



Weekly Digest

Week ending **20 November 2016**

Shaken not stirred, industry zeitgeist following FCA review

Last week saw the publication of the Financial Conduct Authority's (FCA's) findings from a year-long review of the financial services profession. The topics covered, such as pricing, transparency, value for money and appropriateness of benchmarks, are important and will be regularly revisited globally, for the coming years. The portfolio managers put customer needs at the centre of what they do and as a result, welcome any measures that enhance the decision making process for clients and that aid them in deciding whether or not they receive value for money from their investments. Overall, improving transparency is positive and any client-centric firm will welcome measures that improve openness for clients. The managers believe the whole investment practice from fees to holdings and process need to be demystified and as a result, the proposals as they stand seem consistent with their philosophy of Outcomes Based Investment.

It is understandable that the FCA wants to ensure that clients experience value from their investments and experience transparency around fees and performance, and it is fair to assume that this should lead clients to better understand whether they are receiving good value for money overall. However, the topics are complex, somewhat subjective and not easily solved. For example, fund costs: some investment strategies are delivered relatively cheaply and as a result it is reasonable to expect that any 'premium' strategy justify the additional cost over and above the cheapest option. It makes sense that there should be meaningful differentiation between premium investment options which may cost more and cheaper ones that become largely 'commoditised'. Inevitably, many have identified that the most at risk area is the 'closet tracker' (managers that have little difference to their benchmark) because there is no obvious benefit to a client in buying an expensive fund that emulates a tracker's performance. The key differentiator between a tracker and an active fund is that the tracker will usually underperform a given benchmark whereas the active fund may outperform. The value judgment will then need to assess the probability, stability and quantum of outperformance. The risk with this approach is that it is partly backward looking. It is difficult to put a value on the chance of future outperformance.

Ultimately, results should be key for investors. The difficulty is that each investor's requirements are subtly different. This fact is best captured and understood during the advice process and serves to underline the pivotal role that advice performs in translating a client's needs into an investment strategy. A fund judged in isolation cannot really be considered in terms of client needs unless client outcomes form the core of the fund's existence. As a result most funds will probably continue to be judged against arbitrary benchmarks which are a reasonable way to measure manager effectiveness in isolation, but do not help to understand whether the client receives the outcome they need. For example, a fund could beat a benchmark by many percentage points but still be in negative territory in a bad year. At one level the manager justifies a larger fee in that environment but, still, all being equal, the client is poorer at the end of the year despite the manager's best efforts.

It is clear, therefore, that the main challenges facing the FCA come from applying the principles in practice. Value for money, for example, is a subjective concept and it will be interesting to see how good value is eventually defined. The profession will be watching developments in this consultation closely, but if the core spirit is adopted, that is that clients should receive good value from appropriate investments, then that should be a positive evolution.

The Marketplace

- US dollar and global bond yields continue to rise
- Fed Chair Yellen hawkish in latest remarks
- Draghi dovish amid euro weakness
- UK retail sales surprise on the upside
- Safe-haven assets continue to be out of favour

Market Focus

US

- The US dollar index rose by 2.2% last week and for its tenth consecutive day, as investors piled into the currency on the prospect of more fiscal stimulus and tighter monetary policy under President-elect Trump. The same factors led to investors selling more bonds, as global bond prices fell 2.1% last week, with yields on US 10-year Treasuries rising 21 percentage points to reach 2.35%.
- The market implied probability of a US interest rate rise in December is now at 98%. Janet Yellen, Chair of the US Federal Reserve, also primed investors for a rate rise, saying it would be required “relatively soon” if economic data continued to strengthen.
- Economic prints were subsequently positive, also: consumer price inflation rose by 0.4% month-on-month, whilst jobless claims dropped to their lowest level in over forty years at 235,000, and housing construction starts in December reached a nine-year high at 1.32 million.
- US equities rose 0.9% over the week, with the S&P Financials index again standing out, gaining 2.2%.

Europe

- On Friday, European Central Bank President Mario Draghi stated that Europe’s economic recovery “remains highly reliant on financing conditions that depend on continued monetary support”. This counters speculation of an impending tightening of monetary policy.
- These comments and continued support for the dollar ensured a tenth consecutive daily depreciation for the euro against the greenback, it is now at USD 1.06, having depreciated by 5.1% over the last two weeks.
- In France, former Prime Ministers François Fillon and Alain Juppé gained 44.1% and 28.6% of votes, respectively, in the first round of the centre-right primary. They will now face off in a follow-up vote next Sunday, with the winner going on to compete in next year’s presidential election. Ex-President Nicholas Sarkozy dropped out of the race, coming third with 20.6%.
- In the UK, the retail sales data print for October was impressive, rising 2.0% month-on-month, versus +0.4% expected, bringing the year-on-year rate up to +7.6%.
- UK and Continental European equities gained 0.7% and 0.4%, respectively, over the week.

Safe Haven Assets

- Since Trump’s victory in the US election, safe haven assets have surprisingly fallen out of favour. This trend continued last week with the two most well-known safe haven currencies the Japanese yen and Swiss franc, depreciating by 3.8% and 2.2%, respectively, last week against the US dollar.
- Gold, the most traditional safe-haven for investors, fell 1.6% over the week to USD 1,207.9. Prices have now fallen by 5.4% since the day prior to the election. The moves have wrong-footed many investors, who expected such assets to benefit from the uncertainty arising from a Trump win.

James Klempster (CFA) & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 18 November 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	0.9%	2.8%	8.2%	6.4%
United Kingdom	GBP	0.7%	-2.3%	12.8%	12.2%
Continental Europe	EUR	0.4%	-0.6%	-4.3%	-7.1%
Japan	JPY	3.6%	2.5%	-5.8%	-7.9%
Asia Pacific (ex Japan)	USD	-1.4%	-4.3%	5.7%	6.8%
Australia	AUD	0.2%	1.4%	5.5%	9.1%
Global	USD	0.1%	0.5%	4.0%	2.4%
Emerging Market Equities					
Emerging Europe	USD	-0.1%	-3.9%	11.7%	-1.1%
Emerging Asia	USD	-1.4%	-5.4%	5.3%	4.9%
Emerging Latin America	USD	2.8%	-13.1%	26.3%	15.2%
BRICs	USD	-0.1%	-6.2%	10.5%	6.2%
MENA countries	USD	1.0%	2.9%	2.0%	1.6%
South Africa	USD	1.6%	-8.8%	10.9%	-2.0%
India	USD	-3.4%	-8.2%	0.1%	2.7%
Global emerging markets	USD	-0.5%	-6.6%	8.6%	5.1%
Bonds					
US Treasuries	USD	-1.0%	-2.7%	1.3%	1.5%
US Treasuries (inflation protected)	USD	-1.2%	-2.2%	4.8%	4.6%
US Corporate (investment grade)	USD	-1.2%	-2.8%	5.3%	4.9%
US High Yield	USD	-0.3%	-1.2%	14.1%	10.6%
UK Gilts	GBP	-0.7%	-2.1%	7.8%	7.8%
UK Corporate (investment grade)	GBP	-0.6%	-1.6%	8.0%	8.2%
Euro Government Bonds	EUR	0.0%	-1.8%	2.3%	1.7%
Euro Corporate (investment grade)	EUR	-0.5%	-1.2%	3.9%	3.4%
Euro High Yield	EUR	-0.6%	-1.3%	6.7%	4.6%
Japanese Government	JPY	-0.8%	-1.0%	4.0%	4.9%
Australian Government	AUD	-0.7%	-2.0%	2.8%	3.6%
Global Government Bonds	USD	-2.4%	-4.1%	2.6%	3.6%
Global Bonds	USD	-2.1%	-3.7%	2.4%	3.1%
Global Convertible Bonds	USD	-1.0%	-1.9%	-0.5%	-1.0%
Emerging Market Bonds	USD	-2.0%	-4.7%	8.1%	6.5%

Asset Class/Region	Currency	Currency returns			
		Week ending 18 November 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	0.4%	-3.7%	0.6%	4.0%
Australian Property Securities	AUD	1.8%	-2.6%	-0.7%	1.8%
Asia Property Securities	USD	-1.8%	-4.4%	3.6%	3.8%
Global Property Securities	USD	-0.7%	-4.6%	0.6%	2.5%
Currencies					
Euro	USD	-2.5%	-3.6%	-2.5%	-0.7%
UK Pound Sterling	USD	-1.9%	0.9%	-16.2%	-18.9%
Japanese Yen	USD	-3.8%	-5.5%	8.5%	11.5%
Australian Dollar	USD	-2.8%	-3.6%	0.7%	3.2%
South African Rand	USD	-0.3%	-6.8%	7.0%	-2.1%
Swiss Franc	USD	-2.2%	-2.1%	-0.7%	1.0%
Chinese Yuan	USD	-1.2%	-1.8%	-5.7%	-7.3%
Commodities & Alternatives					
Commodities	USD	1.6%	-1.6%	6.7%	1.5%
Agricultural Commodities	USD	1.0%	-0.8%	2.2%	2.5%
Oil	USD	4.7%	-3.0%	25.7%	6.2%
Gold	USD	-1.6%	-5.4%	13.8%	12.8%
Hedge funds	USD	0.3%	0.5%	1.1%	-0.2%

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