



Weekly Digest

Week ending 10 July 2016

UK Property: Risks and Mortar

About a month ago, we commented on the compromises that need to be made when investing in UK property ([Investing in property: which compromise to take](#)), noting that “Open ended funds can invest in direct property but it is important to ensure that the liquidity of the vehicle is appropriate given the illiquidity of the underlying...this is why we saw so many daily dealing open ended funds have to gate or use other exceptional measures, as they experienced outflows post financial crisis.” Last week we unfortunately again experienced the problems posed by this liquidity mismatch as a number of market leading open ended ‘bricks and mortar’ property funds applied valuation adjustments and suspended redemptions as a consequence of substantial withdrawals as sentiment soured following the surprise vote to leave the European Union.

It is well documented that investors are often, collectively, beset by the urges of fear or greed and we all need to ensure that our reaction to these fund suspensions is rational and reflects the best choice for our investors. The risks posed to the UK economy from Brexit are still vague, but as of today there is no evidence of a collective corporate rush to the exit that would suddenly make UK commercial property unattractive. This forced period of consolidation is probably healthy and allows market participants a pause for breath in what has been an extraordinary few weeks. While the market can make some unfortunate choices in the short term, over the long term its participants will allocate capital in a sensible and reasonable manner and, as a result, once the initial fear subsides we will see buying pressure at the margin (once the prevailing prices have adjusted to a level that is perceived to be attractive for investors globally). If property funds have bought themselves sufficient time with the suspension of redemptions then this mitigates, to an extent, the fire sales that we would otherwise see in the direct property market.

Our hope is that 2007 and 2008 still live large in property managers’ – and their oversight committees’ – minds and as a result these funds acted quicker than in the last sell off to protect investors.

Some of the uncertainty caused by the recent suspensions is justified but some of this is becoming overdone. For example, over the weekend the FT suggested that they pose a ‘contagion risk’ to strategies that utilise them, such as multi-asset funds. While this is possible, that would be an extreme outcome for the vast majority of multi-asset funds because even where they do hold the suspended funds it is, on the whole, at such a size that renders the suspension of an underlying holding an inconvenience rather than a catastrophe. It does, however, underline the importance of well established, tested and proven risk controls.

For multi-asset portfolios that do have an allocation to these sorts of property funds, a particular and idiosyncratic risk is brought to the table, but there are a number of ways this can be mitigated such as position sizing and portfolio construction discipline. This should be core tenet of multi-asset investing: namely to provide a prudent and appropriate balance of risks and returns for investors. To that end, multi-asset funds should always be well diversified in terms of asset classes, sectors, regions and, where third party managers are used, multi-asset fund managers must ensure the minimisation of specific risks posed by particular quirks. The very essence of multi-asset funds is to keep eggs in different baskets to ensure that investors are not overly exposed to risks that could otherwise be diversified away. Or to put it another way, the managers of our core portfolios should only take on risks for their investors where they believe they will be well rewarded for it. An illiquidity mismatch is not, in their view, a risk that investors are fully rewarded for.

The Marketplace

- Abe's coalition wins a landslide victory in Japanese elections
- US payrolls show 287,000 jobs created in June
- Chinese inflation slows
- Health of Italian banking sector of increasing concern
- Government bond yields continue to decline

Market Focus

Japan

- Japanese Prime Minister, Shinzo Abe, won a landslide victory in Japan's upper house election on Sunday. The Liberal Democratic Party (LDP) secured 56 out of the 121 contested seats, with Komeito, its coalition partner, winning 14 seats.
- Abe reacted to the victory by stating that "I think this means I am being told to accelerate 'Abenomics', so I want to respond to the expectations of the people".
- Japanese equities are up 4.0% for Monday (11 June) in reaction, but follow a 3.6% loss last week.

US

- Employers added 287,000 jobs in June, beating average expectations by 107,000.
- The S&P 500 closed up 1.5% to end Friday at 2,012.95: 1 point below its record high. This resulted in a weekly gain of 1.3% for the index.
- At the same time, 10- and 30-year Treasury Bills reached new record low yields of 1.4% and 2.1%, respectively.

China

- June's Consumer Price Index (CPI) inflation report showed consumer inflation falling 0.1% month-on-month. This is the fourth consecutive negative reading and brings the year-on-year rate down to 1.9% from 2% in May.
- Meanwhile the Producer Price Index (PPI) showed producer price deflation fell to -2.6% in June, down from -2.8% in May.

Europe/UK

- European equities had a subdued week, with continental European equities falling by 1.4% and the UK equity index rising by 0.2%.
- On Friday, the Governor of the Bank of Italy, Ignazio Visco, confirmed that state intervention to support the struggling banking sector "cannot be excluded" and added that the Bank was working to "promote efficient market interventions". Italian equities rose 4.1% in euro terms throughout the day, with banking stocks experiencing the highest gains.
- In the UK, a total of seven property funds with over GBP15bn of assets have suspended investor withdrawals. Reports have claimed that regulators are considering emergency measures such as additional liquidity requirements to stem continued outflows.

Commodities

- Broad commodities lost 3.1% over the week, with Brent crude oil falling 7.1% after smaller than expected reductions in global supply.

James Klempster, CFA & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 08 July 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	1.3%	1.5%	5.1%	5.7%
United Kingdom	GBP	0.2%	1.3%	8.3%	5.2%
Continental Europe	EUR	-1.4%	-0.5%	-8.5%	-9.1%
Japan	JPY	-3.6%	-2.9%	-20.9%	-21.9%
Asia Pacific (ex Japan)	USD	-0.8%	-0.2%	2.2%	-4.4%
Australia	AUD	-0.3%	-0.1%	1.0%	0.3%
Global	USD	0.2%	0.6%	1.2%	-0.6%
Emerging Market Equities					
Emerging Europe	USD	-0.4%	-0.2%	9.6%	-7.5%
Emerging Asia	USD	-1.2%	-0.6%	1.7%	-5.6%
Emerging Latin America	USD	-1.1%	-0.4%	25.0%	-3.6%
BRICs	USD	-0.5%	-0.4%	4.1%	-7.5%
MENA countries	USD	0.7%	0.7%	-0.2%	-16.7%
South Africa	USD	-2.3%	-1.5%	13.9%	-10.2%
India	USD	0.1%	1.0%	4.2%	-4.7%
Global Emerging Markets	USD	-1.2%	-0.6%	5.8%	-6.1%
Bonds					
US Treasuries	USD	0.7%	0.9%	6.7%	6.9%
US Treasuries (inflation protected)	USD	0.8%	1.4%	8.0%	5.3%
US Corporate (investment grade)	USD	1.2%	1.2%	9.0%	8.3%
US High Yield	USD	0.9%	0.9%	10.1%	2.9%
UK Gilts	GBP	1.0%	1.4%	13.8%	14.9%
UK Corporate (investment grade)	GBP	1.2%	2.0%	9.5%	10.2%
Euro Government Bonds	EUR	0.3%	0.6%	6.3%	8.9%
Euro Corporate (investment grade)	EUR	0.5%	0.7%	4.8%	5.8%
Euro High Yield	EUR	0.0%	0.4%	4.1%	4.1%
Japanese Government	JPY	0.2%	0.5%	8.3%	10.2%
Australian Government	AUD	0.4%	0.6%	6.7%	7.4%
Global Government Bonds	USD	0.6%	0.8%	11.5%	12.0%
Global Bonds	USD	0.4%	0.6%	9.1%	9.0%
Global Convertible Bonds	USD	-0.1%	0.2%	-0.4%	-0.5%
Emerging Market Bonds	USD	1.0%	1.6%	14.1%	14.9%



Asset Class/Region	Currency	Currency returns			
		Week ending 08 July 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	1.2%	1.3%	14.2%	19.6%
Australian Property Securities	AUD	0.8%	1.9%	15.8%	19.1%
Asia Property Securities	USD	-1.3%	-1.2%	1.8%	-0.6%
Global Property Securities	USD	0.0%	0.2%	9.2%	11.4%
Currencies					
Euro	USD	-0.8%	-0.5%	1.8%	-0.2%
UK Pound Sterling	USD	-2.4%	-2.7%	-12.1%	-15.7%
Japanese Yen	USD	2.0%	2.6%	19.6%	20.0%
Australian Dollar	USD	1.0%	1.6%	3.9%	1.9%
South African Rand	USD	0.2%	1.3%	6.5%	-13.5%
Swiss Franc	USD	-1.0%	-0.7%	2.0%	-3.9%
Chinese Yuan	USD	-0.5%	-0.7%	-2.9%	-7.2%
Commodities & Alternatives					
Commodities	USD	-3.1%	-2.2%	8.5%	-14.4%
Agricultural Commodities	USD	-1.0%	-1.6%	3.4%	-8.4%
Oil	USD	-7.1%	-5.9%	25.4%	-18.0%
Gold	USD	1.8%	3.3%	28.7%	17.9%
Hedge funds	USD	0.7%	0.7%	-0.3%	-4.2%

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