FINANCIAL PARTNERS

Weekly Digest

Week ending **26 March 2017**

Expectation not hope – investing shouldn't be a gamble

Investment and gambling are often conflated but the reality is that investment and the mindset required to undertake investment is wholly different from that of a gambler. A dictionary definition* of investment might be "the action or process of investing money for profit", whereas gambling might come up as "play games of chance for money" or "take risky action in the hope of a desired result". There are clear differences in the premises. While investing may be risky in a manner akin to gambling, the major difference is the motive behind the behaviour. While gambling may be a 'game', investing is often of such importance that it is anything but. Furthermore, whereas gamblers may bet in the hope of a desired result an investor puts money at risk with an expectation of achieving a profit.

Is it a reasonable expectation for an investor to expect profit? Clearly not all investments pay off, but the intention, universally, at the start of an investment must be an expectation of a gain. Looking at long term stock market history, while they can be volatile, they have tended to go up over time and so a naïve buy and hold strategy of an index of stocks should fulfil the key requirement for an investment because investors in equity markets have the wind at their backs. Clearly if investments are made in failing companies, or in fundamentally overvalued stocks or markets, investors could lose money that they cannot make back, but under normal circumstances they will be fine provided they are patient. The investment markets are set up to provide a good mechanism such that the benefit of increasing share prices should pass to the end investor (minus frictional costs and probably some fees).

Gambling, on the other hand, is not quite so egalitarian. There is a whole sector whose purpose it is to make a profit out of taking the other side of the bet. If we define gambling as "playing games" why shouldn't an industry be built around profiting from binary win / lose outcomes? It is the setting of the odds that ensures that the true expected probability of an outcome is not reflected in the pricing of the chance of that outcome. For bookmakers to make a profit they must strike a fine balance between offering enticing odds but also skewing them sufficiently to give a good probability of profit for the firm. In fact, the provider of bets may be said to be an investor as per our earlier definition because their business has an expectation of profit. In which case, you as the user must expect a loss because the system itself is closed. So while gamblers may win from time to time on average they lose.

While there are companies associated with investing that must also achieve a profit the generation of their profit is not binary as it is for gambling. There is not simply a winner or a loser. Rather, the markets through time provide ample spoils for all to share. However, this dichotomy between gambling and investment may be too simplistic. In order to have a diversified portfolio effective hedging will require investments into asset classes that may not do well most of the time. Portfolio hedges are really in place to only work when your base case doesn't play out, which by definition, should not be too often. So, in fact, it could be argued that hedged trades are, oddly, more akin to a gamble than the actual core investment strategy of a portfolio, because the expectation for the risk control is not to make a profit unless the base case investment view expressed in the portfolio is wrong.

Clearly, therefore, there are stark differences between investment and gambling. The investment profession doesn't do itself any favours, however, because professional investors regularly slip into using gambling parlance and terminology that can muddy the waters. Trades that may entail higher relative risk or uncertainty may be referred to as a 'punt' for example, but we must remind ourselves that for a trade to be an investment rather than a gamble there must be an expectation of a profit. The core portfolio managers believe that investments should be targeted to achieve a specific investment outcome, rather than speculating on whether the returns of a particular market or benchmark will do the trick in funding long term liabilities. They want investors to not only avoid gambling when investing their capital, but also have a reasonable expectation in terms of their investment outcome.

** Source: https://en.oxforddictionaries.com/*

Source: Bloomberg. Returns in local currency unless otherwise stated.

The **Marketplace**

- Risk-off week led by US equities & dollar weakness
- PMIs suggest strong growth in Europe
- Sterling strengthens following UK inflation pickup
- UK PM to trigger Article 50 on Wednesday
- Oil prices continue to fall

Market **Focus**

US

- Fading hopes of higher economic growth under the Trump regime last week appeared to cause a rotation out of risk assets and into safe haven assets such as government bonds, gold, and the Japanese yen.
- Global developed market equities broadly fell 0.9%, led by US equities which retreated by 1.4%. Global government bonds, meanwhile, rose 1.1%, with yields on 10-year US Treasury bills ending the week at 2.37%, their lowest level since late February.
- Markets appeared to be spooked by Trump's difficulty in garnering enough support within the Republican Party to pass his Affordable Health Care Act; it was seen by some as an early indicator of how successfully the new President would be able to implement his planned policies.
- The US dollar index fell by 0.7% over the week: its third consecutive weekly decline.

Continental Europe

- The composite Purchasing Manager Index for the euro area in March beat expectations by rising by 0.7 points to 56.7, well above the 50 level which separates expansion from contraction. Both elements of the composite index (manufacturing and services) rose.
- Economists have said the latest numbers suggest Eurozone GDP growth of 0.6% for the first quarter of the year.
- The euro rose 0.5% versus the US dollar last week, and has continued to rise following the PMI data on Friday. At time of writing the currency is up another 0.6% at USD 1.09.

UK

- Inflation data from the Office for National Statistics showed the Consumer Prices Index (CPI) rising to 2.3% in February, up from 1.8% in January and its highest level since September 2013.
- Sterling rose 1.0% against the US dollar on the day and ended up 0.8% for the week at USD 1.25, whereas UK equities, following on from losses in the US, fell 1.1%.
- Some are now questioning whether the rise in inflation above the Bank of England's 2% target might tempt them to raise interest rates earlier than previously expected.
- Meanwhile Theresa May announced on Monday that she will trigger Article 50 on March 29th by sending a letter of intent to the president of the European Council, Donald Tusk.

Oil & Gold

- Data showing US oil inventories rising by nearly 5 million barrels (versus expectations for an increase of 2.8 million) over the week commencing March 13th aided the continuing slide in oil prices last week.
- The price of Brent crude oil fell 1.9% over the period to USD 50.8 per barrel, its lowest weekly close since November 25th.
- Over the weekend a group of OPEC country ministers, as well as some from producer countries that sit outside of the cartel, met to discuss whether a global pact to limit oil supply should be extended by six months. The effect on oil prices has been minimal, however, following a rumoured lack of progress during the meeting.
- Gold, meanwhile, benefitted from the risk-off sentiment over the week by rising 1.5%, and is up on Monday morning another 1.1%, at USD 1,256.8.

James Klempster (CFA) & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 Mar. 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-1.4%	-0.7%	5.0%	16.9%
United Kingdom	GBP	-1.1%	1.3%	3.9%	25.1%
Continental Europe	EUR	-0.3%	2.8%	5.4%	17.0%
Japan	JPY	-1.4%	0.6%	1.7%	16.5%
Asia Pacific (ex Japan)	USD	-0.2%	2.9%	12.6%	20.6%
Australia	AUD	-0.8%	1.3%	2.8%	18.2%
Global	USD	-0.9%	0.5%	5.8%	16.1%
Emerging Market Equities					
Emerging Europe	USD	0.5%	3.1%	2.8%	18.1%
Emerging Asia	USD	0.2%	3.8%	13.9%	21.0%
Emerging Latin America	USD	0.6%	0.9%	12.5%	29.0%
BRICs	USD	0.0%	2.3%	12.2%	27.6%
MENA countries	USD	-0.1%	-0.7%	0.7%	12.5%
South Africa	USD	2.0%	8.9%	14.0%	26.1%
India	USD	-0.4%	4.7%	15.9%	22.3%
Global Emerging Markets	USD	0.4%	3.6%	12.6%	21.9%
Bonds					
US Treasuries	USD	0.7%	-0.1%	0.7%	-0.9%
US Treasuries (inflation protected)	USD	0.9%	0.0%	1.5%	3.0%
US Corporate (investment grade)	USD	0.7%	-0.3%	1.1%	4.0%
US High Yield	USD	-0.2%	-1.1%	1.8%	15.8%
UK Gilts	GBP	0.3%	-0.4%	0.8%	6.6%
UK Corporate (investment grade)	GBP	0.1%	-0.3%	1.2%	9.2%
Euro Government Bonds	EUR	0.6%	-0.9%	-1.8%	-1.7%
Euro Corporate (investment grade)	EUR	0.1%	-0.7%	-0.1%	2.3%
Euro High Yield	EUR	0.0%	-0.2%	1.7%	9.0%
Japanese Government	JPY	0.1%	-0.1%	-0.4%	-1.7%
Australian Government	AUD	0.6%	0.1%	0.8%	1.6%
Global Government Bonds	USD	1.1%	0.3%	1.6%	-2.2%
Global Bonds	USD	0.9%	0.3%	1.5%	-1.0%
Global Convertible Bonds	USD	-0.3%	0.2%	3.2%	4.9%
Emerging Market Bonds	USD	0.9%	0.7%	4.1%	8.6%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 24 Mar. 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	0.1%	-3.3%	-0.1%	4.6%
Australian Property Securities	AUD	-0.1%	-0.7%	-2.4%	1.0%
Asia Property Securities	USD	0.6%	2.6%	11.1%	13.8%
Global Property Securities	USD	0.3%	-0.7%	3.7%	6.6%
Currencies					
Euro	USD	0.5%	1.8%	2.7%	-3.3%
UK Pound Sterling	USD	0.8%	0.6%	1.1%	-11.7%
Japanese Yen	USD	1.6%	1.0%	5.5%	1.8%
Australian Dollar	USD	-1.2%	-0.7%	5.9%	1.2%
South African Rand	USD	2.3%	5.4%	10.0%	24.2%
Swiss Franc	USD	0.6%	1.3%	2.9%	-1.5%
Chinese Yuan	USD	0.2%	-0.3%	1.0%	-5.3%
Commodities & Alternatives					
Commodities	USD	-0.9%	-4.3%	-3.2%	10.0%
Agricultural Commodities	USD	-1.6%	-2.1%	0.8%	3.1%
Oil	USD	-1.9%	-8.6%	-10.6%	25.6%
Gold	USD	1.5%	-0.6%	8.3%	2.6%
Hedge funds	USD	-0.3%	-0.3%	1.4%	6.1%

Source: Bloomberg

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Important notes