

Value versus cost

– Andrew Hardy, CFA

All around the world investment businesses are facing the challenges of increasing competition, lower investment returns and greater regulation. For many advisors and end investors these combined pressures have led to arguably too much of a focus on the cost of an investment portfolio over and above its inherent value. Most people are willing to pay a higher price in return for some greater form of utility in other aspects of their life – why should an investment portfolio be any different? It's critical to reduce portfolio costs where possible, given the low inflation and low interest rate environment that has prevailed around much of the developed world looks set to continue for the foreseeable future. However, a very low-cost portfolio is unlikely to represent the best value, nor will it necessarily be the most suitable for a client's circumstances.

It's easy to see why investors and their advisors have been drawn towards entirely passive, index tracking investments given their ultra-low cost and reasonable performance in recent years versus actively managed alternatives. However, this results in many compromises. In equities, the greatest allocations go to the largest stocks; a momentum driven approach that ignores valuation and decades of research on the success of other weighting approaches. In bonds, the largest allocations automatically go to companies with the most debt, which may be the riskiest. Such weighting approaches mean concentration risk can often be high as well, with little underlying diversification across different assets. Passive solutions usually place little if any consideration on ESG (environmental, social and governance) factors either, which investors are rightly focusing on much more now.

Although management costs are lower for passive strategies the resulting net returns will always be below the market index being followed. Furthermore,

notwithstanding the mediocre performance of universe averages, well-chosen actively managed strategies should deliver higher net of fee returns over time, justifying their higher costs. Saving a few basis points on management costs may end up costing much more in foregone returns.

Other expenses beyond ad valorem management charges should also be considered. Small or high turnover portfolios may suffer from relatively high trading or platform costs, while fees for fund service providers (custody, admin services) can sometimes be significant if the manager or fund lacks scale. Unitised UCITS funds disclose the total of all such costs as a 'Total Expense Ratio' (TER) or 'Ongoing Charges Figure' (OCF) in their Key Investor Information Document (KIID), which makes it easier to compare fund charges fairly with everything thrown in. When relying on other sources advisors and investors alike should be careful to ensure that all applicable costs are captured.

At Momentum our investments use a combination of active, systematic and passive strategies, depending on what works for each asset class and how each affects the balance of the overall portfolio. With assets under management of over \$5bn* across our business we use our significant scale to negotiate costs down with underlying managers and counterparties, while our portfolio structures are carefully designed and managed to minimise additional counterparty expenses.

We pull all these levers and more to create optimal portfolios that are cost efficient but also avoid unnecessary compromises, to maximise the probability of achieving targeted outcomes. Our investors have worked hard for their savings and they should ensure their investments work equally hard for them in return.

* Momentum Global Investment Management, as at April 2019.

The Marketplace

- US-China trade talks grind to a halt with more US tariffs threatened
- Central banks mull stimulus measures
- Brent crude declined sharply falling -6.4% to \$62.6 a barrel
- Gold prices rose 1% to \$1426 an ounce

Market Focus

US

- Both major US equity indices declined last week with the industrial average index falling by -0.7% and the wider index falling by -1.2%. Energy stocks performed particularly badly with consumer staples and materials gaining
- The Federal Reserve continued to offer mixed signals over whether the expected rate cut will be 25bps or 50bps at the July 30th meeting. At present, expectations are still for a 25bps cut
- Retail sales posted solid gains for a second consecutive month in June with regional manufacturing activity rising higher than expected
- The 10-year US treasury yield fell sharply last week amidst dovish sentiment from the Fed, ending the week at 2.03%

Europe

- The 10-year Italian bond yield rose to 1.6% after the deputy Italian PM threatened to pull his party out of the current coalition government

European equities fell 0.5% on the week amidst continuing pressure from the US-China trade tensions. The German market, which is heavily reliant on exports fell 0.5%

UK

- UK wages rose 3.6% in the three months up to May, representing the fastest pace in 11 years. The jobless rate also stands at a 44 year low of 3.8% after 28,000 new posts were filled over the same period
- The major blue-chip UK equity benchmark rose by 2.7% last week
- The pound fell to a two-year low against the dollar last week as the odds of Boris Johnson becoming the next PM narrowed and with it the increased chance of a no-deal Brexit
- The UK parliament voted by a margin of 315 to 274 to prevent any incoming prime minister from being able to suspend parliament to force through a no-deal Brexit

Asia/Rest of The World

- The major Japanese exchange fell by 0.8% on the week as exports fell for a seventh consecutive month. They fell 6.7% in June versus a year ago
- The Chinese government announced that the second quarter showed the weakest GDP growth (+6.2%) since records began in 1992. The level is still within tolerance, but more forceful stimulus could be on the horizon if the ongoing trade dispute with the US continues to take its toll. Chinese equities ended the week flat
- Turkish stocks rallied 4.9% amid expectations of central bank stimulus in the US and Europe
- The South African equity market rose 1.7% as the reserve bank continued to make cuts to stimulate borrowing and growth

Asset Class/Region	Currency	Currency returns			
		Week ending 19 July 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	-1.2%	1.3%	20.7%	7.6%
United Kingdom	GBP	0.1%	1.1%	14.0%	2.1%
Continental Europe	EUR	0.1%	0.5%	18.4%	3.9%
Japan	JPY	-0.8%	0.8%	6.1%	-8.5%
Asia Pacific (ex Japan)	USD	0.9%	0.7%	13.4%	2.3%
Australia	AUD	0.1%	1.2%	21.0%	11.7%
Global	USD	-0.8%	0.8%	18.7%	4.8%
Emerging markets equities					
Emerging Europe	USD	0.3%	0.3%	21.2%	17.4%
Emerging Asia	USD	0.9%	0.2%	10.4%	-1.0%
Emerging Latin America	USD	-0.9%	2.6%	15.4%	16.4%
BRICs	USD	0.5%	0.7%	15.1%	5.0%
MENA countries	USD	0.6%	2.8%	12.8%	7.0%
South Africa	USD	2.5%	1.4%	13.2%	0.6%
India	USD	-1.5%	-2.9%	7.6%	5.7%
Global emerging markets	USD	0.7%	0.6%	11.7%	2.2%
Bonds					
US Treasuries	USD	0.4%	-0.2%	5.4%	7.1%
US Treasuries (inflation protected)	USD	0.3%	0.4%	7.0%	5.3%
US Corporate (investment grade)	USD	0.5%	0.0%	10.2%	9.8%
US High Yield	USD	-0.1%	0.1%	10.2%	6.9%
UK Gilts	GBP	1.0%	1.5%	6.5%	5.8%
UK Corporate (investment grade)	GBP	0.7%	1.5%	8.6%	7.2%
Euro Government Bonds	EUR	1.0%	0.9%	6.9%	6.9%
Euro Corporate (investment grade)	EUR	0.5%	0.7%	6.1%	5.0%
Euro High Yield	EUR	-0.2%	0.3%	8.1%	4.5%
Japanese Government	JPY	0.2%	-0.1%	2.8%	3.0%
Australian Government	AUD	0.6%	-0.1%	8.0%	11.4%
Global Government Bonds	USD	0.5%	-0.3%	5.3%	5.8%
Global Bonds	USD	0.4%	-0.2%	5.6%	5.7%
Global Convertible Bonds	USD	0.0%	0.5%	8.4%	3.1%
Emerging Market Bonds	USD	0.7%	0.4%	11.2%	10.1%

Asset Class/Region	Currency	Currency returns			
		Week ending 19 July 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	-2.2%	0.0%	17.3%	9.1%
Australian Property Securities	AUD	-0.6%	3.3%	17.4%	16.6%
Asia Property Securities	USD	0.3%	1.2%	15.2%	13.1%
Global Property Securities	USD	-0.9%	1.1%	16.8%	9.5%
Currencies					
Euro	USD	-0.3%	-1.1%	-1.9%	-3.3%
UK Pound Sterling	USD	-0.5%	-1.5%	-1.5%	-3.7%
Japanese Yen	USD	0.2%	0.2%	2.5%	4.8%
Australian Dollar	USD	0.5%	0.6%	0.2%	-3.8%
South African Rand	USD	0.5%	1.5%	3.4%	-2.4%
Swiss Franc	USD	0.3%	-0.5%	0.3%	2.0%
Chinese Yuan	USD	0.0%	-0.2%	0.0%	-1.1%
Commodities & Alternatives					
Commodities	USD	-2.7%	-1.3%	6.2%	-4.1%
Agricultural Commodities	USD	-1.4%	-1.4%	-2.5%	-6.3%
Oil	USD	-6.4%	-6.1%	19.7%	-13.9%
Gold	USD	1.0%	1.2%	11.5%	17.2%
Hedge funds	USD	0.1%	0.6%	5.2%	-2.0%

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