

# Weekly Digest

Week ending **12 March 2017**

## Do you want guacamole with that?

I heard an entertaining anecdote this weekend informing me that there are more hedge funds than Taco Bell restaurants in the United States. A quick check told me there were probably over 5,700 of these culinary outlets in the US and that over half the US population eats there at least once a month! More interesting would be to know how their respective client bases overlap. My guess is that the hedge fund industry's client base is somewhat more concentrated and happier to spend a little bit more on their lunch (with a generous tip). The true hedge fund count is difficult to pin down but the global total could be between 7,000 and 10,000 with estimates as high as 15,000. The fact is though you could probably name any US or international food brand and they would be dwarfed by this secretive and selective fund category, whose objective is to make positive returns in any market environment, attempting to hedge out a lot of the risk that drives headline market returns, or through numerous small but profitable arbitrage opportunities.

Total assets in the hedge fund sector grew to over \$3trn at the end of 2016 reaching that milestone for the first time; there is a lot of money, in a lot of funds, chasing (what must be) fewer opportunities. More than \$400bn of that pool is controlled by the top 10 managers, some of the few lucky enough to still charge the lucrative '2 and 20' (2% management fee and 20% of profits). You don't have to look far to find similar signs of excess with over \$820bn of 'dry powder' in the private equity industry – the term used to describe money that has been raised but which is yet to be invested. Much of that cash was raised during the last few years but still some 25% of that has been waiting for suitable investment opportunities for over 3 years. Private debt funds – which like private equity are funded with locked up capital and invest in credit opportunities where there are largely no publicly traded bonds or loans – have also amassed a near \$200bn record war chest. The question to us as investors is what, if anything, does this tell us and whether these types of investments have any place in portfolios.

It is hard to argue against there being a glut of capital in these industries, the fact that globally this dry powder has ballooned to well over \$1trn talks in part to that. When considering that private funds were closing in a 'mere' 14 months (the time it takes to raise the cash, compared to 17-18m for the preceding 4 years) and were reaching 111% on average of their target size, further reinforces that view. This seems to square at a very high level with our own thoughts on valuations in the public equity and public credit markets, where in certain regions and sub asset classes we struggle to see great value today. Some value yes, great value no. At times such as these when some markets look at best fair value and at worst frothy (think Snap's 44% opening day surge), we at Momentum feel it can be beneficial to consider a small allocation to alternative risk premia.

In recent years there has been a proliferation of what have been termed liquid alternative strategies which sit between the more core beta strategies and the hedge funds, usually offering daily or weekly liquidity and more palatable fees. These largely regulated funds are not limited to but may include 'smart beta' type strategies investing in equity style risk premia, for example. At Momentum we have been investing in these equity styles for more than a decade; it is nothing new, but packaged differently to remove the directional market risk. When owned in conjunction with other alternative strategies, harvesting for example fixed income risk premia, this can prove to be both a good diversifier and a stable, if not stellar, source of investment returns when core investment opportunities are somewhat lacking. We certainly don't advocate paying '2 and 20' nor do you need to. So if you can't decide between an expensive burrito, fajita or enchilada, maybe it's time to try something different on the side.

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### The Marketplace

- US payrolls give green light for March rate hike
- S&P 500 ends six week winning streak
- Oil price suffers largest weekly fall in 2017
- Euro up & bonds down following ECB meeting
- China lowers target for economic growth

### Market Focus

#### US

- February's non-farm payrolls report showed the US economy adding 235,000 jobs over the month - above expectations of +200,000. The unemployment rate also dropped one tenth to 4.7%, while the participation rate rose one tenth to 63.0%.
- The report was viewed as the last data point that could prevent the Federal Open Markets Committee from raising the pivotal US Federal Funds interest rate at their March meeting. Markets are now pricing in a March rate rise as a certainty.
- US 10-year Treasury yields rose by 9.7 basis points over the week, to reach 2.57%, their highest yield year-to-date.
- In equities, the S&P 500 index retreated 0.4%, recording its first negative weekly return since 20th January. Losses were led by materials and energy stocks amid faltering oil and metal prices.

#### Europe

- Thursday's monetary policy meeting at the European Central Bank (ECB) yielded no policy changes. The bank's base interest rate remained at zero, and no alterations were made to the planned tapering of bond purchases from EUR 80 billion to EUR 60 billion a month commencing in April.
- However, with inflation in the Eurozone at the ECB's 2% target level for the first time in four years, the ECB increased their inflation forecasts for 2017 to 1.7%, from 1.3%.

- ECB Chairman Mario Draghi said there was no longer a "sense of urgency" to implement further monetary stimulus. Speculation is now centred on when, how and if the ECB will further reduce bond purchases or increase interest rates in the next two or three years.
- The euro rose 0.9% against the US dollar following the meeting, and ended the week up 1.0% at USD 1.07. At the same time European government bonds sold off, experiencing a 1.2% weekly fall. While continental European equities were flat for the week.

#### China

- China announced at its National People's Congress last Saturday that its target for annual economic growth would be lowered from 6.5-7% to "around" 6.5%.
- Premier Li Keqiang, who announced the shift, also stated that "overall systemic risks are under control" in regards to China's economic health, but that "risks related to non-performing assets, bond defaults, shadow banking and internet finance" must be monitored carefully.
- Elsewhere, February trade data in renminbi terms showed China running their first monthly trade deficit since February 2014; this was due largely to a 44.7% surge in year-on-year imports, relative to exports rising 4.2% year-on-year. The import figure far outstretched expectations of a 23.1% year-on-year rise.

#### Commodities

- Broad commodity prices fell 4.0% last week, marking their worst collective week since January last year.
- Oil led the falls, with Brent crude down by 8.1% to USD 51.37 per barrel, following weekly US crude inventories rising by 8.2 million barrels; more than double the average prediction of 3.4 million barrels. Markets now appear to be questioning whether increasing stockpiles in the US will render OPEC's coordinated oil production cut as somewhat futile.

*Alex Harvey (CFA) & Oliver Bickley*

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Asset Class/Region	Currency	Currency returns			
		Week ending 10 Mar 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-0.4%	0.4%	6.3%	21.0%
United Kingdom	GBP	-0.4%	1.1%	3.7%	26.4%
Continental Europe	EUR	0.0%	1.9%	4.5%	17.0%
Japan	JPY	1.0%	2.5%	3.7%	19.0%
Asia Pacific (ex Japan)	USD	0.4%	-0.5%	8.9%	19.3%
Australia	AUD	1.1%	1.7%	3.1%	17.1%
Global	USD	-0.1%	0.5%	5.7%	17.9%
Emerging Market Equities					
Emerging Europe	USD	-3.1%	-1.9%	-2.2%	15.3%
Emerging Asia	USD	0.2%	-0.9%	8.8%	19.5%
Emerging Latin America	USD	-2.5%	-2.2%	9.0%	26.8%
BRICs	USD	-0.8%	-1.2%	8.4%	26.7%
MENA countries	USD	-1.1%	-0.7%	0.7%	12.4%
South Africa	USD	-0.8%	0.3%	5.0%	19.8%
India	USD	0.8%	0.8%	11.6%	22.4%
Global Emerging Markets	USD	-0.5%	-1.0%	7.6%	19.9%
Bonds					
US Treasuries	USD	-0.5%	-1.2%	-0.5%	-1.7%
US Treasuries (inflation protected)	USD	-0.9%	-1.6%	-0.2%	2.5%
US Corporate (investment grade)	USD	-0.9%	-1.6%	-0.1%	4.4%
US High Yield	USD	-1.2%	-1.1%	1.8%	17.0%
UK Gilts	GBP	-0.4%	-1.1%	0.1%	6.2%
UK Corporate (investment grade)	GBP	-0.3%	-0.6%	1.0%	10.3%
Euro Government Bonds	EUR	-1.2%	-1.8%	-2.6%	-1.4%
Euro Corporate (investment grade)	EUR	-0.5%	-1.0%	-0.4%	3.2%
Euro High Yield	EUR	-0.4%	-0.3%	1.5%	10.3%
Japanese Government	JPY	-0.3%	-0.5%	-0.8%	-0.9%
Australian Government	AUD	-0.9%	-1.3%	-0.6%	0.3%
Global Government Bonds	USD	-0.6%	-1.9%	-0.6%	-3.5%
Global Bonds	USD	-0.5%	-1.5%	-0.3%	-1.9%
Global Convertible Bonds	USD	-0.2%	-0.4%	2.7%	5.5%
Emerging Market Bonds	USD	-0.9%	-1.1%	2.3%	7.8%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-4.5%	-5.7%	-2.6%	5.1%
Australian Property Securities	AUD	-2.2%	-2.1%	-3.8%	-0.6%
Asia Property Securities	USD	1.2%	-0.3%	7.9%	13.3%
Global Property Securities	USD	-2.2%	-3.5%	0.8%	6.5%
Currencies					
Euro	USD	1.0%	0.6%	1.4%	-4.5%
UK Pound Sterling	USD	-0.7%	-2.0%	-1.5%	-14.8%
Japanese Yen	USD	-0.3%	-2.5%	1.9%	-1.4%
Australian Dollar	USD	-0.4%	-1.8%	4.7%	1.1%
South African Rand	USD	-0.7%	-0.6%	3.8%	17.0%
Swiss Franc	USD	0.1%	-0.7%	0.9%	-2.5%
Chinese Yuan	USD	0.0%	-0.6%	0.7%	-5.7%
Commodities & Alternatives					
Commodities	USD	-4.0%	-4.5%	-3.3%	10.2%
Agricultural Commodities	USD	-2.4%	-1.2%	1.8%	6.0%
Oil	USD	-8.1%	-7.6%	-9.6%	28.3%
Gold	USD	-2.1%	-4.3%	4.3%	-5.5%
Hedge funds	USD	-0.5%	-0.3%	1.4%	6.8%

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