

# Weekly Digest

Week ending 12 June 2016

## Investing in property: which compromise to take

In the UK property is a national preoccupation. Rarely does a dinner party pass without discussion of property prices. In fact the interest in UK property stretches far further than that. At Momentum we work with wealth managers all over the world. And in client meetings we are regularly asked for our view on the UK property market and how best to invest here.

There are a number of different ways to gain exposure to property. Each of these approaches has their pros and cons and, ultimately, the choice of which vehicle to use pivots on which compromise is the most appropriate in the circumstances. Property is illiquid and on the whole, expensive per single unit, so the majority of the potential compromises centre on the ability to deploy or raise capital and the ability to achieve decent diversification in portfolios. Both of these issues are, in part at least, mitigated by investing on a commingled basis. Most of the time investor flows will not all be in the same direction making cash flows more manageable and the aggregation of many investors' assets reduces the idiosyncratic risk of any one holding in the property.

The pros of buying property directly are that the returns series tend to be less volatile than listed equivalents, but the cons are that it is illiquid and it is difficult to achieve diversification, due to the cost of individual properties. Also a portfolio of properties probably needs to use specialist property managers to ensure appropriate management of the assets. This is why investors often join together in funds to invest in direct property. Open ended funds can invest in direct property but it is important to ensure that the liquidity of the vehicle is appropriate given the illiquidity of the underlying. A property can take months to sell in good times and during times of market stress the process

can become even worse: this is why we saw so many daily dealing open ended funds have to gate or use other exceptional measures, as they experienced outflows post financial crisis. Having a fixed pool of capital reduces the risk of outflows. A private equity style vehicle offers only limited liquidity, which gives the property manager time to generate returns undistracted by the whims of investor flows, but the disadvantage for the investor is, should they require the return of their capital soon, they may not be able to without a severe haircut. REITS and listed property companies offer a fixed pool of capital for the investment manager, but because they are listed they are marked to market daily, meaning that their price – in the short term at least – appears more volatile.

The market is, therefore, complex and that is before you take account of leverage, and a variety of other factors unique to each fund, that make them difficult to compare directly. Some invest in relatively unglamorous, secondary, property whereas others invest only in top tier prime locations. Some funds have certain niches or focuses whereas others have greater sector or regional diversification. There are a variety of different pricing methodologies in place too. Given the expense of trading property it is important that the fund you use has a mechanism in place to capture the costs of buying and selling property, to ensure that existing holders are not penalised by the actions of other investors. Finally, to manage liquidity, many open ended direct property funds also make use of listed property securities and cash. Different funds do this to varying degrees. It is therefore key, when considering using property funds, to do a lot of research into the available manager universe and to be clear on which of the many necessary compromises you are willing to take and those you are not.

## The Marketplace

- Poor week for developed market equities
- European government bond yields at record lows
- Sterling volatility peaks
- Mixed Eurozone production data
- Chinese trade surplus increases once more

## Market Focus

### Global

- The only major developed equity market to post a positive return over the week was the Asia Pacific region, with a return of 1.1% in US dollar terms. Developed markets in aggregate lost 0.8%, while emerging markets fared better, advancing by 1.0%.
- The only global bond market to lose ground over the week was convertible bonds, down 0.5%, while US high yield was a notable performer with a return of 1.0%. German 10 year bund yields finished the week at a record low of 0.02%, while UK 10 year gilt yields also hit an all-time low of 1.2%.
- On Tuesday (7 June), the World Bank cut its global GDP forecast from 2.9% to 2.4% in 2016.

### UK

- Polls released during the week showed a lead for “Brexit” in the EU referendum, causing the volatility of the sterling-dollar currency pair to spike to 21.5%, its highest level since February 2009.

- April’s industrial production figure surprised to the upside, with a 2.0% month-on-month gain versus analyst expectations of 0.0%. This, the largest monthly increase since 2012, took the year-on-year figure to 1.6% from -0.2% the previous month.

### Europe

- Industrial production in France advanced by 1.2% in May, compared to expectations for a 0.4% rise, while in Italy figures were also better than predicted at +0.5%. On the flip side, German exports in April were expected to have grown by 0.8%, but came in flat.

### China

- Trade figures for May proved mixed once again: while imports fell just 0.4% on a year-on-year basis compared to expectations for a 6.8% fall, exports fell 4.1%, broadly in line with expectations. Both of these figures were much improved on April’s results. On a monthly basis, exports increased while imports fell, leading to a USD 4.5 billion increase in the trade surplus.

### Commodities

- After Brent crude oil ticked above USD 50 per barrel during the previous week, WTI oil followed suit last week, for the first time since July 2015. The closing price on Wednesday represented a gain of 95.5% from the low in early February, boosted by supply issues in Nigeria.

*James Klempster, CFA & Jonathan Adamson*

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Asset Class/Region	Currency	Currency returns			
		Week ending 10 June 2016	Month to date	YTD 2016	12 months
<b>Developed Market Equities</b>					
United States	USD	-0.1%	0.0%	3.3%	1.1%
United Kingdom	GBP	-1.3%	-1.5%	0.3%	-7.4%
Continental Europe	EUR	-2.3%	-3.7%	-7.2%	-12.1%
Japan	JPY	-0.5%	-3.6%	-13.1%	-16.6%
Asia Pacific (ex Japan)	USD	1.1%	1.6%	1.8%	-11.1%
Australia	AUD	-0.1%	-1.2%	2.4%	1.7%
Global	USD	-0.8%	-0.5%	1.3%	-4.3%
<b>Emerging Market Equities</b>					
Emerging Europe	USD	0.4%	0.9%	11.5%	-11.2%
Emerging Asia	USD	1.3%	1.8%	1.2%	-13.4%
Emerging Latin America	USD	0.3%	3.5%	16.6%	-15.3%
BRICs	USD	0.3%	0.9%	1.5%	-19.7%
MENA countries	USD	1.7%	2.1%	0.6%	-19.3%
South Africa	USD	-0.6%	4.6%	12.4%	-14.6%
India	USD	-0.5%	0.6%	2.4%	-2.9%
Global emerging markets	USD	1.0%	2.2%	4.5%	-13.7%
<b>Bonds</b>					
US Treasuries	USD	0.5%	1.3%	4.6%	6.6%
US Treasuries (inflation protected)	USD	0.6%	1.5%	5.8%	5.2%
US Corporate (investment grade)	USD	0.6%	1.4%	6.8%	7.6%
US High Yield	USD	1.0%	1.0%	9.2%	1.2%
UK Gilts	GBP	0.5%	2.1%	8.0%	11.4%
UK Corporate (investment grade)	GBP	0.5%	1.8%	6.3%	7.9%
Euro Government Bonds	EUR	0.5%	1.0%	4.3%	8.1%
Euro Corporate (investment grade)	EUR	0.3%	0.7%	3.8%	4.9%
Euro High Yield	EUR	0.4%	0.5%	4.8%	3.6%
Japanese Government	JPY	0.5%	0.4%	6.6%	9.3%
Australian Government	AUD	0.6%	1.1%	5.2%	7.9%
Global Government Bonds	USD	0.3%	2.3%	9.2%	10.6%
Global Bonds	USD	0.3%	1.8%	7.6%	8.0%
Global Convertible Bonds	USD	-0.5%	0.2%	0.5%	-2.5%
Emerging Market Bonds	USD	0.6%	1.9%	9.4%	11.2%

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Asset Class/Region	Currency	Currency returns			
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<b>Property</b>					
US Property Securities	USD	0.3%	1.2%	6.9%	13.5%
Australian Property Securities	AUD	1.4%	1.2%	12.7%	15.8%
Asia Property Securities	USD	0.0%	1.4%	1.9%	-6.9%
Global Property Securities	USD	1.3%	1.5%	6.6%	5.6%
<b>Currencies</b>					
Euro	USD	-1.0%	1.2%	3.6%	-0.7%
UK Pound Sterling	USD	-1.9%	-1.6%	-3.3%	-8.2%
Japanese Yen	USD	-0.4%	3.5%	12.4%	14.6%
Australian Dollar	USD	0.1%	1.9%	1.2%	-5.0%
South African Rand	USD	-0.4%	3.7%	2.2%	-18.7%
Swiss Franc	USD	1.2%	3.1%	3.9%	-3.4%
Chinese Yuan	USD	-0.3%	0.2%	-1.2%	-5.6%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	1.8%	3.2%	11.8%	-16.8%
Agricultural Commodities	USD	1.8%	4.9%	10.6%	2.0%
Oil	USD	1.8%	1.7%	35.6%	-23.1%
Gold	USD	2.4%	4.8%	20.0%	7.4%
Hedge funds	USD	0.5%	0.7%	-0.5%	-6.1%

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