Investment Insight

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Inside the Trojan horse: *Seasoned investors play a long game. While the most famous example of this is probably Warren Buffett, another highly successful proponent is Troy Asset Management's Sebastian Lyon with whom we have invested for several years. This week, in his 53rd Investment Report, Sebastian he reflected on some of the behavioural factors that impact investment and how he has capitalised on these over the years. In October 2000 when Sebastian was launching Troy and the Trojan Fund, he was convinced that stock markets were expensive. While he admits that in many respects 2017 has little in common with 2000, he notes that "Most investors I meet and talk to are not thinking bullishly, but they are acting bullishly". In the* ***Inside Track****, we delve further into Sebastian's reflective insights, including his views on why passive investors might be more vulnerable at the current stage of the market cycle.*

Bonding*: At an investment conference this week we heard a well-respected economist express the view that bonds will almost certainly lose money for investors over the coming years but you've got to be invested in them. This might seem like a perplexing approach – consciously investing in something you expect to lose money – and in many ways it is. But rather than explain why this mightn't be an entirely irrational strategy, in this week's* ***Pic of the Week*** *we explain why bonds might lose money for investors and what the potential of such losses could be.*

Quoted...

"Patience is bitter, but its fruit is sweet"
– Jacques Rousseau

The Inside Track

Sebastian Lyon is Chief Investment of Troy Asset Management which he founded in 2000. The following are some of his recent comments from Troy's Investment Report released earlier this week.

Today's marginal equity buyer is more cautious than the retail investor day trader so prominent in 1999. Private investors are less interested in share tips, having learned from the permanent capital losses they endured as the tech boom turned to bust. With much of their capital gone to money heaven, a more diversified approach to investing has been desired. Index funds and exchange traded funds ("ETFs") are increasingly selected to do the job, leaving savers to invest without concern for stock picking or even selecting managers.

As active managers, we are admittedly at risk of appearing self-serving if we discuss the merits and drawbacks of passive investing. Our central concern is unsurprisingly related to blindly allocating capital according to market capitalisation rather than by means of value. Yet we would not deny that there is a time to "buy the market" via the purchase of an index. We have done just that at close to previous market bottoms in 2003 and 2008 by purchasing FTSE Futures.

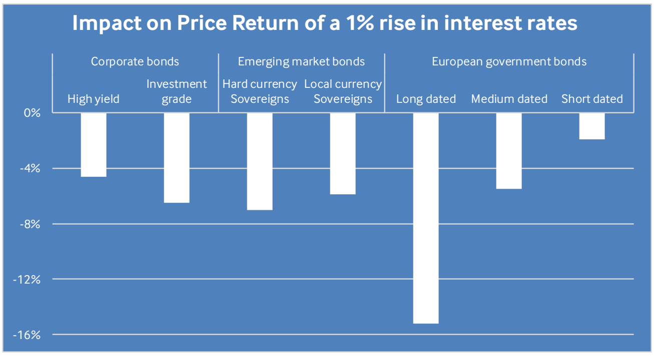
Following market bottoms it is the rump of distressed equities that bounce back the hardest. These are the types of business we actively eschew and so the purchase of index funds means our stringent approach to stock selection is not tainted. (In the spring of 2009, Barclays share price rose from 50 pence to 350 pence in a period of six months as disaster was averted for the banking sector. Interestingly this hope of recovery proved far too optimistic. The Barclays share price, eight years on, is 210 pence.) In short, when we buy the index we do so always as a deliberate choice, and never as a conditioned reflex.

To have some index exposure makes sense when you believe you are at the bottom of the cycle. Investors benefit from holding distressed shares that they may not wish to purchase individually, when the difference between survival and failure is binary. Today, over eight years into a cyclical bull market, we are as far away from those circumstances as it is possible to be.

Our fiduciary duty tells us to reduce risk into higher prices yet passive investing ignores such rationality. Passive investors, so right for so long, have become momentum investors. One day these forced buyers may become forced sellers. Indifferent purchases can just as easily be indifferent sales. Where will the value investors with cash appear? Arguably at significantly lower levels.

Pic of the Week

When bonds mature, all going well, bondholders get back the par value of the bonds. In the meantime, bondholders generally receive a "coupon", an interest payment set at a fixed rate determined when the bonds were issued. The coupon interest rate will reflect, amongst other things, the wholesale interest rate at the time the bonds are being issued. As wholesale interest rates fall the bond, which is then paying a relatively higher fixed interest rate, goes up in value, and vice-versa. With wholesale interest rates now starting to rise, it seems likely that many bond investors will suffer losses, but those most affected with be the holders of "long-dated" bonds – i.e. bonds that have a long period still to go before they are due for redemption. The following chart gives an indication, for a variety of bond types, of the impact on the bond returns of a 1% rise in interest rates.



Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	+0.8%	+17.6%	+7.8%	+10.2%
US equities	+0.5%	+16.2%	+6.8%	+12.0%
European equities	+1.2%	+18.7%	+9.2%	+9.0%
EM equities	+1.5%	+23.2%	+15.4%	+0.5%
Irish equities	+0.6%	+15.4%	+8.9%	+17.6%
Commodities	+1.2%	-4.3%	-5.1%	-9.2%
Hedge funds	+0.2%	+7.0%	+2.3%	+1.6%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.9%	+0.9%	+7.2%
Germany	+0.4%	+2.0%	+1.7%
USA	+2.4%	+2.4%	+1.9%
China	+3.6%	+1.2%	+6.9%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.09	+3.3%
EUR:GBP	0.84	-1.1%
EUR:CNY	7.51	+2.3%
GBP:USD	1.29	+4.3%
Bitcoin	1,863.49	+95.7%

Week ahead: Key events

15/05 UK House Prices & Japan PPI
15/05 China Retail Sales & Industrial Production
16/05 UK CPI & Eurozone GDP
16/05 US Housing Starts & Industrial Production
17/05 Japan Industrial production & UK Employment
18/05 Japan GDP & China Property Prices
18/05 US Jobless Claims & Leading Index
19/05 Eurozone Consumer Confidence

Commodities	*Current*	*YTD Δ*
Gold	1,223.72	+6.2%
Copper	5,475.25	-0.9%
Oil	50.83	-13.4%
Wheat	432.00	-0.5%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.00%
UK	0.25%

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