IMPERIUM CAPITAL

momentum

Dodgeball

Weekly Digest

6 August 2018

– James Klempster, CFA

When I meet our investors and potential investors I often make the point that one of the facets of our approach that I am most proud of is our track record of keeping investors out of mischief. There are a number of different ways that investors can lose money. Some are risks that are inherent in investing such as having to convert a paper loss into an actual loss because you have to liquidate a holding which is underwater which would likely recover if given time. There are many other ways to lose client money which are permanent. These are often a result of careless strategy selection rather than market characteristics.

The irony is that there is no track record that we can point to that overtly shows the impact of avoiding stumbles. Rather the absence of these potential drags on returns are only evident from the good long terms returns we have delivered to clients which would be lower had we seen greater impairments of capital.

There are a number of different types of potential mishaps that exist for the unwitting, but generally they fit into one of three broad categories.

The first are liquidity mismatches. The funds that we invest in are generally daily dealing and many of these daily dealing funds buy illiquid assets within them. This is a clear risk that is manageable in normal times but if there is a rush for the door these funds turn into lobster pots – very easy to get into but devilishly difficult (and all too often impossible) to exit when you want to. If these strategies become forced sellers, investor losses can accumulate rapidly. Worse still, they may be 'gated' and it could be months before you get your money back (at a likely discount).

The second are naïve investment theses. Many sound good on paper but even the most level headed back tests are the product of hindsight which may not fit the future as well as the past. Hedges are often imperfect, long term relationships can break down sporadically and ultimately there have been many smart investors undone by a heady mix of overconfidence and the perniciousness of markets. Remember David Viniar's remark in 2007: "We were seeing things that were 25-standard deviation moves, several days in a row." That's so vanishingly close to meaning "impossible" that we can allow ourselves to paraphrase it as such. Improbable is not the same as impossible, sadly. The usual suspects that can lead to a strategy coming unstuck include leverage, poor risk controls, mark to model, regulatory or tax changes and so on.

The third is malign intent. Rarely is this patently obvious, of course, but there have been a number of instances where we have recommended our investors steer clear of strategies that didn't 'smell right'. If something appears too good to be true, or too mind-bendingly difficult to comprehend or so opaque that it is difficult to fathom, we tend to walk away.

Our process is not infallible, and this article tempts fate, but over the years by doing very detailed research, being savvy and unafraid to ask simple questions we have saved our investors literally tens millions of dollars, if not more and, while far less glamourous than stellar gains, avoiding permanent losses is actually very rewarding indeed. Unfortunately, you'll have to take my word for it.

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The Marketplace

- Brent crude oil finished the week at 73.5, up 0.4%
- Gold was down 0.8% to $1215.88 per ounce
- Trade disputes rumble on, fuelling uncertainty
- Stocks slide amid trade war fears

Market Focus

US

- The Dow Jones index fell 0.3% closing at 25333
- The Nasdaq 100 rose 1.4% to 7395.5
- Apple shares jumped 3.5% on the back of strong results in its services business and better than expected iPhone sales
- The S&P index rose 0.8% to 2840
- US Non-farm payrolls increased by 157,000 in July and the jobless rate fell back below 4%. These were in line with Federal Reserve's outlook

UK

- UK was the only G7 country to see slowed growth during 2017, down to 1.7% from 1.8%
- The Bank of England's Monetary Policy Committee voted unanimously to increase interest rates to 0.75%, their highest level in almost a decade
- July Composite PMI dropped to 53.5 in July from 55.1 in June
- 20% of UK retailers plan to reduce headcount over the next quarter according to the British Retail Consortium
- The FTSE 100 fell over the week to 0.5% to 7659

Europe

- The Eurostoxx 50 fell 1.3% to 3482
- Euro area inflation accelerates to 2.1%, the highest since 2012. This was largely driven by increased energy prices
- GDP rose by 0.3% in Q2, this was slightly below expectations
- Economic sentiment for the Eurozone fell last month to 112.1 points to 112.3 in June. The largest decline came for the manufacturing sector amidst rising trade tensions

Asia

- The Nikkei fell 0.8% to 22525
- The US could be prepared to more than double tariffs on Chinese goods worth $200bn from 10% to 25% in an effort to bring China back to the negotiating table. A move described by the Chinese as 'blackmailing'
- Japan overtook China to become the world's second largest stock market last Thursday –a reversal of four years
- The Hang Seng fell by nearly 4% in a tough week for Asian equities

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 3 Aug. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	0.8%	1.4%	7.1%	16.5%
United Kingdom	GBP	-0.5%	-0.5%	1.8%	6.0%
Continental Europe	EUR	-0.6%	-0.4%	2.2%	4.6%
Japan	JPY	-1.9%	-1.4%	-3.0%	8.9%
Asia Pacific (ex Japan)	USD	-2.2%	-1.9%	-4.9%	3.6%
Australia	AUD	-1.0%	-0.7%	5.0%	13.5%
Global	USD	0.0%	0.4%	3.7%	11.5%
Emerging markets equities					
Emerging Europe	USD	-0.5%	-1.7%	-7.1%	1.6%
Emerging Asia	USD	-2.3%	-1.9%	-6.0%	3.7%
Emerging Latin America	USD	0.9%	0.6%	-1.1%	1.6%
BRICs	USD	-2.7%	-2.2%	-5.2%	5.7%
MENA countries	USD	-0.3%	0.0%	10.8%	10.4%
South Africa	USD	-1.4%	-1.7%	-13.1%	3.8%
India	USD	0.9%	0.5%	1.6%	6.8%
Global emerging markets	USD	-1.7%	-1.5%	-5.8%	3.2%
Bonds					
US Treasuries	USD	0.1%	0.2%	-1.5%	-1.6%
US Treasuries (inflation protected)	USD	0.2%	0.1%	-0.6%	1.0%
US Corporate (investment grade)	USD	0.2%	0.3%	-2.3%	-1.1%
US High Yield	USD	0.3%	0.3%	1.4%	2.7%
UK Gilts	GBP	-0.4%	0.3%	0.0%	0.7%
UK Corporate (investment grade)	GBP	0.0%	0.5%	-1.5%	-0.5%
Euro Government Bonds	EUR	-0.4%	-0.1%	-0.1%	0.2%
Euro Corporate (investment grade)	EUR	0.0%	0.2%	-0.2%	0.4%
Euro High Yield	EUR	0.1%	0.1%	-0.3%	1.0%
Japanese Government	JPY	-0.3%	-0.1%	-0.3%	0.3%
Australian Government	AUD	-0.4%	-0.4%	1.6%	2.6%
Global Government Bonds	USD	-0.4%	-0.4%	-1.9%	-1.6%
Global Bonds	USD	-0.3%	-0.3%	-2.0%	-1.4%
Global Convertible Bonds	USD	-0.3%	0.0%	-0.4%	0.2%
Emerging Market Bonds	USD	-0.6%	-0.3%	-4.6%	-3.8%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 3 Aug. 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	3.3%	3.1%	2.6%	3.7%
Australian Property Securities	AUD	0.6%	0.7%	1.8%	8.4%
Asia Property Securities	USD	-4.2%	-3.7%	-5.1%	-0.5%
Global Property Securities	USD	0.4%	0.4%	-0.3%	4.3%
Currencies					
Euro	USD	-0.5%	-1.0%	-3.6%	-2.3%
UK Pound Sterling	USD	-0.7%	-0.9%	-3.7%	-0.9%
Japanese Yen	USD	-0.3%	-0.3%	1.2%	-0.9%
Australian Dollar	USD	0.1%	0.0%	-5.2%	-6.8%
South African Rand	USD	-0.7%	-1.0%	-6.8%	0.9%
Swiss Franc	USD	0.1%	-0.5%	-1.9%	-2.3%
Chinese Yuan	USD	-0.5%	-0.5%	-4.9%	-1.9%
Commodities & Alternatives					
Commodities	USD	0.0%	-0.8%	3.0%	12.4%
Agricultural Commodities	USD	1.3%	0.4%	1.4%	-2.4%
Oil	USD	-1.5%	-2.3%	9.5%	40.8%
Gold	USD	-0.8%	-0.6%	-6.9%	-4.1%
Hedge funds	USD	-0.3%	-0.1%	-1.0%	1.5%

Source: Bloomberg. Past performance is not indicative of future returns

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Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at
The Rex Building, 62 Queen Street, EC4R 1EB

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