Weekly Digest

Week ending **13 December 2015**

The inexorable rise in passive strategies over recent years is undoubtedly impressive. It has been fuelled by a heady mix of fee pressure at all levels of the investment value chain combined with patchy outperformance generated by active asset managers as markets climbed out of the post financial crisis trough.

Passive strategies are known as trackers for a reason. They need to have a reference benchmark to replicate. Whereas active managers would aim to exceed a given benchmark, the aim of a tracking fund is to match it as closely as possible. In recent years the gap has closed between traditional active and passive strategies due to the rise of 'smart beta'. Crucially, however, the role of the passive vehicle has not changed. The aim of the passive vehicle continues to be: track a particular benchmark as closely as possible and in fact it is these benchmarks that have become 'smart'.

So it is not a question of whether you think that a particular smart beta strategy will add value over a given benchmark, but rather whether a second benchmark will be able to add value over and above a more traditional reference index and then whether, in light of the additional cost of the smart product, it is still worthwhile. There are a wide and growing number of smart beta strategies available. The key here, however, is that the determination of a style must be made on a quantitative basis. Given the rules-based nature of an index, there is no room for a judgmental element.

To us, even the advent of smart beta does not really put the active versus passive debate to the sword. This is because regardless of how smart the benchmark is, a passive strategy is still going to underperform it, albeit modestly. As a result proponents of active management will continue to assert that a good investment manager should be able to outperform a 'smart' benchmark and therefore continues to be the 'better' option. The problem with this is that, while managers may outperform, they also could underperform more meaningfully than the passive strategy too. As a result the decision between active and passive is, to us, less about the 'smartness' or lack thereof of a particular benchmark and more about the purpose of the holding itself in the context of the greater portfolio.

The question of what to choose is driven by the required outcome. There will be plenty of opportunities for investors to make use of smart beta where the level of pick-up over the traditional index is sufficient. All is not lost for active managers, however. If, over time, the indices used for smart beta strategies persistently outperform the traditional market cap weighted benchmarks, then surely the old benchmarks will become obsolete? In such an environment, would it not make sense for there to be scope to outperform the smart beta index? Passive strategies will, by definition, underperform so in a future where smart beta has proven its worth, active managers will shift their focus to producing alpha against these new, more effective, performance benchmarks. To us the key consideration will always be whether a holding improves our chances of achieving the client outcome.

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

The **Marketplace**

- Global stocks tumble
- Oil reaches lowest level since 2009
- South African rand tumbles
- Renminbi falls to four-year lows
- Japanese firms confident about prospects

Market **Focus**

Global

- Global equities fell by 3.3% as markets saw the price of oil continue to tumble. Emerging markets fared worse, down by 4.8% over the period.
- US Treasuries and UK gilts lived up to their safe-haven status, and returned 0.8% and 1.3% in local currency terms respectively.
- The South African rand collapsed against the dollar last week, as news broke that President Zuma had replaced his respected finance minister with a relatively unknown backbencher. The currency hit a record low of 15.2 rand per dollar.
- Following significant pressure and dramatic market moves, Mr Zuma backtracked on his earlier decision and handed the job to Pravin Gordhan who had served successfully as finance minister between 2009 and 2014. The rand saw a modest rally in response.
- In Japan, the Tankan Large Enterprises confidence survey surprised on the upside, printing 10.8% (versus forecasts of 10.2%).

United States

- Third Avenue, a US asset manager, announced that it has closed one of its more illiquid high yield funds last week, preventing investors from redeeming their money. The asset class, which has already come under pressure due to the fall in oil price, fell by 2.4% as nervousness spread.

China

- The People's Bank of China allowed the renminbi to fall to its lowest level versus the US dollar in four years on Friday, adding to deflationary fears elsewhere.

Commodities

- The price of Brent crude fell by 11.8% last week, to reach levels not seen since the global financial crisis. At time of writing a barrel of Brent crude is trading at circa $37 a barrel.
- The RICI commodity index fell by 4.6% last week, demonstrating the broad based commodity weakness at the moment.

James Klempster, CFA & Scott Gordon

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Week ending **13 December 2015**

Asset Class/Region	Currency	Currency returns			
		Week ending 11 Dec. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-3.8%	-3.2%	-0.9%	0.3%
United Kingdom	GBP	-4.6%	-6.4%	-6.7%	-5.2%
Continental Europe	EUR	-3.8%	-7.4%	7.6%	7.4%
Japan	JPY	-1.5%	-1.9%	12.1%	13.0%
Asia Pacific (ex Japan)	USD	-3.6%	-3.0%	-12.3%	-11.0%
Australia	AUD	-2.4%	-2.6%	-2.8%	0.7%
Global	USD	-3.3%	-3.3%	-2.4%	-1.8%
Emerging Market Equities					
Emerging Europe	USD	-5.9%	-8.3%	-16.3%	-21.5%
Emerging Asia	USD	-3.5%	-3.4%	-12.2%	-10.9%
Emerging Latin America	USD	-4.8%	-3.1%	-30.2%	-29.0%
BRICs	USD	-4.0%	-3.5%	-14.9%	-14.2%
MENA countries	USD	-3.4%	-2.4%	-15.4%	-14.6%
South Africa	USD	-16.3%	-21.0%	-34.2%	-29.8%
India	USD	-2.9%	-5.0%	-12.6%	-13.7%
Global emerging markets	USD	-4.8%	-5.0%	-17.3%	-16.2%
Bonds					
US Treasuries	USD	0.8%	0.7%	1.7%	1.9%
US Treasuries (inflation protected)	USD	-0.1%	-0.4%	-1.2%	-1.8%
US Corporate (investment grade)	USD	0.4%	0.2%	0.3%	0.6%
US High Yield	USD	-2.4%	-2.6%	-4.5%	-3.5%
UK Gilts	GBP	1.3%	0.5%	2.8%	3.8%
UK Corporate (investment grade)	GBP	0.8%	0.2%	1.7%	2.8%
Euro Government Bonds	EUR	0.9%	-0.4%	2.3%	3.3%
Euro Corporate (investment grade)	EUR	0.3%	-0.5%	-0.3%	0.2%
Euro High Yield	EUR	-0.9%	-1.2%	1.8%	1.7%
Japanese Government	JPY	0.2%	0.2%	0.7%	1.6%
Australian Government	AUD	0.5%	0.0%	2.0%	2.9%
Global Government Bonds	USD	1.4%	1.8%	-1.7%	-1.8%
Global Bonds	USD	1.0%	1.5%	-2.4%	-2.7%
Global Convertible Bonds	USD	-1.2%	-0.8%	-0.6%	-1.0%
Emerging Market Bonds	USD	-0.8%	-1.4%	1.7%	2.3%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 11 Dec. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	-1.9%	-2.2%	-2.5%	-1.9%
Australian Property Securities	AUD	0.4%	0.5%	6.8%	7.7%
Asia Property Securities	USD	-2.0%	-0.7%	-0.5%	0.5%
Global Property Securities	USD	-2.1%	-1.9%	-3.0%	-2.2%
Currencies					
Euro	USD	1.0%	4.0%	-9.2%	-11.4%
UK Pound Sterling	USD	0.6%	1.0%	-2.4%	-3.3%
Japanese Yen	USD	1.7%	1.7%	-1.1%	-1.6%
Australian Dollar	USD	-2.1%	-0.5%	-12.0%	-13.1%
South African Rand	USD	-9.5%	-9.1%	-27.2%	-26.7%
Swiss Franc	USD	1.4%	4.7%	1.2%	-1.5%
Chinese Yuan	USD	-0.9%	-0.9%	-3.8%	-4.1%
Commodities & Alternatives					
Commodities	USD	-4.6%	-4.5%	-26.0%	-30.3%
Agricultural Commodities	USD	-1.3%	1.2%	-13.4%	-13.9%
Oil	USD	-11.8%	-15.0%	-33.8%	-40.4%
Gold	USD	-1.1%	0.9%	-9.3%	-12.4%
Hedge funds	USD	-0.6%	-1.0%	-3.3%	-2.4%

* Estimate

Source: Bloomberg

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Important notes