Investment Insight

Friday, 9 February 2018

Bank on it: *Since the global financial crisis, investors have, quite understandably, put a premium on "quality". This means the share prices of companies with steady businesses and stable cash flows have been particularly strong. In contrast, those companies that were more directly mired in the financial crisis, such as banks, in relative terms struggled. However, Fidelity's Alex Wright thinks that this could be the year that investors reassess, swapping demand for sensible consumer staples for more apparently risqué financials. In* ***The Inside Track*** *we look at what informs his often contrarian (and just as often correct!) analysis.*

No bargains at the short sale: *This week saw a large spike in equity market volatility accompanying a material correction in prices. While some of the correction was fundamentally driven (some investors decided the stock market was overpriced and started heading for the exits), some of it was programmatic (computer-driven trades following pre-set rules). Many hedge fund investors, who were positioned "short VIX" for a continuation of the recent pattern of historically low volatility, experienced heavy losses this week as a result. In* ***Pic of the Week*** *we take a look.*

Quoted...

"It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning." – Henry Ford

The Inside Track

Fidelity's Alex Wright is one of today's most successful contrarian investors. He predicts a shift in investor sentiment this year will see previously unloved banking stocks come back into fashion. The following is a summary of his reasoning.

Steady businesses with stable cash flows have been in favour [for the past 10 years] and this has driven strong growth in the share prices of areas like consumer staples. These types of companies have historically struggled in an environment of rising interest rates and we could now be at a point of change where the market may start to reassess the prospects of hitherto unloved sectors.

In particular, banks could continue to positively surprise investors in the coming months. Valuations are attractive as they have been out of favour for some time, with most investors viewing banks as one of the riskiest sectors in the market.

This viewpoint is understandable, albeit one that I fundamentally disagree with. The trauma and aftermath of the crisis still dominates the collective imagination of the market and seems to be preventing investors from recognising the profound changes that have occurred inside banks and in the external operating environment.

Intense regulatory scrutiny means balance sheets are now generally much stronger than they have been for some time and the loans that are being written would seem to be much less risky than those made pre-2007. Regulators are also now becoming more willing for banks to make sizeable distributions to shareholders in the form of dividends and share buybacks.

Overall, financials remain the largest absolute sector weighting in both the Fidelity Special Situations Fund and Fidelity Special Values PLC. Key positions include Lloyds Banking Group as well international holdings in Citigroup and Bank of Ireland, where I see decent downside protection as well as the potential to deliver expectation-beating results as we progress through 2018.

Pic of the Week

One of the consequences of programmatic trades can be to amplify market movements and, therefore, volatility. Thus, when the VIX (which measures volatility) spiked this week from historically low levels, some hedge fund investors, who were "short VIX" (i.e. they were betting on its continued benign volatility) felt the pain. The overnight spike on Monday night meant a decline of almost one-third in the value of some of the short-VIX based exchange-traded notes held by many of these hedge funds. All good things come to an end.

Week ahead: Key events

12/02 UK Regional PMI Data & ECB Long-term interest rate statistics
13/02 UK Inflation
13/02 US Retail Sales & Japan GDP Estimates
14/02 Japan Retail Sales & Eurozone GDP
14/02 US CPI Data
15/02 Japan Industrial Production & US Manufacturing Data
16/02 UK Retail Sales & US Housing Data

Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	-4.9%	+2.9%	-4.0%	+11.6%
US equities	-5.0%	+2.7%	-3.8%	+14.8%
European equities	-5.4%	+5.6%	-4.1%	+8.2%
EM equities	-7.2%	+10.4%	-3.3%	+5.2%
Irish equities	-3.0%	+5.6%	-4.1%	+13.7%
Commodities	-2.3%	-7.5%	-3.3%	-7.9%
Hedge funds	-2.3%	+2.0%	-0.4%	-0.8%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.2245	+2.1%
EUR:GBP	0.8797	-1.0%
EUR:CNY	7.7465	-0.8%
GBP:USD	1.3914	+3.0%
Bitcoin	8,439	-41.8%

Commodities	*Current*	*YTD Δ*
Gold	1,318.85	+1.2%
Copper	7,005.00	-2.1%
Oil	65.33	-3.5%
Wheat	456.63	+7.0%

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

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.1%	+0.4%	+7.2%
Germany	+0.8%	+1.7%	+2.8%
USA	+2.8%	+2.1%	+2.5%
China	+2.1%	+1.8%	+6.8%

66 Fitzwilliam Square
Dublin 2
D02 AT27
Ireland

T: (+353 1) 685 4100
E: research@aria-capital.ie
W: www.aria-capital.ie

UNDIVIDED
ATTENTION

Important Disclosure. Aria Capital Limited is regulated by the Central Bank of Ireland. Financial data provided by Bloomberg. All values are indicative only. This Investment Insight has been prepared for information purposes only. It does not constitute investment advice or an offer to buy or sell securities. No investment decisions should be made without seeking appropriate professional advice. This document may not be reproduced in whole or in part without Aria Capital's permission. © Aria Capital Limited 2018 . All rights reserved.