Weekly Digest

Week ending **11 October 2015**

Following on from last week's digest, there is a wide range of hedging strategies available to investors today. Indeed, we are spoilt for choice. Some are pretty effective but others are less so and, while they can be complex, the purpose of most major hedging strategies is clear. Needless to say, however, it is important to enter into any hedging strategy having done your research and with your eyes wide open. The attitude with these strategies should always be 'how can this blow me up' rather than 'how can this help' and things like the structure, liquidity, counterparty risk, and the effectiveness of the hedge are all very important.

Simplicity is sometimes undervalued. As Albert Einstein once said "If you can't explain it to a six year old, you don't understand it yourself." Things that are overly complex are often a labour of love, and as a result, those that are closest to it can often be very poorly placed to critique it properly. Also, some structures may be deliberately over-complex, so never be afraid to admit you don't understand something. Understanding how a product might unravel is critical, and an investor tends to be better placed to understand how this might happen in regards to a simple hedging strategy rather than a complex one.

Everyone in my position has their favourite 'low volatility' funds that went up in a nice straight line and subsequently dropped off a cliff. There are plenty of vehicles available today that use methods such as mark-to-model to value on an ongoing basis. This is generally because it is impossible to readily determine a genuine market price and as a result the 'value' must be derived by some other means. If there is not a sufficiently active market to provide a price, then there is not much of a ready market, especially at times of market stress. We all know what this means in times of market extremes or when people are rushing for the door.

Furthermore, valuation is a key way to reduce risk in a portfolio. If you can buy an asset class when it is cheap relative to its history, the risks associated with that investment are lower than if it is simply bought at an average valuation or when it is overvalued. In other words, buying things that are cheap stacks the odds in your favour.

The use of a valuation-driven, active asset allocation process can apply this logic across asset classes, and place emphasis on assets when they are cheap and comparatively less risky, while underweighting those which are expensive and inherently contain a greater element of price risk.

Another very important source of potential risk that is not reflected in a volatility number is the prospect of a liquidity mismatch. Investments that have an inappropriate level of liquidity are akin to a lobster pot: very easy to get into, but devilishly difficult to get out. For example, daily dealing funds that buy assets that cannot be liquidated for a number of months are a risk.

Overall, we focus on allowing our funds to contain risks that we are fairly or well rewarded for, and remove the others. Indeed, some risk in portfolios will always be necessary to reach the returns our investors expect. As a result, when I buy something, I focus on ensuring that we do it knowingly and that what we are rewarded commensurately for the risks being taken.

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

The **Marketplace**

- Global equities rally
- Central banks strike dovish tone
- VIX index dips below 20
- China's FX reserves dwindle
- Commodities rise as supply is cut

Market **Focus**

Global

- Global equities rallied last week, adding 4.2% with emerging market equities bouncing off their recent lows to rise by 6.9%.
- US Treasuries fell by 0.6% and UK gilts declined by 1.7% in sterling terms as investors eschewed traditional safe-haven assets.
- Global markets were buoyed by the prospect of further monetary loosening by central banks in Europe, Japan and China, whilst the prospect of a rate hike by the US Federal Reserve in 2015 looks increasingly unlikely.
- The VIX index of implied volatility, also known as the 'Wall Street Fear Gauge', fell below the psychologically important 20.0 level – indicating a dramatic reduction in volatility since the measure hit 40.7 in August.

US

- The S&P 500 index added 3.3% last week to mark its best week so far this year. Year-to-date however, the US equity index remains down by 1.0%.

China

- In China, FX reserves shrank by USD 43.3 billion in September, down from August when they fell by USD 93.9 billion, but still a significant decline. Over the quarter, foreign currency reserves have dwindled by USD 180 billion, the largest shift since records began in 1995, as the authorities look to prop up the value of the yuan.

Commodities

- Commodities saw a sharp reversal in prices last week, as supply cuts across industries are starting to affect prices. Zinc rose by a spectacular 9.0% as the embattled Glencore announced it would reduce its output by a third.
- Brent crude touched $53.90 a barrel last week and ended the week up by 9.4%, while the price of gold rose by 1.6%.

Russell Andrews & Scott Gordon

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Weekly Digest

Week ending **11 October 2015**

Asset Class/Region	Currency	Currency returns			
		Week ending 9 Oct. 2015	Month to date	YTD 2015	12 months
Developed Market Equities					
United States	USD	3.3%	5.0%	-1.0%	6.0%
United Kingdom	GBP	4.9%	6.2%	0.3%	2.7%
Continental Europe	EUR	4.5%	4.3%	8.8%	14.6%
Japan	JPY	4.9%	7.4%	9.5%	22.5%
Asia Pacific (ex Japan)	USD	6.5%	8.0%	-7.0%	-7.9%
Australia	AUD	4.5%	5.2%	1.3%	4.4%
Global	USD	4.2%	5.8%	-0.5%	3.2%
Emerging Market Equities					
Emerging Europe	USD	12.3%	10.7%	-0.4%	-19.1%
Emerging Asia	USD	5.8%	7.4%	-6.3%	-6.2%
Emerging Latin America	USD	9.5%	12.4%	-20.4%	-33.7%
BRICs	USD	6.8%	9.2%	-6.7%	-13.2%
MENA countries	USD	2.7%	2.2%	-6.0%	-22.4%
South Africa	USD	8.7%	11.8%	-6.8%	-5.1%
India	USD	4.4%	4.3%	-2.5%	-1.8%
Global emerging markets	USD	6.9%	8.5%	-8.3%	-12.7%
Bonds					
US Treasuries	USD	-0.6%	-0.2%	1.7%	2.9%
US Treasuries (inflation protected)	USD	-0.4%	0.7%	-0.4%	-1.5%
US Corporate (investment grade)	USD	0.0%	0.3%	0.2%	0.6%
US High Yield	USD	2.7%	2.1%	-0.3%	-1.6%
UK Gilts	GBP	-1.7%	-1.0%	1.5%	6.4%
UK Corporate (investment grade)	GBP	-0.7%	-0.2%	0.0%	3.1%
Euro Government Bonds	EUR	-0.5%	0.1%	1.2%	3.8%
Euro Corporate (investment grade)	EUR	0.3%	0.6%	-1.3%	0.1%
Euro High Yield	EUR	1.2%	1.5%	1.0%	1.9%
Japanese Government	JPY	0.0%	0.3%	0.4%	2.7%
Australian Government	AUD	-0.4%	-0.5%	2.5%	6.5%
Global Government Bonds	USD	-0.4%	0.5%	-1.0%	-3.1%
Global Bonds	USD	-0.1%	0.7%	-1.5%	-3.3%
Global Convertible Bonds	USD	1.9%	2.7%	0.5%	1.4%
Emerging Market Bonds	USD	1.9%	3.0%	3.1%	1.2%

* Estimate

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 9 Oct. 2015	Month to date	YTD 2015	12 months
Property					
US Property Securities	USD	3.3%	4.6%	-0.7%	10.8%
Australian Property Securities	AUD	0.7%	1.1%	5.5%	13.3%
Asia Property Securities	USD	3.5%	5.9%	4.1%	5.9%
Global Property Securities	USD	3.4%	4.8%	0.1%	6.0%
Currencies					
Euro	USD	1.3%	1.6%	-6.1%	-10.5%
UK Pound Sterling	USD	0.8%	1.3%	-1.6%	-4.9%
Japanese Yen	USD	-0.3%	-0.3%	-0.5%	-9.6%
Australian Dollar	USD	4.1%	4.6%	-10.2%	-16.5%
South African Rand	USD	2.9%	3.8%	-13.3%	-17.0%
Swiss Franc	USD	1.0%	1.2%	3.4%	-0.8%
Chinese Yuan	USD	0.2%	0.2%	-2.2%	-3.4%
Commodities & Alternatives					
Commodities	USD	4.7%	4.8%	-12.8%	-26.2%
Agricultural Commodities	USD	1.6%	1.7%	-11.5%	-9.2%
Oil	USD	9.4%	8.8%	-8.2%	-41.5%
Gold	USD	1.6%	3.8%	-2.3%	-5.5%
Hedge funds	USD	0.8%	1.0%	-2.1%	-2.2%

* Estimate

Source: Bloomberg

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Important notes