Weekly Digest

15 April 2019

Making the Difficult Decisions

– *Michael Clough*

When we meet with fund managers we spend just as much time discussing holdings they have disposed of as those they have recently purchased. Why did they sell out of that position? Was that in line with expectations given our understanding of their process and philosophy? Why did it take them many months to sell out of a stock? These are some of the questions we think about and put to all our incumbent and potential new managers. Selling also plays a crucial part in our own investment process and we recommend clients challenge us on why we have sold holdings or indeed why we continue to hold managers when, say, they are materially underperforming.

Ensuring you have strong sell discipline is crucial within any portfolio. Of course, it can be a difficult decision. You spent weeks and months researching a strategy in depth to build conviction, all for something to change either abruptly, or more subtly over time, and action must be taken. Ultimately though, why hold on to strategies you no longer have confidence in? You must replace them with those you really believe can either add alpha to your portfolio or improve an existing blend within the portfolio.

Let's explore some of the reasons why we replace managers. Starting with the more obvious, a key individual or the team leaving a firm would often result in an automatic sell, not only because they are responsible for the alpha generated but we also do not want to be the last out of a strategy, knowing a manager departure usually leads to an instant sell rating from consultants. Corporate change which we view as harmful or a clear change to the investment process would also be warnings. Poor performance can also clearly be a factor in a decision to sell and one of the hardest decisions can be selling a manager who has significantly underperformed.

There are less obvious changes though too. Style drift is something which can only really be identified by forensic portfolio holdings analysis. Is there sufficient evidence that the manager's philosophy is changing? We analyse monthly holdings going back several years to answer this question. Poor capacity management, or crucially a lack of acknowledgement of its importance, is another major concern. Higher assets often means less flexibility and managers may not be able to access the opportunities they really want to, and/or it takes them far longer to implement their desired strategy as it takes longer to build and sell out of positions.

Having back up managers or a 'subs bench' in place can help the process. It allows you to have conviction in your decision rather than let the process drag on. Having detailed notes covering why you invested in a manager in the first place (and identifying in advance what might be reasons for selling in the future) is a great reference point when assessing if things have changed over time. Face the issues straight away. Some decisions are easier than others and can be made quickly. Others require more work, analysis and a formalised discussion but addressing issues immediately serves to make for a more efficient decision.

At Momentum, selling managers is never a decision we take lightly. Whilst the intention when first investing with a manager is clearly to be longer term holders, things do change, and we are not afraid to make the difficult decisions when required.

The **Marketplace**

- EU granted UK Brexit extension to 31st October 2019
- IMF cut global growth outlook
- Brent crude rallied 1.7%, ending the week at $71.6 per barrel
- Gold prices ended the week flat at $1292 per ounce

Market **Focus**

US

- US weekly jobless claims; the number of Americans filing for unemployment benefits, has fallen to a seasonally adjusted 196,000 for the week, its lowest level since 1969
- President Trump has threatened to impose tariffs on $11 billion of imports from Europe raising fears of an escalation in transatlantic tensions. The Trump administration said it was considering the new tariffs in response to EU subsidies to support Airbus, the European aerospace and defence group
- Longer-term Treasury yields moved modestly higher for the week. The yield on the 10-year Treasury note rose 7 basis points to 2.56%
- Q1 earnings season started strongly last Friday, with JP Morgan and Wells Fargo reporting better-than-expected quarterly earnings
- The US large-cap benchmark index recorded small gains on the week, advancing 0.5%, led by financials

UK

- European Union leaders granted the UK an extension on Article 50 for a second time, delaying Brexit until 31st October 2019, with a review on progress in June. If Prime Minister Theresa May fails to get her Withdrawal Agreement ratified by parliament by the end of May, the UK will have to hold European elections, or leave on 1st June without a deal
- The British pound appreciated 0.6% against the US dollar, while UK large-cap equities were flat on the week

Europe

- The European Central Bank held interest rates steady last Wednesday and the ECB President Mario Draghi commented that eurozone risks remain tilted to the downside
- The International Monetary Fund (IMF) sharply downgraded its economic growth forecast for the eurozone economy to 1.3% in 2019, from a previous estimate of 1.6% in January and following a 1.8% expansion in 2018
- Italy's populist coalition government concedes that economic growth will be sharply lower in 2019 than previously forecasted, down to 0.2% in 2019, in line with IMF estimates
- Continental European equities were flat on the week

Rest of The World

- The IMF's latest economic forecasts cut the outlook for growth in 2019 to 3.3% from estimates of 3.5% in January and 3.7% in October
- Japanese equities declined 1.3% on the week
- China's trade data showed imports into the country fell by 7.6% in March compared with a year earlier, while exports came in much higher than expected, jumping 14.2% from a year ago
- Chinese equities fell 1.2% on the week following four straight weeks of gains
- On Tuesday, Saudi Arabia's state-owned oil company Saudi Aramco received more than $100 billion in orders for its $12 billion debut in the international bond market

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

Asset Class/Region	Currency	Currency returns			
		Week ending 13 Apr. 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	0.5%	2.6%	16.5%	10.7%
United Kingdom	GBP	0.0%	2.4%	12.0%	6.9%
Continental Europe	EUR	0.0%	2.5%	15.3%	4.9%
Japan	JPY	-1.3%	0.9%	8.7%	-4.3%
Asia Pacific (ex Japan)	USD	0.6%	2.6%	14.4%	-2.3%
Australia	AUD	1.1%	1.2%	12.2%	12.2%
Global	USD	0.5%	2.5%	15.3%	5.3%
Emerging markets equities					
Emerging Europe	USD	1.6%	4.1%	12.2%	1.8%
Emerging Asia	USD	0.5%	2.8%	14.2%	-5.1%
Emerging Latin America	USD	-2.5%	0.6%	8.5%	-7.3%
BRICs	USD	0.0%	2.5%	16.9%	-1.5%
MENA countries	USD	0.5%	2.4%	10.6%	10.5%
South Africa	USD	3.2%	9.5%	14.4%	-10.8%
India	USD	-0.2%	0.3%	8.2%	6.4%
Global emerging markets	USD	0.4%	3.0%	13.2%	-5.2%
Bonds					
US Treasuries	USD	-0.3%	-0.8%	1.4%	3.9%
US Treasuries (inflation protected)	USD	0.0%	-0.3%	3.0%	2.3%
US Corporate (investment grade)	USD	0.2%	0.0%	5.1%	5.0%
US High Yield	USD	0.6%	1.1%	8.4%	6.1%
UK Gilts	GBP	-0.9%	-2.1%	1.4%	2.9%
UK Corporate (investment grade)	GBP	-0.2%	-0.8%	3.7%	3.5%
Euro Government Bonds	EUR	-0.1%	-0.3%	2.2%	2.0%
Euro Corporate (investment grade)	EUR	0.0%	0.0%	3.2%	2.3%
Euro High Yield	EUR	0.4%	1.0%	6.4%	2.3%
Japanese Government	JPY	0.3%	-0.2%	1.5%	2.0%
Australian Government	AUD	0.1%	-0.6%	3.4%	8.0%
Global Government Bonds	USD	0.1%	-0.6%	1.2%	-1.3%
Global Bonds	USD	0.2%	-0.4%	1.9%	-0.5%
Global Convertible Bonds	USD	0.4%	1.6%	7.3%	-0.2%
Emerging Market Bonds	USD	-0.7%	-0.6%	5.5%	1.8%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 13 Apr. 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	0.2%	1.2%	17.3%	22.6%
Australian Property Securities	AUD	2.3%	-1.0%	12.8%	18.7%
Asia Property Securities	USD	-1.3%	-1.5%	13.6%	4.9%
Global Property Securities	USD	0.0%	0.3%	14.8%	10.3%
Currencies					
Euro	USD	0.7%	0.7%	-1.3%	-8.4%
UK Pound Sterling	USD	0.6%	0.7%	2.7%	-8.0%
Japanese Yen	USD	-0.3%	-1.1%	-2.1%	-4.3%
Australian Dollar	USD	1.1%	1.1%	1.9%	-7.6%
South African Rand	USD	1.0%	3.4%	3.2%	-13.8%
Swiss Franc	USD	-0.2%	-0.6%	-1.9%	-4.0%
Chinese Yuan	USD	0.2%	0.1%	2.6%	-6.0%
Commodities & Alternatives					
Commodities	USD	0.5%	2.2%	11.4%	-2.6%
Agricultural Commodities	USD	-0.1%	0.9%	-1.2%	-10.8%
Oil	USD	1.7%	4.6%	33.0%	-0.7%
Gold	USD	0.0%	-0.1%	0.8%	-3.4%
Hedge funds	USD	0.0%	0.2%	2.8%	-3.6%

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