

weekly digest

Week ending 01 October 2017

global investment management

Opportunity Cost

Income strategies continue to be remarkably popular. To an extent this is understandable given many retirees rely on their defined contribution pension pot to provide income that funds their retirement. However I suspect that the rationale for using an income fund is less to do with practical considerations and more to do with John D. Rockefeller's famous quote *"Do you know the only thing that gives me pleasure? It's to see my dividends coming in!"*. There is something satisfying about watching regular income flow into transaction statements but I fear that some investors fail to grasp that a paid out dividend is also a missed opportunity to stay in the market. Over the long term, staying in the market has proven itself to be the better option when seeking capital returns. This drip of assets from the markets into cash can have a significant impact on total returns over time.

Many investors conflate 'income' with 'low risk'. That may be a reasonable assumption with nominal yields of circa 5% available from even the highest quality sovereign bonds. However income strategies generally rely on assets at the other end of the risk spectrum with equity and sub investment grade debt making up a large proportion of an income funds' asset allocations. If investors buy these strategies then there shouldn't be a problem but a significant market correction will be felt in the price of most income funds, as acutely as they would be in an aggressive balanced fund. We are careful to ensure that investors in our income strategies do so for the right reasons and with their eyes open.

A final and potentially important consideration to bear in mind when assessing income funds is the currency in which this income is generated. A yield of, say, 5% in US dollar terms is only a stable yield number if you are an investor that thinks in US dollar terms. For example if a sterling based investor bought the US asset yielding 5% in dollars, there is a chance that the actual yield on their original home currency investment is less than (or greater than) the yield originally envisaged as a consequence of currency moves. The investor would have exchanged a fixed amount of home currency to make the foreign currency investment but the income (while fixed in foreign currency terms) will move with the vagaries of the foreign exchange market on an ongoing basis, thus impacting the achieved yield. This may well come out in the wash over the very long term but if the investor is relying on a known yield in local currency terms then the risks of searching for yields in another currency may be too much to bear. Also, should the investor need the income to be swept into local currency, it will result in regular, relatively small, foreign exchange transactions which may prove uneconomical as well as an administrative burden. It is possible to hedge expected cash flows well into the future using currency forward contracts but unless the cash flow is for a known amount then these small hedges are, themselves, a potential source of risk.

We do make selective use of income strategies in some of our portfolios but via an accumulation share class, enabling us to strengthen our capital return. Some of the funds with an 'income' label also provide good exposure to the 'Quality' investment style factor so we use these holdings as a quality tilt rather than for the income.

The Marketplace

- Oil rose 1.2% on the week with Brent at USD 56.6
- Gold fell 0.9% to 1273
- Global bonds continue sell off, equities rise
- BoE hold conference for world's central bankers

Market Focus

US

- USD rallies to a six week high on the back of Trump's tax plans
- The S&P 500 Index closed at 2497
- 10 year Treasury yields hit a two month high at 2.3%
- The Dow Jones index ended the week at 22406, up 0.3%
- Nasdaq was up 0.8% at 5979.298
- Record breaking week on all major US indices
- US households Net Worth continues to grow to new highs, up \$1.7Tr quarter on quarter (1.8% quarter on quarter) as financial assets and real estate grow faster than debt (+5.7% vs+3.8%)

UK

- The UK Budget deficit narrowed in August, down 0.7% on the year on the back of improved tax receipts and budget cutting
- The FTSE was up 0.9% at 7323
- UK manufacturing PMIs released for September. Factory output slipped slightly to 55.9 from 56.7 in August, though the outlook is still seen as solid and not pointing towards a contraction. Service PMIs to be released this week.
- BoE held a conference last Thursday, governor Mark Carney's speech suggested that any interest rate rises would be 'gradual' and 'limited'
- UK consumer confidence hits highest level since March according to the YouGov/Cebr Consumer Confidence Index, standing at 108.6 (anything >100 is seen as positive)
- Deadlock eased somewhat in Brexit negotiations with the EU showing willingness to bring forward talks on the nature of the transitional period

Europe

- The unofficial Catalanian referendum descends into violence; separatist leaders may call for independence this week. Spanish Government bond spreads increase
- Euro area confidence reached a 10 year high after the index of industry and consumer sentiment reached 113 in September, up from 111.9 in August
- The Eurostoxx 50 closed up 0.4% at 3555
- The Dax increased 1.9% to 12829
- Norway's sovereign wealth fund, the world's largest, reached \$1 Trillion in assets

Asia

- Nikkei closed relatively flat +0.3 % on the week at 20356.28
- The Hang Seng finished the week up 0.5% at 27554
- China's sovereign credit rating reduced from AA- to A+
- Mixed signals from Chinese PMI data though the larger NBS PMI survey showed positive results overall with production output up 54.7 from 54.1



Asset class/region	Currency	Currency returns			
		Week ending 29 September	Month to date	YTD 2017	12 months
Developed markets equities					
United States	USD	0.7%	2.0%	13.7%	18.8%
United Kingdom	GBP	0.9%	-0.8%	6.5%	10.7%
Continental Europe	EUR	1.3%	3.9%	12.1%	19.5%
Japan	JPY	1.4%	4.3%	12.5%	27.3%
Asia Pacific (ex Japan)	USD	-1.6%	-0.3%	26.9%	19.4%
Australia	AUD	0.0%	0.0%	3.9%	8.5%
Global	USD	0.4%	2.2%	16.0%	18.6%
Emerging markets equities					
Emerging Europe	USD	-0.8%	-1.4%	14.6%	23.9%
Emerging Asia	USD	-1.7%	0.0%	31.8%	22.4%
Emerging Latin America	USD	-2.2%	1.6%	26.7%	24.5%
BRICs	USD	-1.9%	0.9%	33.0%	26.6%
MENA countries	USD	-1.1%	-0.7%	4.7%	17.9%
South Africa	USD	-3.3%	-6.5%	12.1%	6.7%
India	USD	-2.5%	-3.3%	25.8%	17.9%
Global emerging markets	USD	-1.8%	-0.4%	27.8%	21.1%
Bonds					
US Treasuries	USD	-0.3%	-0.9%	2.4%	-2.1%
US Treasuries (inflation protected)	USD	-0.4%	-0.7%	1.9%	-1.0%
US Corporate (investment grade)	USD	0.1%	-0.2%	5.2%	2.0%
US High Yield	USD	0.3%	0.9%	7.0%	9.2%
UK Gilts	GBP	0.2%	-2.7%	-0.1%	-4.5%
UK Corporate (investment grade)	GBP	0.2%	-1.9%	2.6%	-0.4%
Euro Government Bonds	EUR	0.0%	-0.5%	-0.4%	-3.4%
Euro Corporate (investment grade)	EUR	0.0%	-0.2%	1.8%	0.5%
Euro High Yield	EUR	0.1%	0.6%	6.0%	8.0%
Japanese Government	JPY	-0.4%	-0.4%	-0.2%	-2.1%
Australian Government	AUD	-0.1%	-0.5%	1.9%	-1.8%
Global Government Bonds	USD	-0.8%	-1.1%	5.8%	-3.1%
Global Bonds	USD	-0.6%	-0.8%	6.3%	-0.8%
Global Convertible Bonds	USD	-0.4%	0.5%	9.2%	6.2%
Emerging Market Bonds	USD	-0.2%	-0.1%	8.6%	3.0%

Source: Bloomberg. Past performance is not indicative of future returns



Asset class/region	Currency	Currency returns			
		Week ending 29 September	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	0.6%	-0.3%	2.7%	-1.3%
Australian Property Securities	AUD	1.0%	0.5%	-5.3%	-7.6%
Asia Property Securities	USD	-1.9%	-0.5%	21.4%	12.3%
Global Property Securities	USD	-0.5%	0.4%	11.9%	5.5%
Currencies					
Euro	USD	-1.2%	-0.7%	12.2%	5.2%
UK Pound Sterling	USD	-1.0%	3.9%	8.4%	3.3%
Japanese Yen	USD	-0.4%	-2.2%	3.9%	-10.3%
Australian Dollar	USD	-1.5%	-1.1%	8.9%	2.7%
South African Rand	USD	-2.3%	-3.9%	1.1%	2.7%
Swiss Franc	USD	0.1%	-0.8%	5.1%	-0.3%
Chinese Yuan	USD	-0.8%	-0.6%	4.8%	0.5%
Commodities & Alternatives					
Commodities	USD	0.0%	1.5%	-1.4%	2.7%
Agricultural Commodities	USD	-0.7%	-0.1%	-3.7%	-1.4%
Oil	USD	1.2%	9.9%	1.3%	16.9%
Gold	USD	-0.9%	-2.5%	11.4%	-2.8%
Hedge funds	USD	0.0%	0.5%	4.3%	5.7%

Source: Bloomberg. Past performance is not indicative of future returns

For more information, please contact:

David Hansen

Distribution Services

E: distributionservices@momentum.co.uk

T: +44 (0)207 618 1806



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