



Investment Insight

Friday, 19 May 2017

Asleep at the wheel? The risk of investments is commonly (although not necessarily correctly) measured in terms of volatility. Volatility is generally a calculation of how much the price of a security varies from its average price over a period of time. So, if two securities have an average price of 10 but the first ranges from 5 to 15 and the second from 9 to 11, the first will have a higher volatility measure and, as such, be regarded as a lot more risky. However, as with many statistics, this measure can generate misleading results which can be very dangerous for investors. In **The Inside Track**, we look at just such a situation which could see many investors sleepwalking into a trap.

Just peachy: With the media basking in impeachment inspired frenzy, how do we find out what the man or woman on the street thinks about the latest US political shenanigans? Well, we turn to the social sphygmomanometer of course: Twitter. Has the number of tweets containing the words "Trump" and "impeach" changed much, or does the media's interest in the matter far outweigh the general public's interest? In this week's **Pic of the Week** we take a look.

Quoted...

"Don't try to buy at the bottom and sell at the top. It can't be done except by liars."
 — Bernard Baruch

The Inside Track

Stock markets have exhibited historically low volatility over the year, and most particularly so over the past six months since Donald Trump's election. However, this has resulted in an important warning system for investors breaking down, with nasty consequences emerging this week.

It is not uncommon for investments, be they mutual funds, ETFs, stocks or bonds, to have their riskiness measured by how volatile their price is, measured in terms of standard deviation from their average price over a set period of time. They are then typically ranked on a scale from low to high risk. Ordinarily you would expect equities to score towards the higher end of this scale as they tend to be quite volatile.

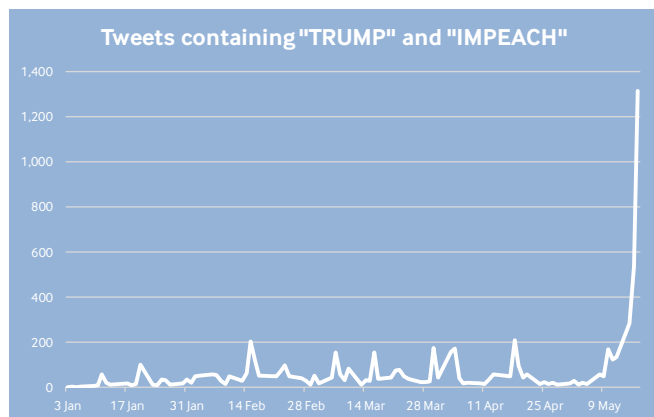
However, equity markets have been historically calm over the past year, demonstrating unusually low volatility. As a result, anyone calculating one-year volatility for equities is finding them scoring only around a 2 on the scale of 1 (low risk) to 5 (high risk), as opposed to a 4 or 5 which might be more normal. So, have equities become a low risk investment?

Well, of course not. A variety of factors have contributed to low levels of short-term volatility, but the inherent risk associated with investing in stock markets has not changed. Effectively what has happened is this key mechanism for assessing the riskiness of investments has broken down – it doesn't work properly in the current environment. This is starkly illustrated when we examine a Factsheet for a leading global equity ETF which shows the ETF in risk category 2 (assessed on 1-year volatility). The equivalent Factsheet from just 9 months earlier has the identical ETF in risk category 4, which is where we would expect it to be. Anyone who invested recently in what they thought was a relatively low-risk ETF will have gotten a rude awakening this week when volatility spiked by over 60% and global equities reported a material correction. This key investor risk assessment tool was asleep at the wheel.

In Europe, investors have become familiar in recent years with "ESMA Rankings" which are based on standard deviation rankings. They operate in a similar manner to what was described above, calculating weekly volatility of fund returns. However, a key attribute of ESMA Rankings is that they are measured over a five-year period, rather than just over one year. Consequently, it takes a lot longer for their "signals" to become distorted in the way some of the US risk ratings have been. Caveat emptor...or take advice!

Pic of the Week

A few tweets fantasising about the possible impeachment of the then President-elect Trump started just a few days after last November's election. In mid-February, when National Security Adviser Michael Flynn resigned, this grew to a few hundred. In recent days it's been heading towards a few thousand. With the media and Twitterers baying on one side, and Trump's unlikely ally Putin proffering evidence on the other, it presents an intriguing vista for neutral observers...if there is such a person!



Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-1.0%	+16.8%	+6.5%	+10.9%
US equities	-1.8%	+15.1%	+5.6%	+12.8%
European equities	-0.7%	+16.3%	+7.9%	+9.9%
EM equities	+0.8%	+27.0%	+17.0%	+2.2%
Irish equities	-4.1%	+10.0%	+5.5%	+17.9%
Commodities	-0.1%	+0.2%	-4.5%	-9.3%
Hedge funds	+0.2%	+6.8%	+2.4%	+1.8%

Economic indicators	Bond yields	Inflation	GDP YoY
Ireland	+0.8%	+0.9%	+7.2%
Germany	+0.3%	+2.0%	+1.7%
USA	+2.2%	+2.2%	+1.9%
China	+3.6%	+1.2%	+6.9%

Currencies	Current	YTD Δ
EUR:USD	1.11	+5.8%
EUR:GBP	0.86	+0.2%
EUR:CNY	7.67	+4.5%
GBP:USD	1.30	+5.4%
Bitcoin	1,853.31	+94.7%

Commodities	Current	YTD Δ
Gold	1,253.43	+8.8%
Copper	5,592.50	+1.3%
Oil	52.41	-10.7%
Wheat	428.25	-1.4%

Week ahead: Key events

22/05 UK House Prices & Japan Leading Index
23/05 Germany GDP & US New Home Sales
24/05 Japan & EU Manufacturing Data
24/05 US PMI Data & Existing Home Sales
25/05 UK GDP
26/05 Japan CPI & US GDP

Central Bank rates

	<i>Current</i>
Eurozone	0.00%
USA	1.00%
UK	0.25%

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