Investment Insight

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ARIA | CAPITAL

Cheap or value? *Investors like to discover shares that look like they are compelling value. Even better if there is an identifiable catalyst that will unlock that value and cause the share price to re-rate. "Special situations" investment funds often thrive on just such opportunities. But just because something is cheap doesn't mean it's good value, a phenomenon investors refer to as a "value trap". Cheap shares can just get cheaper, and sometimes with good reason.*

This week we saw at a good example of this. Having fallen by over 15% since last Summer and by almost 50% from their 2015 high, the shares of this venerable institution, founded in 1844, ticked a lot of the boxes for value investors. However, on Wednesday this week they collapsed by a further 30% leaving many investors licking their wounds. In ***The Inside Track****, we take a look.*

Dead calm: *The only investment certainty at the moment is uncertainty. Nobody really knows what's around the corner, increasingly because of the totally unpredictable nature of many of the political and geo-political events that affect investors' sentiments these days. Of course that doesn't stop people predicting, and betting on those predictions. One such prediction is for more volatility in 2017, and plenty of people have placed bets on that basis. However, large speculators are betting the other way around. In* ***Pic of the Week*** *we take a look.*

Quoted...

"My fellow Americans, our long national nightmare is over." – Gerald Ford, 1974

The Inside Track

Many Pearson plc shareholders felt that they had absorbed their dose of punishment by the time 2016 ended. That was until the shares fell by a further 30% on one day this Wednesday. So where did it all go wrong?

We all know that investors hate uncertainty. It's not all they hate; they're not big on disappointment either. Beleaguered Pearson shareholders, particularly any who acquired their shareholdings since 2012, have had a difficult time of it. Towards the end of March 2015 they finally looked like they were being rewarded for their endurance after the share price had gone on a modest run, nothing they could retire on but enough to have made it worth the effort, just. Since then, however, the shares have lost almost two thirds of their value, the boot having been put in once again this week then they fell by 30%.

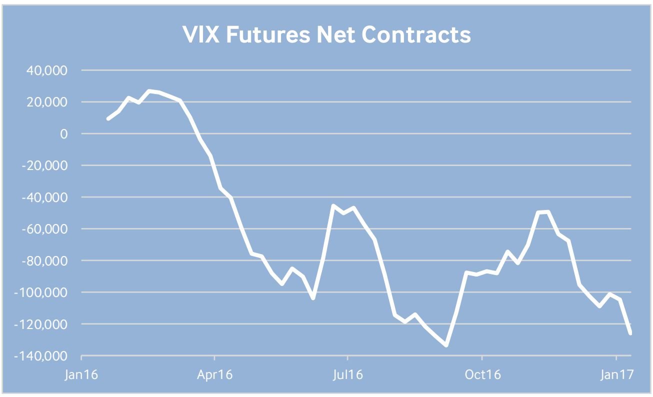
Pearson was founded in the UK in 1844, originally operating as a construction company until it moved all its activities into publishing in the 1920s. As with any business that lasts as long as they have, it has metamorphosed further over the years to the point where it now describes itself as the world's largest education company, with over 35,000 employees in more than 70 countries.

Being a publisher, Pearson's business is of course cyclical, but its exposure to educational publishing should give it some attractive defensive characteristics. Allied to this, its sharp decline in share price since 2015 meant, for someone considering it afresh on 1 January 2017, that it seemed cheap. Certainly it passed several of investors' value screening criteria. So what caused its precipitous decline this week? While confirming that 2016 was coming in in line with expectations, Pearson indicated that while it had previously anticipated a broadly stable North American higher education courseware market in 2017, they now assume that many of the downward pressures experienced in 2016 will continue. In summary, the US sales outlook is disappointing.

So, Pearson was "cheap", but this week it got a whole lot cheaper, so it wasn't "value". Easy to analyse with hindsight of course, but seasoned investors know that they never get it right all the time and the only way to mitigate such disappointments is to make sure portfolios are diversified. As for Pearson, is it "value" now? Shares are often over-sold on a disappointment, so perhaps so.

Pic of the Week

We can gauge the level of expectation of market volatility by looking at the number of net-short positions on the CBOE Volatility index (commonly known as the VIX index). Large investors have pushed the VIX to its lowest level since September, when it hit an all-time bottom. Bearing in mind that the S&P 500 is trading at all-time highs, is such calmness warranted? Unlikely.



Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-0.1%	+18.0%	+1.5%	+9.0%
US equities	+0.1%	+20.8%	+1.3%	+11.5%
European equities	+0.1%	+9.8%	+0.4%	+6.7%
EM equities	+0.1%	+25.7%	+4.1%	-2.0%
Irish equities	-0.8%	+2.9%	+1.1%	+16.8%
Commodities	+1.2%	+10.7%	+0.7%	-9.1%
Hedge funds	-0.3%	+5.5%	+0.3%	+1.5%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.9%	0.0%	+6.9%
Germany	+0.4%	+1.7%	+1.7%
USA	+2.5%	+2.1%	+1.7%
China	+3.2%	+2.1%	+6.7%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.06	+1.0%
EUR:GBP	0.86	+1.2%
EUR:CNY	7.28	-0.7%
GBP:USD	1.23	-0.3%
Bitcoin	905.64	-4.9%

Week ahead: Key events

23/01 Japan Leading Index & EU Consumer Confidence
24/01 Japan Manufacturing PMI
24/01 EU PMI Data
24/01 US Manufacturing PMI Data & Existing Home Sales
25/01 US Mortgage Applications
26/01 UK GDP & US Initial Jobless Claims
26/01 US New Home Sales & Tokyo CPI
27/01 US GDP

Commodities	*Current*	*YTD Δ*
Gold	1,199.55	+4.1%
Copper	5,740.50	+3.9%
Oil	54.19	-4.6%
Wheat	425.75	+4.4%

Central Bank rates	*Current*
Eurozone	0.00%
USA	0.75%
UK	0.25%

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