

Brain on, tape off

Weekly Digest

15 October 2018

– *Lorenzo La Posta*

Thus far, October has proven to be an unpleasant month: rain falling from the sky, financial markets falling off their paths and investment managers falling off their chairs. Whenever everything seems to be falling apart, it is of foremost importance not to let irrationality, anxiety and hurry undermine investment decisions. Rather, the most effective way to ride the rollercoaster without being bounced off is to fasten your seatbelt, isolate yourself from the screaming kids, separate the important information from the noise and act rationally upon it. Upon real information, only.

Month-to-date all major equity and bond markets have sold off, the VIX index (Wall Street's so-called 'fear gauge') has increased more than 115% within a week and the media are knocking at the vet's door to check if the bull is dead. Often in these situations investment managers feel the urge to adjust their portfolios in response to an altering environment. Speed of reaction is crucial as it can sometimes draw the line between outperformers and laggards; however, being quick at repositioning will only be effective when done rationally, with a solid basis and meaningful reasons for it.

Unfortunately, understanding whether something has actually changed in the market environment is harder than it sounds and distilling the real, useful information from the noise requires rational and meticulous analysis. Career risk is one of the main drivers of this adjustment urge: managers who do nothing during market downturns might look careless and negligent while the ones trading a lot might appear as if they are at least trying. After all, why hire experienced investment professionals if they just

sit and wait? The reason is that sometimes doing nothing is the best thing to do. Have you ever queued at the supermarket, thought that the queue next to yours was "clearly moving faster", switched to that and realised that your new queue was now proceeding slower than your old one? If there is no valid reason why one queue should flow faster than the other, then the best plan is to stick to yours. Changing queue has a cost (leaving the current position to end up at the back again) as much as continuously tweaking a portfolio just for the sake of it does: trading costs pile up and potentially erode a significant portion of returns, precious time is diverted away from research and the portfolio drifts away from the previous allocation that was the product of rational and rigorous analysis.

Managers believe that portfolio management requires continuous monitoring, relentless research and a calm, rational thought process. As such, we want to be constantly aware of each portfolio's alignment to its objective and risks while at the same time testing our assumptions, challenging our holdings and incorporating new information as soon as it becomes available. In addition, focusing only on meaningful, value-adding information allows us to be efficient in responding to a changing environment as this October appears to be. Since the first signs of increased market stress appeared, as high-grade bonds sold-off and risk-assets were dragged lower, we have been working to understand what (if any) risks have changed and how our portfolios will fair across possible future scenarios. Although markets and economies evolve tirelessly, high-conviction portfolios with quality components supported by extensive research should prove a safer route to travel along.

The Marketplace

- Global equity market sell-off
- VIX Index spiked to 28.8 in the week, closing at 21.3
- Brent crude fell 4.4% to \$80.4 per barrel
- Gold ended the week 1.5% higher at 1219.9 per ounce

Market Focus

US

- In response to rising US interest rates and a shift in rhetoric from the US Federal Reserve the US stock market fell sharply on Wednesday, triggering a global market sell off on Thursday through Asia, Europe and the UK
- The S&P 500, Nasdaq Composite and Dow Jones Industrial Average declined 4.10%, 3.74% and 4.19% respectively
- The Russell 2000 declined 5.23%, the worst performance since January 2016
- US headline and core inflation both came in weaker than consensus at 0.1% month-on-month, below expectations of 0.2%
- US Treasuries returned 0.5% in the week, as investors fled equity markets

UK

- A busy week for Brexit negotiations ended in stalemate; Brexit Secretary Dominic Raab met with EU chief negotiator Michel Barnier on Sunday and confirmed Prime Minister Theresa May would not sign the draft treaty

- The FTSE 100 fell 4.41% to 6,995 while UK gilts returned 0.2%

Europe

- European equities followed global stocks lower; the Stoxx Europe 600 Index fell 4.64%
- Italian government bond yields rose as the stand-off over Italy's budget with the EU continues; the spread between yields on 10-year Italian and German bonds widened to 308 basis points, the highest level since 2013
- Italian stock market entered bear market territory, the FTSE MIB fell 5.36% in the week and is down 21% since a 2018 high reached in May
- Germany's economy minister downgraded growth forecasts for 2018 to 1.8% from 2.3% and 2019 forecasts to 1.8% from 2.1%
- In the Bavarian state parliament election on Sunday, the CSU, sister party of German Chancellor Angela Merkel's CDU, lost its long held majority

Asia / Rest of The World

- International Monetary Fund reduced the global growth forecast for 2018 and 2019 to 3.7% from 3.9% and expressed concerns of the global trade war on growth
- Turkish Lira appreciated 4.45% against the US dollar in the week following better than expected current account balance figures and the Turkish government releasing the US Pastor Brunson
- China's September trade balance came in above market expectations on the back of higher exports and lower imports
- The Peoples Bank of China lowered its reserve requirement ratio by 1%, effective on the 15th October

Asset Class/Region	Currency	Currency returns			
		Week ending 12 Oct. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-4.1%	-5.0%	4.6%	9.9%
United Kingdom	GBP	-4.2%	-6.5%	-5.6%	-3.6%
Continental Europe	EUR	-4.7%	-6.5%	-5.6%	-6.8%
Japan	JPY	-5.0%	-6.3%	-4.5%	2.3%
Asia Pacific (ex Japan)	USD	-3.2%	-7.8%	-12.9%	-9.1%
Australia	AUD	-4.7%	-5.0%	0.6%	6.1%
Global	USD	-4.1%	-5.5%	-0.3%	3.9%
Emerging markets equities					
Emerging Europe	USD	-0.9%	-4.3%	-10.3%	-7.2%
Emerging Asia	USD	-3.0%	-8.2%	-14.5%	-11.1%
Emerging Latin America	USD	1.0%	3.2%	-3.9%	-7.2%
BRICs	USD	-1.6%	-5.6%	-13.7%	-11.4%
MENA countries	USD	-3.6%	-3.0%	4.0%	4.9%
South Africa	USD	2.0%	-5.9%	-26.4%	-15.5%
India	USD	2.2%	-5.6%	-12.7%	-7.1%
Global emerging markets	USD	-2.0%	-6.4%	-13.6%	-10.5%
Bonds					
US Treasuries	USD	0.5%	-0.4%	-2.2%	-2.1%
US Treasuries (inflation protected)	USD	0.3%	-0.9%	-1.8%	-0.8%
US Corporate (investment grade)	USD	0.4%	-0.7%	-3.0%	-2.2%
US High Yield	USD	-0.5%	-0.9%	1.7%	1.9%
UK Gilts	GBP	0.2%	-1.2%	-2.7%	-0.5%
UK Corporate (investment grade)	GBP	0.2%	-0.6%	-2.7%	-0.6%
Euro Government Bonds	EUR	-0.1%	-1.0%	-1.5%	-1.1%
Euro Corporate (investment grade)	EUR	0.1%	-0.2%	-0.8%	-0.4%
Euro High Yield	EUR	-0.5%	-0.5%	-0.6%	-0.2%
Japanese Government	JPY	0.1%	-0.1%	-0.7%	-0.2%
Australian Government	AUD	-0.2%	-0.3%	2.0%	3.4%
Global Government Bonds	USD	0.7%	-0.5%	-3.1%	-2.1%
Global Bonds	USD	0.5%	-0.6%	-2.9%	-2.0%
Global Convertible Bonds	USD	-1.7%	-3.4%	-3.3%	-3.5%
Emerging Market Bonds	USD	0.3%	-1.6%	-6.2%	-6.7%

Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-2.8%	-5.8%	-4.5%	-5.2%
Australian Property Securities	AUD	-2.6%	-4.4%	-2.9%	2.9%
Asia Property Securities	USD	-1.9%	-5.6%	-11.2%	-9.2%
Global Property Securities	USD	-2.3%	-5.5%	-7.5%	-5.5%
Currencies					
Euro	USD	0.4%	-0.4%	-3.8%	-2.3%
UK Pound Sterling	USD	0.5%	0.9%	-2.7%	-0.7%
Japanese Yen	USD	1.5%	1.4%	0.6%	0.3%
Australian Dollar	USD	0.9%	-1.7%	-9.0%	-9.1%
South African Rand	USD	1.7%	-2.7%	-15.0%	-7.5%
Swiss Franc	USD	0.1%	-1.5%	-1.7%	-1.6%
Chinese Yuan	USD	-0.8%	-0.8%	-5.9%	-5.1%
Commodities & Alternatives					
Commodities	USD	-1.1%	0.7%	5.1%	11.6%
Agricultural Commodities	USD	0.7%	3.4%	-1.9%	-2.5%
Oil	USD	-4.4%	-2.8%	20.3%	43.0%
Gold	USD	1.5%	2.3%	-6.6%	-5.7%
Hedge funds	USD	-1.8%	-2.4%	-3.6%	-2.5%

For more information, please contact your adviser or alternatively contact:

Financial Partners Ltd.
泛柏資產管理有限公司
Unit 01 - 03
24/F, Kinwick Centre
32 Hollywood Road
Central, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
client.services@f-p.hk
www.f-p.hk

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