lead for “Brexit”
- US payrolls show a mere 38,000 jobs added
- Poor week for European equities, while bunds rally
- Gold ends its losing streak; rallies on Friday
- Oil reaches USD 50 per barrel

Market Focus

UK

- Polls by ICM Unlimited, both over the phone and online, showed a lead for the “Brexit” campaign in the EU Referendum vote. After these results were released on Tuesday (31 May), the pound slid by 1.1% against the US dollar.

US

- The positive news out of the US early in the week, including increased consumer confidence and spending in April, was vastly overshadowed by Friday’s non-farm payrolls report. During May only 38,000 jobs were added, while market expectations were for 160,000 additional jobs. This is the lowest number since September 2010. At the same time the unemployment rate came in at 4.7%, down from 5.0% in April and beating expectations of 4.9%.
- In response to the payrolls report, yields on 10-year US Treasuries fell by 0.1% on Friday: the greatest falls since early February. Another effect was a dramatic decrease in expectations for an interest rate hike by the Federal Reserve over the summer: the probability of a hike in July sat at 27.0% at the end of Friday, after having been 54.8% just 24 hours earlier.

Europe

- The Eurozone economic sentiment index value for May was released at the beginning of the week, showing a gain of 0.7 points during the month. April’s euro area unemployment reading came in at 10.2%, unchanged from March. Meanwhile Germany’s 6.1% rate fell by 0.1% from the previous month.
- Despite this positive data the week saw an overall risk-off shift, with the Stoxx 600 equity index falling by 2.4%. This move took German bund yields further down, while the 8- and 9-year maturity bonds reached all-time historical lows.

Commodities

- After nine consecutive days of losses, and having fallen 6.9% from April’s high, gold rallied by 0.9% on Tuesday (31 May 2016). This gain was compounded on Friday after the poor US Payrolls number caused a rush to safe haven assets, including a further 2.6% gain for gold: the biggest daily gain since early February.
- The meeting of the Organisation for Petroleum Exporting Countries (OPEC) meeting on Thursday was a source of nervousness in oil markets at the start of the week, but suggestions that certain nations were willing to consider the proposed production ceiling buoyed the price. Despite no such freeze materialising, positive rhetoric after the meeting led to a gain for oil on Thursday, with Brent crude pricing above USD 50 per barrel: a closing price not seen since November 2015.

James Klempster, CFA & Jonathan Adamson

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Asset Class/Region	Currency	Currency returns			
		Week ending 3 June 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	0.0%	0.1%	3.4%	0.8%
United Kingdom	GBP	-0.9%	-0.3%	1.6%	-7.7%
Continental Europe	EUR	-1.9%	-1.5%	-5.0%	-11.4%
Japan	JPY	-0.9%	-3.1%	-12.7%	-18.2%
Asia Pacific (ex Japan)	USD	0.8%	0.4%	0.7%	-14.4%
Australia	AUD	-1.6%	-1.1%	2.5%	-0.1%
Global	USD	0.2%	0.3%	2.1%	-4.3%
Emerging Market Equities					
Emerging Europe	USD	-0.5%	0.5%	11.1%	-12.4%
Emerging Asia	USD	0.8%	0.4%	-0.1%	-16.7%
Emerging Latin America	USD	2.2%	3.2%	16.2%	-15.0%
BRICs	USD	0.9%	0.5%	1.2%	-21.5%
MENA countries	USD	-0.4%	0.4%	-1.1%	-21.5%
South Africa	USD	4.3%	5.2%	13.0%	-13.5%
India	USD	1.1%	1.1%	2.9%	-2.0%
Global Emerging Markets	USD	1.1%	1.1%	3.5%	-16.0%
Bonds					
US Treasuries	USD	0.9%	0.8%	4.1%	5.6%
US Treasuries (inflation protected)	USD	0.7%	0.8%	5.1%	4.1%
US Corporate (investment grade)	USD	0.9%	0.8%	6.1%	6.2%
US High Yield	USD	0.2%	0.0%	8.1%	-0.5%
UK Gilts	GBP	1.7%	1.5%	7.4%	10.1%
UK Corporate (investment grade)	GBP	1.2%	1.2%	5.7%	6.5%
Euro Government Bonds	EUR	0.4%	0.4%	3.8%	6.2%
Euro Corporate (investment grade)	EUR	0.4%	0.3%	3.4%	3.7%
Euro High Yield	EUR	0.3%	0.1%	4.4%	2.4%
Japanese Government	JPY	-0.1%	-0.1%	6.1%	8.6%
Australian Government	AUD	0.2%	0.5%	4.6%	6.5%
Global Government Bonds	USD	1.7%	1.9%	8.8%	10.0%
Global Bonds	USD	1.4%	1.5%	7.3%	7.4%
Global Convertible Bonds	USD	0.7%	0.8%	1.0%	-2.8%
Emerging Market Bonds	USD	1.1%	1.2%	8.7%	8.5%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	0.9%	0.9%	6.6%	11.5%
Australian Property Securities	AUD	-0.2%	-0.2%	11.1%	12.6%
Asia Property Securities	USD	2.0%	1.4%	1.9%	-10.0%
Global Property Securities	USD	0.2%	0.1%	5.1%	2.5%
Currencies					
Euro	USD	2.3%	2.2%	4.7%	0.8%
UK Pound Sterling	USD	-0.6%	0.3%	-1.4%	-5.3%
Japanese Yen	USD	3.5%	3.9%	12.9%	16.6%
Australian Dollar	USD	2.6%	1.9%	1.1%	-5.4%
South African Rand	USD	4.2%	4.1%	2.5%	-18.4%
Swiss Franc	USD	1.9%	1.9%	2.7%	-4.3%
Chinese Yuan	USD	0.2%	0.5%	-0.9%	-5.4%
Commodities & Alternatives					
Commodities	USD	1.1%	1.3%	9.8%	-16.9%
Agricultural Commodities	USD	2.2%	3.0%	8.6%	0.9%
Oil	USD	0.6%	-0.1%	33.2%	-22.2%
Gold	USD	2.6%	2.4%	17.2%	5.0%
Hedge funds	USD	0.5%	0.3%	-0.9%	-6.9%

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