ARIA | CAPITAL

Investment Insight

Friday, 13 April 2018

A view from the trenches: *Recent military activities in Syria make this more than just a metaphorical title. Markets are vacillating between "risk on" and "risk off" according to the latest geo-political and military events, this at least temporarily displacing tariff concerns as investors' dominant concern.*

We have observed in previous Investment Insights how all conventional asset classes – equities, bonds, property and cash – are, on a variety of metrics, expensive. In some cases they reach close to all-time high expense levels. Markets tend to mean-revert over time meaning that, simply put, if you buy something that's cheap you've a better chance of making above-average returns over time and vice-versa. This presents a challenging vista for many investors; however, all is not lost. Regulated "alternative" investments have flourished over the past decade, meaning that it's quite possible to make very acceptable investment returns without taking excessive risk notwithstanding the fact that traditional asset classes are expensive. One highly regarded exponent of this science is London-based Ruffer. In ***The Inside Track*** *we share their assessment of investment markets over the last couple of months and where they see things going from here.*

Reinvention*. IBM was founded over a century ago and in the intervening period it has, of necessity, reinvented itself on more than one occasion. Some of the changes have been iterative, some more transformational. IBM no longer makes PCs and one of its more recent acquisitions was of an online weather-forecasting company. Regardless, this week it faced investors to deliver lacklustre Q1 results and those investors were fairly unforgiving. In stark contrast Netflix, founded a mere 21 years ago, also released results this week and investors celebrated. In* ***Pic of the Week*** *we look a bit closer at how the new kid on the block has rapidly caught up with the establishment player.*

Quoted...

"Now let it work. Mischief, thou art afoot. Take thou what course thou wilt." – William Shakespeare, Julius Caesar

The Inside Track

"Nowhere to hide" describes the investment landscape for investors in traditional asset classes. Looking back over the last couple of months, "alternative" investor Ruffer explains why.

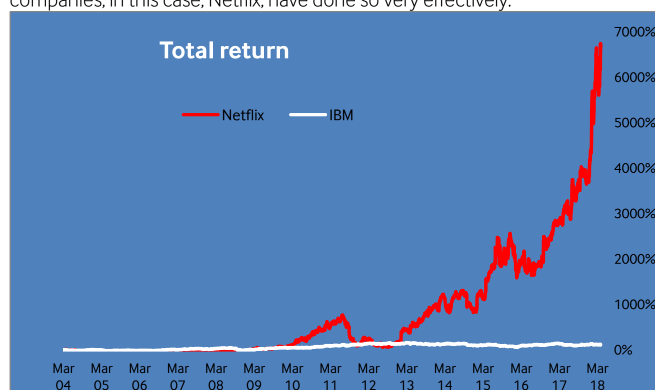
On the heels of new U.S. sanctions and a chemical weapon attack in Syria, the Russian market fell 10% The main news flow during the month related to good old-fashioned geopolitical tensions. The risk of President Trump's tariff chatter becoming a reality had a meaningful impact as the possibility of trade wars became more likely. Technology stocks also suffered, led by Facebook as the company came under scrutiny for the (mis)use of customer data.

Perhaps the most significant feature of financial markets in both February and March has been the scarcity of hiding places. Many traditional safe-havens failed to perform. In sterling terms, gold, gilts, treasuries, the dollar and the Swiss franc have all fallen in value since the start of the year. For most of the last 30 years (the career span of most fund managers) simply holding a portfolio of equities and bonds has worked well (with a couple of notable exceptions). The promise of central bank support has encouraged and sustained rises in asset prices, whilst at times of distress, negative bond-equity correlation has ensured a portfolio of equities and bonds would be sufficient to make at least some headway. More recently zero interest rates have suppressed yields while also driving up equity values. This has resulted in a significant increase in the correlation between equities and bonds, which has substantially reduced the effectiveness of traditional offsetting assets. For this reason, we have stressed the importance of some of the more esoteric parts of the portfolio, principally the option exposure and credit default swaps. We think that recent correlation is here to stay and, if we are right, these assets will have an important role to play. Our option exposure is positioned to protect from large market moves not bumps in the road. The latter would likely result in a zero-sum game or worse, and we prefer to focus on what we fear will be the significant inflection points.

Where do we go from here? The bulls will view the 7% fall in global equities in the last ten weeks as a bump in the road. The bears fall into two camps. On the one hand, this is the late stage of the economic cycle and valuations look unjustifiably high. On the other, the combination of recent fiscal stimulus on top of an overheating US economy will lead to a spike in inflation and bond yields, undermining the argument that high valuations in equities can be justified by low interest rates. We would fall into the latter camp, yet remain cognisant of the fact that economic growth could remain robust. In this case, we want our equities to benefit and hence the bias towards cyclical stocks. In the very short-term, the summary of Nick Carn of Carn Macro Advisors seems apt: markets will continue to behave in a way that disappoints the bulls and frustrates the bears. After February's sell-off (on seemingly good economic news), we should all be careful what we wish for.

Pic of the Week

To illustrate just how times have changed, IBM's market cap is now smaller than Netflix's. A mere one year ago, there was almost $100 billion in the difference, while five years ago the difference was about $225 billion. The total-return chart illustrates just how, despite its best efforts to remain current, IBM has struggled to create shareholder value while other newer technology companies, in this case, Netflix, have done so very effectively.



Week ahead: Key events

Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	+1.7%	+2.6%	-2.3%	+11.3%
US equities	+2.0%	+2.0%	-2.5%	+14.1%
European equities	+1.6%	+4.3%	-1.5%	+8.7%
EM equities	+0.2%	+8.2%	-1.3%	+6.4%
Irish equities	+2.8%	+1.3%	-3.9%	+12.2%
Commodities	+1.4%	-10.6%	+0.2%	-6.8%
Hedge funds	+0.5%	+0.5%	-2.0%	-1.3%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.2339	+2.8%
EUR:GBP	0.8693	-2.2%
EUR:CNY	7.7434	-0.8%
GBP:USD	1.4194	+5.1%
Bitcoin	8,220	-43.3%

Commodities	*Current*	*YTD Δ*
Gold	1,345.30	+3.3%
Copper	6,784.00	-5.2%
Oil	73.74	+11.5%

23/04 Eurozone & US PMI
24/04 UK House Price Index & US Retail Sales
24/04 US House Prices & Consumer Confidence
25/04 US Mortgage Applications
26/04 ECB Interest Rate Announcement
26/04 US Initial Jobless Claims
27/04 Japan Monetary Policy Meeting & UK Consumer Confidence
27/04 US GDP

Wheat	473.50	+11.0%

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

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.0%	+0.2%	+7.2%
Germany	+0.6%	+1.6%	+2.9%
USA	+2.9%	+2.4%	+2.2%
China	+2.1%	+2.1%	+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.