

Disruption's coming home

Weekly Digest

9 July 2018

– Alex Harvey CFA

Anyone with half an interest in the World Cup (plus the partners and families of those people) will know that as well as England making it through to Wednesday's semi-final, the traditional big hitters (think Argentina, Brazil and Germany) have all gone home early to rue what might have been. Is it too much of a stretch to say that the beautiful game itself is being disrupted, and if it is, are there any lessons to be learnt? The 'giant killers' theme could be transposed over many a field today from politics to retail, as the mighty fall and their usurpers gain momentum. Or perhaps it is simply what inevitably happens in any knockout tournament where there can only be one winner.

Psychology plays an increasingly important role in both sports and investment today. On the field of play it is not uncommon for elite sportspeople and teams to surround themselves with a team to exploit behavioural science to enhance the opportunity for individual and team success. This is how smaller teams can gain an edge, which when it works, gains momentum resulting in peak team performance when it counts most. We are told that Gareth Southgate doesn't just make his players practice hundreds of penalties, he has them make the long walk out to the penalty spot to better visualise the reality of the situation.

The behavioural parallel with the field of investment is perhaps more subtle to the outside observer and manifests itself not so much in the investment teams as in the market, where herd behaviour has implications for both momentum and value styles of investing as investor flows distort valuations. Everyone thought Brazil and Germany were the teams to beat simply because they

were Brazil and Germany. They were the most expensive teams to back at the start but far from the madding crowd the real value lay with Belgium.

Psychology also works against you and it is hard not to think that the amateur dramatics of certain players ultimately cost them more than they gained. In some ways the big teams have been a victim of football's global success as the ultimate disruptive force – money – has poured into the game creating a handful of star players perhaps more interested in their own success than that of their country. Team success then becomes much harder to achieve. This is not dissimilar from the 'star manager' investment culture which these days is mostly eschewed by fund management houses who prefer to emphasise the team approach, something we both look for and practice in our external manager teams and internal investment team at Momentum. Extrapolating that theme through a different lens one could equate the highest football earners to the strategies pulling in the most assets – namely passive. Both work best when they are relatively simple, but attention to detail in execution is paramount (hence the need for VAR).

What we are seeing today is an evolving management style that seeks marginal outperformance from a number of different areas, the combination of which creates the edge. If you can put together a team that is aligned to a specific long term outcome, and couple that with a clearly defined and well executed strategy, then your probability of success will be greater. The obvious choices will always garner interest but there's usually better value to be found elsewhere. Big is not always better.

The Marketplace

- Cabinet agrees Brexit plan after Chequers talks
- US imposes 25% levy on Chinese goods and China retaliates
- Brent Crude oil fallen 2.9% to \$77.11
- Gold remains unchanged at 1255 per ounce

Market Focus

US

- US tariffs on \$34.0 billion of Chinese goods came into effect on Friday. China retaliated with a 25% tariff on 545 of US products.
- The US Institute of Supply Management (ISM) manufacturing report increased to 60.2 in June from 58.7 in May and beat expectations of 58.5. The ISM non-manufacturing figure of 59.1 was also above expectations and was 0.5 points higher than the figure in May.
- In the jobs report, the US economy added 213,000 jobs in June, above expectations of 195,000. The unemployment rate rose from an 18-year low of 3.8% in May, climbing to 4.0% in June. Average hourly earnings growth remained subdued; on monthly basis average hourly earnings was 0.2%, below expectations of 0.3%.
- US equities gained 1.6% this week and US Treasuries rose 0.2%

UK

- The Cabinet of Ministers reached a 'collective' agreement on the basis of the UK's future relationship with the EU after Brexit; including the proposal to create a UK-EU free trade area of goods. However, Brexit Secretary David Davis and Foreign Secretary Boris Johnson have both resigned after disagreement with Prime Minister Theresa May's Brexit plans
- The UK services PMI rose to 55.1 in June; reaching an eight month high and a jump from the 54.0 reading in May.
- The Bank of England Governor Mark Carney announced there is 'greater confidence' in the UK economy following stronger growth in the UK services sector
- UK equities were down 0.3% in the week

Europe

- The Euro area services PMI rose to 55.2 in June; this follows from the sixteen month low of 53.8 in May and was above expectations of 55.0.
- Continental Europe equities ended the week 1.1% higher

The rest of the world

- The escalation of trade tensions has led to continued declines in the Asian equity markets. Japanese stocks fell 2.3% in the week, declining for a third consecutive week. The Shanghai composite index fell 3.5% this week, its seventeen straight down week.

Asset Class/Region	Currency	Currency returns			
		Week ending 7 July 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	1.6%	1.6%	3.9%	16.1%
United Kingdom	GBP	-0.3%	-0.3%	1.1%	7.6%
Continental Europe	EUR	1.1%	1.1%	-0.2%	1.9%
Japan	JPY	-2.3%	-2.3%	-5.9%	6.9%
Asia Pacific (ex Japan)	USD	-0.9%	-0.9%	-5.0%	8.9%
Australia	AUD	1.3%	1.3%	5.6%	13.7%
Global	USD	1.2%	1.2%	1.6%	12.8%
Emerging markets equities					
Emerging Europe	USD	2.0%	2.0%	-6.6%	8.1%
Emerging Asia	USD	-1.6%	-1.6%	-6.5%	8.6%
Emerging Latin America	USD	1.9%	1.9%	-9.4%	2.3%
BRICs	USD	-0.9%	-0.9%	-5.5%	14.4%
MENA countries	USD	-0.3%	-0.3%	8.7%	9.8%
South Africa	USD	1.6%	1.6%	-14.2%	9.7%
India	USD	0.2%	0.2%	-4.2%	6.2%
Global emerging markets	USD	-0.7%	-0.7%	-7.3%	7.7%
Bonds					
US Treasuries	USD	0.2%	0.2%	-0.9%	-0.1%
US Treasuries (inflation protected)	USD	0.5%	0.5%	0.4%	3.0%
US Corporate (investment grade)	USD	0.5%	0.5%	-2.8%	-0.1%
US High Yield	USD	0.0%	0.0%	0.2%	2.7%
UK Gilts	GBP	0.3%	0.3%	0.6%	3.2%
UK Corporate (investment grade)	GBP	0.2%	0.2%	-1.7%	1.0%
Euro Government Bonds	EUR	0.0%	0.0%	0.6%	2.4%
Euro Corporate (investment grade)	EUR	0.2%	0.2%	-0.5%	1.4%
Euro High Yield	EUR	0.7%	0.7%	-1.1%	1.5%
Japanese Government	JPY	0.2%	0.2%	0.9%	1.8%
Australian Government	AUD	0.0%	0.0%	1.9%	3.0%
Global Government Bonds	USD	0.5%	0.5%	-0.5%	2.8%
Global Bonds	USD	0.5%	0.5%	-1.0%	2.4%
Global Convertible Bonds	USD	0.1%	0.1%	0.0%	3.1%
Emerging Market Bonds	USD	1.5%	1.5%	-4.7%	-1.9%

Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	1.9%	1.9%	2.4%	6.2%
Australian Property Securities	AUD	1.7%	1.7%	2.0%	9.5%
Asia Property Securities	USD	-0.6%	-0.6%	-3.3%	6.9%
Global Property Securities	USD	0.8%	0.8%	-0.1%	8.8%
Currencies					
Euro	USD	0.6%	0.6%	-2.3%	2.9%
UK Pound Sterling	USD	0.5%	0.5%	-1.9%	2.3%
Japanese Yen	USD	0.3%	0.3%	1.9%	2.6%
Australian Dollar	USD	0.4%	0.4%	-5.0%	-2.1%
South African Rand	USD	1.9%	1.9%	-8.2%	-0.4%
Swiss Franc	USD	0.2%	0.2%	-1.6%	-2.8%
Chinese Yuan	USD	-0.3%	-0.3%	-2.0%	2.2%
Commodities & Alternatives					
Commodities	USD	-1.1%	-1.1%	4.6%	16.9%
Agricultural Commodities	USD	0.7%	0.7%	0.0%	-6.8%
Oil	USD	-2.9%	-2.9%	15.3%	60.3%
Gold	USD	0.0%	0.0%	-3.9%	2.6%
Hedge funds	USD	0.3%	0.3%	-0.5%	2.9%

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