

Weekly Digest

Week ending **27 September 2015**

The recent VW scandal is a salutary reminder to all of the risks of investing, especially in the equity market. This topic has, rightly, dominated the papers in the past week as it represents a spectacular fall from grace for a poster child of Germany's economic and manufacturing might. To me, the debacle highlights a number of interesting issues with respect to how investment can take place today and highlights some potential flaws in a couple of de rigueur investment approaches.

Firstly, passive investors would, by definition, have an allocation to VW's shares in proportion to their weight in a given index. At the end of August, passive European equity investors in the Eurostoxx 50 index would have held 1.3% in VW and investors in Germany's main market had a 3.2% exposure to VW. Luckily, in this instance, VW's market capitalisation is not as large as it might have been, but it is still substantial. This issue serves to highlight the potential risks from concentrated indices as a single stock specific event such as this could have a substantial impact on a more 'top heavy' index. One solution to this is to use passive vehicles that have a large number of holdings such as the MSCI Europe ex UK which has 347 holdings and so VW only accounted for 0.7% of assets. A second means to reduce this risk is to use an active manager on the basis that the manager's high quality research could unearth suspicions over issues such as these, but the danger with active managers is that they could also be overweight, thus augmenting the negative impact.

The second market fashion which has been dragged into the spotlight by the VW scandal is that of Environmental, Social (sustainable) and Governance (ESG) investors. While VW did not score well in a number of corporate governance rankings, Monday's FTFM notes that the firm was "chosen as the industry group leader for the Dow Jones Sustainability index on September 10, based on strong economic, environmental and social dimensions". Investors that had relied on the analysis, compiled by the sustainable investment arm of Robeco, may feel disappointed. This again serves to highlight the fact that ESG considerations may be important for the long term prospects of a firm (one can hardly argue VW's prospects have been helped by this scandal), but as a means to capture the prowess or otherwise of a firm, a naïve reliance on scores of this sort is potentially ineffectual.

Finally, an age old problem: protecting shareholder rights. VW Group's capital structure is relatively complex and there is a little over 40% of the shareholder capital supplied by public sources and yet these shares enjoy only 12.3% of the voting rights (as of fiscal year end 2014). The majority of the voting rights are split between three bodies: Lower Saxony, Qatar Holdings and Porsche Holdings SE, with the latter retaining over 50% of voting rights despite committing only 31.5% of submitted capital. Capital structures which overly concentrate voting rights in the hands of minority shareholders can be difficult in the sense that it is difficult for the largely uncoordinated majority to demonstrate their views through voting at AGMs and EGMs. While this is not universally the case, it seems equitable that voting rights be allocated in proportion to the ownership interest of a firm.

The Marketplace

- Global equities fall amid growth concerns and Fed inaction
- Volkswagen embroiled in corporate scandal
- US government shutdown fears re-emerge
- China manufacturing data remains at 2008 lows
- Rand and lira fall to record lows

Market Focus

Global

- Global equities fell by 2.2% last week as Volkswagen's emissions scandal combined with persistent global growth concerns and mixed signals from the US Federal Reserve resulted in a risk-off environment.
- European stocks tumbled 1.9% in euro terms, while emerging market equities fell by 4.9%. Fixed income assets also struggled, with global investment grade bonds falling by 1.0%.
- Elsewhere in emerging markets, the macro-environment continued to worry investors as the South African rand and Turkish lira both fell to record lows against the US dollar.

United States

- In the US, Chair of the Federal Reserve Janet Yellen, indicated that she still expects an interest rate rise before the end of the year, despite the recent turbulence seen in global markets.
- The prospect of a government shut-down in the US also dampened sentiment last week, with Congressional Republicans threatening to prevent the passage of funding legislation ahead of the end of the fiscal calendar on 30 September.
- In a surprise move however Speaker of the House, John Boehner, resigned on Friday amid growing tensions within the Republican Party. The move gives him more freedom to work with Democrats to pass a budget ahead of his departure at the end of October.

Europe

- Revelations that Volkswagen, the world's largest car manufacturer, had fitted 11 million cars with software that allowed them to cheat emissions tests reverberated through markets last week, as other car manufacturers scrambled to protest their innocence.
- The car maker saw its equity decline by 28.4% in euro terms as it put aside €6.5 billion in anticipation of fines and litigation costs, and saw its CEO Martin Winterkorn resign.
- In Europe, the September estimate for the euro area composite services and manufacturing PMI fell to 53.9 from 54.3 in August, but remains comfortably above the 50.0 level which indicates expansion within the industries.

China

- The Caixin/Markit China manufacturing purchasing managers' index (PMI) remained at 47.0 in August below forecasts of 47.5 and keeping the index at its lowest level since April 2008.

James Klempster, CFA & Scott Gordon

Asset Class/Region	Currency	Currency returns			
		Week ending 25 Sep. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	-1.4%	-2.0%	-5.2%	-0.3%
United Kingdom	GBP	0.0%	-2.3%	-4.9%	-5.5%
Continental Europe	EUR	-1.9%	-4.2%	4.5%	5.0%
Japan	JPY	-0.6%	-5.4%	4.3%	10.0%
Asia Pacific (ex Japan)	USD	-4.8%	-2.4%	-13.9%	-16.3%
Australia	AUD	-2.5%	-2.6%	-3.3%	-1.9%
Global	USD	-2.2%	-3.0%	-5.4%	-4.6%
Emerging Market Equities					
Emerging Europe	USD	-4.7%	-4.1%	-9.8%	-29.9%
Emerging Asia	USD	-4.7%	-2.1%	-13.3%	-15.2%
Emerging Latin America	USD	-5.7%	-7.7%	-29.2%	-40.4%
BRICs	USD	-3.8%	-3.1%	-14.4%	-20.6%
MENA countries	USD	0.0%	-1.0%	-7.9%	-23.9%
South Africa	USD	-6.0%	-6.5%	-16.5%	-14.4%
India	USD	-2.2%	-1.0%	-8.5%	-6.7%
Global emerging markets	USD	-4.9%	-3.4%	-15.8%	-21.2%
Bonds					
US Treasuries	USD	-0.1%	0.4%	1.3%	3.6%
US Treasuries (inflation protected)	USD	-1.0%	-1.1%	-1.5%	-1.7%
US Corporate (investment grade)	USD	-0.4%	0.6%	-0.3%	1.2%
US High Yield	USD	-1.4%	-1.4%	-1.2%	-2.5%
UK Gilts	GBP	0.0%	0.6%	1.8%	8.2%
UK Corporate (investment grade)	GBP	-0.3%	0.2%	0.2%	4.6%
Euro Government Bonds	EUR	0.0%	0.6%	0.8%	3.7%
Euro Corporate (investment grade)	EUR	-0.5%	-0.4%	-1.6%	0.0%
Euro High Yield	EUR	-1.0%	-1.2%	0.4%	0.8%
Japanese Government	JPY	0.1%	0.6%	0.3%	2.9%
Australian Government	AUD	0.4%	-0.2%	2.4%	8.0%
Global Government Bonds	USD	-0.9%	0.4%	-2.0%	-3.3%
Global Bonds	USD	-1.0%	0.2%	-2.5%	-3.7%
Global Convertible Bonds	USD	-1.6%	-0.8%	-1.7%	-2.8%
Emerging Market Bonds	USD	-2.2%	-0.9%	0.2%	-1.9%

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Property					
US Property Securities	USD	-0.3%	2.7%	-5.2%	8.7%
Australian Property Securities	AUD	0.6%	-0.8%	3.8%	13.0%
Asia Property Securities	USD	-0.5%	-0.2%	-1.1%	-2.2%
Global Property Securities	USD	-0.6%	0.9%	-4.4%	1.2%
Currencies					
Euro	USD	-0.9%	-0.1%	-7.4%	-12.2%
UK Pound Sterling	USD	-2.3%	-1.1%	-2.5%	-7.0%
Japanese Yen	USD	-0.5%	0.5%	-0.8%	-8.9%
Australian Dollar	USD	-2.7%	-1.2%	-14.0%	-20.0%
South African Rand	USD	-4.3%	-4.5%	-16.8%	-19.4%
Swiss Franc	USD	-1.1%	-1.2%	1.6%	-3.3%
Chinese Yuan	USD	-0.2%	0.0%	-2.6%	-3.7%
Commodities & Alternatives					
Commodities	USD	0.9%	-3.8%	-16.2%	-30.1%
Agricultural Commodities	USD	2.0%	0.7%	-12.7%	-7.2%
Oil	USD	2.4%	-10.2%	-15.2%	-49.9%
Gold	USD	0.6%	1.0%	-3.2%	-6.2%
Hedge funds	USD	-0.8%	-1.2%	-2.2%	-4.0%

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