# Investment Insight

Friday, 23 February 2018

ARIA | CAPITAL

***No shelter:*** *Where do you shelter when it's raining everywhere? This is analogous to the predicament that faces investors when all, or almost all, return-generating asset classes are simultaneously expensive, as is the case currently. It is certainly an issue that investment manager Ruffer grapples with. Ruffer is concerned that the seeds of the next financial crisis are in the fund management industry, not the banking system because, unlike bonds in 2008 or old-economy stocks in 2000, there are no conventional moneymaking protective assets in which to hide. Thus, despite their uncomfortable cost of carry, options and illiquid strategies may be a necessary cost of providing essential downside protection. Indeed, this strategy paid dividends a few weeks ago when volatility spiked. In* ***The Inside Track*** *we look in some more detail at Ruffer's prescient analysis, which was penned prior to the recent market selloff.*

***Watch out:*** *Despite the fact that the Apple Watch is consistently playing second (or third) fiddle to the iPhone in terms of public attention, the evidence suggesting that Apple has yet another hit product on its hands is piling up.*

*According to estimates, Apple shipped 8 million watches between October and December 2017, bringing its total for the year to more than 18 million. So while Apple shareholders may be pleased, shareholders in Swiss watch companies are less so. In* ***Pic of the Week*** *we show why!*

## Quoted…

*"It has been said that politics is the second oldest profession. I have learned that it bears a striking resemblance to the first." – Ronald Reagan*

## The Inside Track

London-based Ruffer manages over €25 billion of investment assets, and having been around since 1994, they've seen quite a few cycles come and go. However, this time they really do feel it's a bit different. The following are extracts from their recent report which help to explain why.

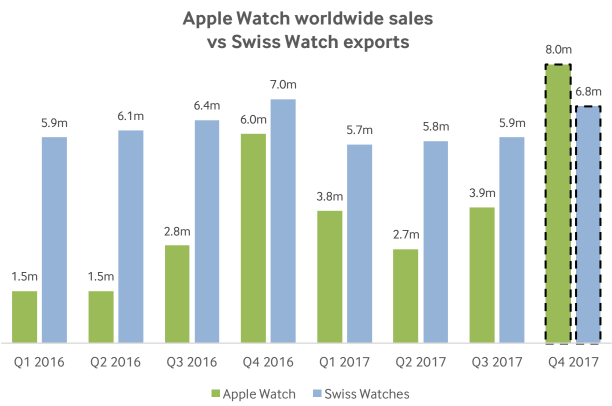
There is currently a tension at the heart of our analysis and this translates into the portfolio: on the one hand we are positive on the global economy, on the other, we are nervous about valuations and the technical fragilities we observe in financial markets. The momentum of synchronous global growth across all economic zones in 2017 has carried over into 2018. Advanced economies are growing at rates last seen in the early 2000s. Several factors give us confidence this could be sustained for a while longer. Despite the US Federal Reserve raising rates, global financial conditions are getting easier, not tighter. This is attributed to global quantitative easing, a weaker US dollar, rising equity markets and tightening credit spreads. There is a helpful fiscal tailwind across developed markets, given further impetus by President Trump's tax cuts. Labour markets are tightening gradually and we are seeing positive wage inflation. Lastly, a case can be made that we are at a favourable point in the inventory cycle with significant destocking over the last few years. It is for this reason we maintain our equity positions (albeit at an overall low weighting of 43%) and have focussed on cyclical stocks.

With this rose-tinted outlook investors might ask why we are not more bullish? The answer is our concern regarding valuations and technical stresses and skews in financial markets. Most investors accept, after nine years of zero rates and quantitative easing, that valuations across almost all asset classes have reached extraordinary levels. The wall of worry has been demolished and animal spirits are ablaze. The less obvious risk relates to investment behaviours that have evolved in recent years. Volatility is an obscure financial metric, having morphed from an observed output and barometer of financial stress, into a widely used input for many investment strategies. Goodhart's Law tells us 'when a measure becomes a target, it ceases to be a good measure'.

We estimate at least $1 trillion is, explicitly or implicitly, invested in assets using strategies designed to make money as volatility falls and this leverages exposure to risky assets the more this continues. This self-feeding mechanism is inherently unstable and if events cause a reversal (*i.e.* a spike in volatility) the result could be a sharp sell-off in asset markets. This process is exacerbated by the rise of computer-driven trading models and passive investment, both of which are strictly rule-based and unthinking in execution.

## Pic of the Week

In Q4 2017, sales of Apple Watches outstripped Swiss watch exports for the first time. For the full-year 2017, the Swiss reportedly exported more watches than Apple shipped, and the Chinese still make far more watches than anyone, but as the chart by Statista shows, Apple is rapidly gaining ground.




## Week ahead: Key events

26/02 Japan Business Conditions & US Residential Sales
27/02 Germany CPI & Eurozone Sentiment Indicators
27/02 US Retail Sales & House Prices
28/02 UK Consumer Confidence & House Prices
28/02 Japan Construction & EU Inflation
01/03 Japan, US & Eurozone PMI Data
01/03 BOE Interest Rates & EU Unemployment
02/03 US Consumer Data

## Market View

| | Last 7 days (€) | Last 12 mths (€) | YTD (€) | 5Y Ann. (€) |
|---|---|---|---|---|
| Global equities | +2.2% | +0.4% | -2.4% | +11.9% |
| US equities | +2.4% | -0.2% | -2.0% | +14.8% |
| European equities | +1.2% | +4.0% | -2.8% | +8.3% |
| EM equities | +2.4% | +10.7% | +1.1% | +6.1% |
| Irish equities | +1.0% | +2.5% | -3.5% | +13.4% |
| Commodities | +0.9% | -9.5% | -2.7% | -7.7% |
| Hedge funds | +0.3% | +1.1% | -0.5% | -0.9% |

| **Currencies** | *Current* | *YTD Δ* |
|---|---|---|
| EUR:USD | 1.2331 | +2.8% |
| EUR:GBP | 0.8842 | -0.5% |
| EUR:CNY | 7.8297 | +0.3% |
| GBP:USD | 1.3949 | +3.3% |
| Bitcoin | 10,564 | -27.1% |

| **Commodities** | *Current* | *YTD Δ* |
|---|---|---|
| Gold | 1,328.11 | +2.0% |
| Copper | 7,002.00 | -2.2% |
| Oil | 65.02 | -1.4% |
| Wheat | 447.38 | +4.8% |

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

| **Economic indicators** | *Bond yields* | *Inflation* | *GDP YoY* |
|---|---|---|---|
| Ireland | +1.2% | +0.2% | +7.2% |
| Germany | +0.7% | +1.6% | +2.8% |
| USA | +2.9% | +2.1% | +2.2% |
| China | +2.1% | +1.5% | +6.8% |

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