



# Investment Insight

Friday, 20 October 2017

**Sin in the City:** So-called “sin stocks”, companies directly involved in the alcohol, tobacco, gambling or weapons industries, have delivered significantly positive returns over the long term, often abnormally positive.

This might seem surprising. If anything, the existence of “responsible investing” strategies that specifically avoid investing in these types of companies should mean that they underperform. So why might this be the case? In this week’s **Inside Track** Robeco’s David Blitz provides an explanation.

**30 years young:** Yesterday was the 30th anniversary of Black Monday where the Dow, S&P 500, FTSE, DAX and CAC fell -23%, -20%, -11%, -9% and -10% respectively.

We thought it would be interesting to see how we might have fared had we invested in various assets the morning after the crash. In this week’s **Pic of the Week** we share the results.

### Quoted...

“Stocks fluctuate, next question.” - Alan Greenberg, CEO Bear, Stearns & Co., in response to questions about the crash in 1987

### The Inside Track

David Blitz, co-head of quantitative research at Robeco, and Frank Fabozzi, Professor of Finance at EDHEC Business School, investigated the outperformance of “sin stocks” in their article ‘Sin Stocks Revisited: Resolving the Sin Stock Anomaly’ published in the Journal of Portfolio Management. The following are some extracts that help to explain this apparent anomaly.

Companies selling alcohol or cigarettes among other human vices have historically enjoyed higher returns than the stock market indices to which they belong. Ironically, the stocks of tobacco companies have at times performed better than the pharma companies making cancer drugs to combat smoking-related illnesses.

Since all active fund managers chase alpha – seeking to make higher returns than the benchmark – this in theory makes them [sin stocks] ideal holdings. However, investors holding them can face reputational risk, particularly as lobbyists become increasingly vocal against industries known to harm human health such as alcohol or weapons.

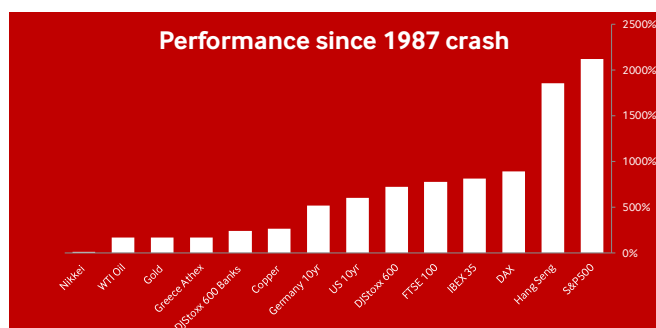
A popular explanation for the observed abnormal returns of sin stocks is that they are systematically under-priced because so many investors shun them. This enables investors who are willing to invest in sin stocks, going against social norms, to earn a reputation risk premium. Other explanations are that sin industries could benefit from monopolistic returns, or that these stocks face increased litigation risk for which investors are rewarded.

In fact, the outperformance of sin stocks can be explained by the two new quality factors in the recently introduced five-factor model by renowned economists Eugene Fama and Kenneth French. The profitability factor maintains that stocks with a high operating profitability perform better, while the investment factor suggests that companies with high total asset growth perform worse. Sin stocks tend to have high exposure to both factors; cigarette makers, for example, enjoy high margins due to relative price inelasticity, and are restricted in how they can grow their assets.

It means that investors who are uncomfortable holding sin stocks but don’t want to miss out on outperformance can proxy them by weighting their portfolios towards the Fama-French factors including profitability and investment.

### Pic of the Week

The jury is out as to what actually caused the 1987 crash. Reasons cited for the event include a slowdown in the US economy, falling oil prices, and escalating tensions between Iran and the US. However, a more sophisticated culprit that was a new entrant to the financial system should shoulder at least some of the blame for exaggerating the problem: computerised trading. The chart below details the performance across a number of asset classes since the crash. Although you might have been considered crazy at the time to dip your toe in when the markets were crashing, the rewards would have been considerable...mostly!



### Week ahead: Key events

- 23/10 Japan Business Conditions & Eurozone Consumer Confidence
- 24/10 Eurozone PMI Data & US Retail Sales
- 24/10 US Manufacturing PMI & Employment Data
- 25/10 UK GDP & US Mortgage Applications
- 25/10 US Durable Goods & New Home Sales
- 26/10 UK Manufacturing & ECB Interest Rate Announcement
- 26/10 US Initial Jobless Claims & Consumer Comfort Data
- 27/10 Japan Inflation Data & US GDP Estimates

### Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	+0.5%	+18.4%	+14.2%	+10.2%
US equities	+0.2%	+19.2%	+14.2%	+12.3%
European equities	+0.4%	+13.8%	+7.9%	+7.0%
EM equities	+0.5%	+23.4%	+30.7%	+2.3%
Irish equities	-1.1%	+12.5%	+3.5%	+15.8%
Commodities	+0.2%	+1.4%	-2.6%	-10.2%
Hedge funds	+0.1%	+6.6%	+4.8%	+2.0%

Economic indicators	Bond yields	Inflation	GDP YoY
Ireland	+0.6%	+0.2%	+5.8%
Germany	+0.4%	+1.8%	+2.1%
USA	+2.3%	+2.2%	+2.2%
China	+3.7%	+1.6%	+6.8%

Currencies	Current	YTD Δ
EUR:USD	1.18	+12.5%
EUR:GBP	0.90	+5.4%
EUR:CNY	7.83	+6.7%
GBP:USD	1.32	+6.6%
Bitcoin	5,678.30	+496.5%

Commodities	Current	YTD Δ
Gold	1,287.14	+11.7%
Copper	6,949.00	+25.8%
Oil	57.24	-2.5%
Wheat	433.50	-6.8%

Central Bank rates	Current
Eurozone	0.00%
USA	1.25%
UK	0.25%

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