

Weekly Digest

Week ending **21 May 2017**

The end of the car industry

One of the most interesting parts of the portfolio managers jobs is having the opportunity to have great debates with some of the best fund managers in the world. A recent discussion the they had with one of their more aggressive growth managers– Is the way we drive about to radically change, and are we seeing the last days of the car industry?

The car industry has gone relatively undisrupted for the past 100 years but is now under threat from the emergence of the electrical car. Initial demand for electrically powered automotives is very strong; Tesla is perhaps the greatest example of this movement after receiving more than 400,000 pre-orders for their new Model 3, which is now sold out until mid-2018. Most remarkable is that this level of market penetration has been achieved on the back mere concept art and without any initial advertising. Whether or not Tesla actually manages to deliver doesn't change the trend and car makers are increasingly worried about losing market share. While manufacturers have started to invest in electrical cars to keep up with demand, our manager thinks they will face a lot of difficulties. A major component of this is the need to adapt infrastructure and platforms designed for combustion models whilst a new mover like Telsa has the advantage of starting their processes from scratch.

But even if they manage to address the competition from electrical cars, an even bigger challenge might be around the corner: the arrival of autonomous driving. If industrial engineers eventually adapt their platform to the electrical model, they will encounter a new struggle to attain competitive edge in the artificial intelligence space, which is the basis of autonomous driving. The winners in this sphere are more likely to be software engineers and big tech companies such as Apple and Google. Its unclear how advanced those companies are at this stage but they are heavily investing in the industry. Is autonomous driving the future? From a regulatory point of view, it raises a lot

of difficult questions which might significantly slow its expansion. However studies have shown that it could be a much more efficient way to use cars and that there is strong demand for it, especially from millennials who don't want to own a car anymore. Think about it for a second – one day, instead of using your car to go to work and leave it parked outside unused 90% of the time, why wouldn't you just use an autonomous Uber who will come pick you up at home, drop you at work and then will go on to proceed with the next task?

Autonomous driving is unlikely to completely replace the traditional car. Some people like driving too much to give it up and it won't have the same appeal in rural areas. But it's definitely disrupting the car industry and raising questions on whether or not the traditional auto manufacturers will be able to change their own business models fast enough to react to the challenge. There is little evidence they will be able to and as our manager pointed out – you don't see many of the brightest PhD graduates wanting to work for auto manufacturers anymore!

The managers of the core portfolios invest some of their equity allocation in aggressive growth managers who are looking for ideas in industries like electrical cars and autonomous driving alongside other areas with strong earnings acceleration growth potential. Tesla is arguably the best example but there are many ways to play this theme. Those stocks however trade at very high multiples and we recognise that this type of approach can be very risky. By blending styles with other managers that are more valuation sensitive or those that focus on high quality franchise, the portfolios managers are able to deliver the best outcome for our investors while providing a consistent outperformance in different market environments over the long term.

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The Marketplace

- Pressure builds on Trump and equity markets
- US dollar index back to pre-election levels
- Brazilian asset prices fall amid corruption scandal
- Japan experiences steady Q1 growth
- Sterling climbs on UK inflation and employment data

Market Focus

US

- Most major equity markets fell last week amid rising political concerns in the US, after President Trump's firing of FBI director James Comey was followed by allegations that the President had previously asked Comey to drop an investigation into US ties with Russia, as well as reports that Mr Trump had given away confidential intelligence information to Russian representatives in a meeting in Washington. An investigation by the US Department of Justice into links between Russia and the Trump campaign in last year's presidential election is ongoing.
- The S&P 500 index lost 0.3% over the week, including a 1.8% drop on Thursday as pressure on Mr Trump's administration mounted. Money exiting equities appeared to move into safe haven assets such as US Treasuries (+0.5%), gold (+2.0%) and the Japanese yen (+1.8% versus the USD).
- The dollar index retreated 2.1% over the week, and has now fallen 5.0% year-to-date, sacrificing its entire gain since the US election in November.

UK

- April's inflation report showed the headline Consumer Prices Index rising 0.5% for the month, resulting in the annual inflation rate rising to its highest level since September 2013 at +2.7%, from +2.3% in March.

- Evidence of a spending squeeze on households came via data showing average weekly earnings, at +2.4% year-on-year, rising by less than inflation over the same period.
- More encouraging was data showing employment rising by 122,000 over Q1, which was ahead of expectations, while the unemployment rate also fell by one-tenth to 4.6%.
- All of the above proved supportive for sterling, which rose 1.2% against the US dollar, finishing the week above USD 1.30 for the first time since September..

Japan

- Japan's economy was shown to have started 2017 on the front foot, with GDP growing at an annualised rate of +2.2%, up a whole percentage point from growth in Q4 2016. Net exports rose 2.1% quarter on quarter, while private consumption rose 0.4%.
- Japanese equities fell 1.3% over the week – largely a result of the Yen's appreciation versus the dollar making Japanese exports more expensive..

Brazil

- Brazil's President Michel Temer is potentially facing impeachment after an audio recording emerged of him seemingly endorsing the bribery of a political figure. The President has denied any wrongdoing, but if found guilty his government's chances of implementing reforms to salvage the country's perilous financial position would likely be ruined.
- Market regulators were forced to trigger a circuit breaker suspending trading on Thursday morning after the Bovespa index quickly fell by over 10%. Over the week the Brazilian Real fell 4.2%, while Brazilian shares fell 8.2%.

Jeromine Bertrand (CFA) & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 19 May 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-0.3%	0.0%	7.0%	18.5%
United Kingdom	GBP	0.8%	4.2%	6.7%	28.5%
Continental Europe	EUR	-1.0%	1.7%	11.2%	23.6%
Japan	JPY	-1.3%	1.8%	3.7%	19.2%
Asia Pacific (ex Japan)	USD	0.1%	1.4%	16.2%	28.2%
Australia	AUD	-1.4%	-2.7%	3.0%	12.3%
Global	USD	0.2%	1.1%	9.2%	18.7%
Emerging Market Equities					
Emerging Europe	USD	0.1%	-0.1%	5.8%	21.6%
Emerging Asia	USD	0.4%	2.9%	19.2%	32.7%
Emerging Latin America	USD	-7.3%	-3.0%	8.7%	25.2%
BRICs	USD	-1.5%	0.8%	14.6%	32.3%
MENA countries	USD	0.3%	0.5%	1.4%	9.6%
South Africa	USD	1.2%	3.0%	13.4%	31.8%
India	USD	-0.3%	0.9%	21.6%	28.5%
Global Emerging Markets	USD	-0.6%	1.9%	16.1%	30.3%
Bonds					
US Treasuries	USD	0.5%	0.4%	1.8%	-0.3%
US Treasuries (inflation protected)	USD	0.7%	-0.3%	1.7%	2.3%
US Corporate (investment grade)	USD	0.6%	0.7%	3.1%	4.2%
US High Yield	USD	0.3%	0.5%	4.4%	14.5%
UK Gilts	GBP	0.3%	0.1%	2.0%	7.3%
UK Corporate (investment grade)	GBP	0.1%	0.6%	2.9%	9.4%
Euro Government Bonds	EUR	0.4%	0.2%	-0.8%	-0.5%
Euro Corporate (investment grade)	EUR	-0.1%	0.0%	0.8%	2.7%
Euro High Yield	EUR	-0.2%	0.5%	3.5%	9.2%
Japanese Government	JPY	0.3%	-0.2%	-0.1%	-2.1%
Australian Government	AUD	0.9%	0.7%	2.9%	1.7%
Global Government Bonds	USD	1.6%	1.0%	3.8%	-1.3%
Global Bonds	USD	1.4%	1.2%	3.8%	0.2%
Global Convertible Bonds	USD	0.8%	1.1%	6.6%	7.8%
Emerging Market Bonds	USD	0.1%	0.1%	6.1%	8.8%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	1.1%	-0.7%	0.1%	4.3%
Australian Property Securities	AUD	-2.0%	-3.0%	-1.6%	-4.0%
Asia Property Securities	USD	0.9%	1.6%	13.4%	17.8%
Global Property Securities	USD	0.8%	0.6%	5.8%	8.1%
Currencies					
Euro	USD	2.5%	2.7%	6.4%	-0.1%
UK Pound Sterling	USD	1.2%	0.6%	5.4%	-10.9%
Japanese Yen	USD	1.8%	0.0%	5.0%	-1.3%
Australian Dollar	USD	0.9%	-0.4%	3.5%	3.1%
South African Rand	USD	1.3%	1.0%	3.3%	19.3%
Swiss Franc	USD	2.8%	2.0%	4.6%	1.7%
Chinese Yuan	USD	0.4%	0.4%	1.2%	-4.7%
Commodities & Alternatives					
Commodities	USD	2.1%	1.2%	-2.9%	2.5%
Agricultural Commodities	USD	0.1%	1.4%	0.1%	-1.7%
Oil	USD	5.4%	3.6%	-5.6%	9.8%
Gold	USD	2.0%	-1.2%	8.7%	-0.2%
Hedge funds	USD	-0.4%	-0.2%	1.9%	6.6%

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