FP FINANCIAL PARTNERS

momentum

Weekly Digest

Week ending **4 October 2015**

Can we control risk in multi-asset portfolios? No. Hand on heart we can't pretend to have influence that might be considered genuine control over portfolio risk. This is an important realisation and rather than being a defeatist notion, it is actually a powerful insight. Our profession's history is replete with people who believe that their influence is greater than it really is, until a fateful day of reckoning which often results in painful and unnecessarily high losses.

Luckily, even though we cannot control risk, we can manage it. We think about risk as being more than just volatility. While volatility is important, it is often the manifestation of risk rather than the risk itself and we must also avoid conflating a lack of volatility with an absence of risk.

Firstly, we can manage portfolio volatility during the design and build stage of a fund. The design stage is where we set up long term asset allocations that are targeting a certain risk and return. It's a destination and a journey; it is important to get the Strategic Asset Allocation (SAA) right as it informs us and clients about the levels of volatility and returns they should expect.

Ongoing portfolio construction is an important means to manage volatility and risk. Building a portfolio atop of the foundations laid in the SAA process is an ongoing and ever evolving process: our portfolios are dynamic and we need to remain active to enable us to make the journey to the outcome as comfortable as possible.

When building portfolios the key tool for managing volatility and risk is diversification. It works well but it is imperfect and frustrating when viewed over too short a time period because, from time to time, it seems to fail. For example, there are plenty of months where bonds and equity sell off together – as we have recently witnessed – but over time this tends not to be the case. Diversification, like returns, sometimes needs time to work and we need to have the necessary patience to let it come to fruition.

There are finer levels to diversification than just equity and bonds though. For example sub-asset classes and regional biases are extremely important. Small-cap equity does not behave in the same way as a blue chip behemoth. A low quality bond does not behave the same as a government bond, so we need to understand and have a high degree of focus into the finer elements of asset classes. Currencies can also muddy the water: a large proportion of the risk from sovereign fixed income holdings comes from the currency translation of the returns into a reporting currency.

Manager styles is an underused means of managing risk in a portfolio. Because managers are, by definition, different from one another, they have offsetting and somewhat complementary characteristics. They can knock off each other's rough edges and the combination is greater than the sum of the parts in terms of risk adjusted return. This is only true to a point, however. After a certain level the benefits of using active managers erode because the portfolio becomes overly diverse and akin to an index fund but with much higher costs. It is tricky knowing when to stop. That's where high quality analysis combined with collective expertise comes in. Manager selection can also help manage beta in a portfolio but unlike styles, beta can drift up and down as different stocks drive the market. Hedging is a more reliable way to manage beta – something we will look at next week.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

The **Marketplace**

- US jobs and wage data disappoints
- Expectations of Fed hike pushed back further
- Europe re-enters disinflationary period
- Japanese PMI data drops while earnings growth slows
- Central bank of India cuts rates to 6.75%

Market **Focus**

Global

- Global equities added 0.9% last week, with emerging market equities returning 1.9%. The UK equity market rose by 0.5% in sterling terms, while the S&P 500 in the US rose by 1.1%.
- In Japan, the Nikkei/Markit Purchasing Managers' Index (PMI) data fell to 51.4 in September from 53.7 in August, while year-on-year earnings grew by a mere 0.5% in August versus 0.9% in July.
- Elsewhere in the emerging world, India cut its main interest rate by 0.50 percentage points last week, to take its benchmark repo rate to 6.75%. This is the fourth interest rate cut by the Indian central bank so far this year, signalling continued concerns around slowing global growth.

United States

- US Treasuries added 1.0%, and the US dollar fell by 0.5% against a basket of major currencies.
- In the US, the latest non-farm payrolls number indicated that 142,000 jobs were added in September which was well below expectations of the 200,000 predicted.
- Earnings growth also disappointed falling from +0.3% in August to being flat in September (versus forecasts of a 0.2% rise).
- The data has cast further doubts upon whether the Federal Reserve will raise interest rates this year.
- The US ISM manufacturing index fell from 51.1 in August to 50.2 in September (versus forecasts of 50.6) and hitting its lowest level since May 2013.

Europe

- In Europe, consumer prices fell by 0.1% year-on-year according to Eurostat, increasing fears that a disinflationary trend may be returning to Europe. Core inflation, which excludes volatile food and energy prices, printed 0.9% year-on-year in September, mirroring the August number.

China

- In China the official manufacturing PMI number nudged up to 49.8 in September from 49.7 in August, but importantly it remained below 50.0 (indicating continued contraction within the manufacturing sectors).

James Klempster, CFA & Scott Gordon

FP FINANCIAL PARTNERS

momentum

Asset Class/Region	Currency	Currency returns			
		Week ending 2 Oct. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	1.1%	1.6%	-4.2%	1.7%
United Kingdom	GBP	0.5%	1.2%	-4.4%	-2.2%
Continental Europe	EUR	-0.4%	-0.2%	4.1%	7.3%
Japan	JPY	0.1%	2.4%	4.5%	15.0%
Asia Pacific (ex Japan)	USD	1.5%	1.4%	-12.6%	-12.8%
Australia	AUD	0.2%	0.6%	-3.1%	-0.2%
Global	USD	0.9%	1.6%	-4.5%	-1.8%
Emerging Market Equities					
Emerging Europe	USD	-1.7%	-1.4%	-11.3%	-27.7%
Emerging Asia	USD	2.1%	1.5%	-11.5%	-10.9%
Emerging Latin America	USD	2.7%	2.6%	-27.3%	-35.8%
BRICs	USD	2.2%	2.3%	-12.6%	-15.4%
MENA countries	USD	-0.7%	-0.5%	-8.5%	-24.5%
South Africa	USD	2.7%	2.8%	-14.3%	-10.8%
India	USD	2.0%	-0.1%	-6.6%	-4.9%
Global emerging markets	USD	1.9%	1.5%	-14.2%	-17.0%
Bonds					
US Treasuries	USD	1.0%	0.4%	2.3%	4.2%
US Treasuries (inflation protected)	USD	1.5%	1.1%	0.0%	-0.3%
US Corporate (investment grade)	USD	0.5%	0.3%	0.2%	1.4%
US High Yield	USD	-1.8%	-0.6%	-3.0%	-4.1%
UK Gilts	GBP	1.4%	0.7%	3.2%	8.9%
UK Corporate (investment grade)	GBP	0.5%	0.5%	0.8%	4.6%
Euro Government Bonds	EUR	1.0%	0.5%	1.7%	4.4%
Euro Corporate (investment grade)	EUR	0.0%	0.3%	-1.5%	-0.1%
Euro High Yield	EUR	-0.6%	0.3%	-0.2%	0.7%
Japanese Government	JPY	0.0%	0.3%	0.4%	2.9%
Australian Government	AUD	0.5%	-0.1%	2.9%	7.6%
Global Government Bonds	USD	1.4%	0.9%	-0.6%	-2.0%
Global Bonds	USD	1.1%	0.8%	-1.4%	-2.6%
Global Convertible Bonds	USD	0.3%	0.7%	-1.4%	-1.0%
Emerging Market Bonds	USD	1.0%	1.1%	1.2%	0.0%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 2 Oct. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	1.4%	1.3%	-3.8%	9.6%
Australian Property Securities	AUD	0.9%	0.4%	4.8%	14.4%
Asia Property Securities	USD	1.7%	2.3%	0.6%	3.5%
Global Property Securities	USD	1.2%	1.3%	-3.3%	3.8%
Currencies					
Euro	USD	0.1%	0.3%	-7.3%	-11.5%
UK Pound Sterling	USD	0.1%	0.5%	-2.4%	-5.9%
Japanese Yen	USD	0.6%	0.0%	-0.2%	-9.3%
Australian Dollar	USD	0.3%	0.4%	-13.8%	-19.9%
South African Rand	USD	1.3%	0.9%	-15.7%	-18.5%
Swiss Franc	USD	0.8%	0.2%	2.3%	-1.8%
Chinese Yuan	USD	0.3%	0.0%	-2.4%	-3.4%
Commodities & Alternatives					
Commodities	USD	-0.6%	0.1%	-16.7%	-29.7%
Agricultural Commodities	USD	-0.2%	0.1%	-12.9%	-8.3%
Oil	USD	-1.0%	-0.5%	-16.0%	-48.5%
Gold	USD	-0.7%	2.1%	-3.9%	-6.2%
Hedge funds	USD	-0.7%	0.1%	-3.0%	-3.9%

Source: Bloomberg

For more information, please contact your adviser or alternatively contact:

Financial Partners Ltd.
泛柏資產管理有限公司
24/F, Kinwick Centre
32 Hollywood Road
Central, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
client.services@f-p.hk
www.f-p.hk

Important notes

This communication is issued by Financial Partners Limited 泛柏資產管理有限公司 and/or a Financial Partners' related company (collectively, and individually "FP") solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of FP. Opinions or views of any FP company expressed in this communication may differ from those of other departments or companies within FP, including any opinions or views expressed in any research issued by FP. FP may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. FP has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advice to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by FP.

No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or returns (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by FP are not the only ones that might reasonably have been selected and therefore FP does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of FP, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. FP therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communications carried within the FP system may be monitored.