Weekly Digest

Week ending **20 August 2017**

North Korea: a real cause for concern?

Since its independence from Japan at the end of the Second World War, North Korea has remained one of the most secretive, isolated countries in the world. The country operates as a one-party state, governed by the Worker's Party of Korea (WPK) and led by supreme leader Kim Jong-un, Chairman of the WPK. The WPK in combination with the army dominate all aspects of Korean life, with the state controlling almost every means of production and subsidising most services. The media is strictly controlled by the government with the sole purpose of maintaining the personality cult of the Kim family and the agenda of the state. Perhaps unsurprisingly, North Korea ranked last on the 'Press Freedom Index' in 2017.

The US and North Korea have maintained hostile relations since the beginning of the cold war and relations continue to be in focus as they have been at the forefront of President Trump's foreign policy agenda since the beginning of his presidency. Tensions have intensified following an announcement that North Korea has produced a nuclear warhead small enough to fit inside missiles, marking a major advancement in their ability to strike the US. In response to this, Donald Trump threatened a retaliation "like the world had never seen before" should North Korea strike US territory. North Korea stated they had plans to strike a major US military base on Guam by the middle of August; however, a few days afterwards they retracted the statement, easing tensions.

For months the US and its allies have sought to pressure the North Korean regime to give up its nuclear programme and solve issues diplomatically. In response to North Korean missile tests in July, the United Nations passed further economic sanctions, which China recently adopted. Despite the efforts, North Korea views nuclear weapons as indispensable for national defence and hence the continuation of the regime. Experts believe it is likely North Korea will continue to develop nuclear weapons until they have the ability to strike mainland US, after which they would have sufficient bargaining power to enter full-scale diplomatic negotiations. Given Donald Trump's aggressive stance to the regime's nuclear program, such progress could be misinterpreted and strongly acted upon. Many of Trump's administration, including Secretary of State Rex Tillerson, prefer a more diplomatic stance; however, this may require concessions to the regime which Trump is unlikely to give way on. For now it appears only China could pressure North Korea to stop its nuclear programme, but China is highly unlikely to destabilise the region for the benefit of mostly the USA long-term.

Amidst all this, is there genuine cause for concern? Given that North Korea's primary objective is survival of their regime, it is highly unlikely they wish to engage in full scale nuclear war as this would achieve quite the opposite. The risk pertains to the unpredictable nature of both leaders and the potential for misinterpretation of moves by both sides, combined with North Korea's rapidly advancing nuclear programme. Even considering this, many of Trump's advisors would discourage a strengthening of his rhetoric, whilst China is likely to pressure Kim into avoiding war should the situation escalate to that level.

Although the war of words is unlikely to transpire into full scale war, it has at the very least had an impact on the otherwise benign financial markets of late and brings into question the ability of a portfolio to tolerate such shocks.

The market response to the tensions has been broadly predictable; since Monday 7th of August, US equities have fallen 2.1%, whilst investors have bid-up safe haven assets such as gold and US Treasuries which have risen 2.1% and 0.5% respectively. In addition, at its peak, the VIX index of volatility increased up to 62%, rising from 9.9 to 16.0. The portfolio manager's positioning has not been adjusted based on these particular risks; rather, they construct portfolios to ensure they are robust throughout the cycle and capable of cushioning such market shocks. The best method to achieve this is through constructing well diversified portfolios across a wide range of parameters including asset classes, geography and investment strategy, to guard against eventual outcomes becoming hostage to one particular scenario. In the past year, the managers have made adjustments to the portfolios to ensure further resilience. They have reduced the portfolios equity and credit exposures, taking note of heightened valuations, whilst increasing their exposure to liquid alternative strategies with returns that are likely to be uncorrelated relative to more typical asset classes. They have also introduced positions in S&P 500 put options, on the basis that put options offer cheap protection at a time of relatively low volatility. Whilst the managers believe the bull market in equities has further to run, valuations have risen and are increasingly vulnerable to a correction, justifying a more conservative stance.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

The **Marketplace**

- Eurozone GDP growth outpaces expectations
- US-North Korea tensions ease
- Japan reports strong GDP growth
- UK records negative inflation in June
- President Trump disbands Business and Manufacturing forums

Market **Focus**

US

- Following a war of words between US President Donald Trump and Kim Jong-un of North Korea, tensions cooled after North Korea announced it would re-think targeting the US military base on Guam.
- The S&P 500 fell 1.5% on Thursday, its worst day of the year. This follows an increasingly uncertain US political backdrop heightened by speculation that President Trump's chief economic advisor Gary Cohn, a key orchestrator for tax reforms, was due to resign. US equities ended the week down 0.6%.
- Inflation expectations among Federal Reserve members continue to differ as several Federal Open Market Committee members stated they expect inflation to remain below 2.0% for longer than expected, shortly after New York Federal Reserve President William Dudley suggested inflation will move higher as the labour market tightens.
- On Wednesday Donald Trump disbanded the Business Advisors and Manufacturing Council forums. This follows a series of resignations as members condemn Donald Trump's response to the violent events in Charlottesville.
- President Trump's chief strategist Steve Bannon resigned on Friday.

UK

- Consumer price index inflation for July was -0.1% leaving year-on-year core inflation at 2.4%. July inflation was slightly below expectations of 0.0%, dampening policy rate rise expectations.
- The UK unemployment rate for June fell to 4.4%, the lowest rate since 1975.
- In response to the European Union's suggestion that the UK was unclear on numerous Brexit issues, the UK published papers detailing their stance on key issues including the rights of EU citizens living in the UK.
- UK equities rose 0.3% during the week.

Europe

- Year-on-year GDP growth in Germany outpaced expectations at 2.1% versus a 1.9% consensus. This follows revisions upwards to Q1 GDP growth and Q2 growth announced at 0.6%.
- Eurozone year-on-year GDP rose to 2.2%, the highest rate since March 2011, following better than expected growth in the Netherlands, Germany and Italy.
- In the week, Brent crude rose 1.2% whilst Continental European equities rose 0.9% in Euro terms.

Asia

- China implemented United Nations sanctions on North Korea in response to missile tests in July, banning imports of North Korean coal, iron ore and seafood.
- Japan's economy grew faster than expected after reporting a 4.0% annualised increase in GDP in Q2 2017 versus expectations of 2.5%
- The IMF upgraded China's growth outlook, anticipating an average of 6.4% GDP growth during 2017-2021 versus 6.0% anticipated the year before. The revision is partly due to an evidently more sustainable growth path and the implementation of widespread reforms.

Oliver Cooper & Stephen Nguyen (CFA)

Source: Bloomberg. Returns in US dollars unless otherwise stated.

IMPERIUM CAPITAL

momentum

Weekly Digest

Week ending **20 August 2017**

Asset Class/Region	Currency	Currency returns			
		Week ending 18 August 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-0.6%	-1.7%	9.3%	12.5%
United Kingdom	GBP	0.3%	0.0%	5.8%	10.8%
Continental Europe	EUR	0.9%	-0.2%	8.2%	15.3%
Japan	JPY	-1.2%	-1.3%	6.4%	26.5%
Asia Pacific (ex Japan)	USD	1.5%	-0.9%	24.9%	19.1%
Australia	AUD	1.3%	0.9%	4.1%	8.9%
Global	USD	-0.3%	-1.4%	11.7%	13.3%
Emerging markets equities					
Emerging Europe	USD	0.2%	0.4%	9.4%	17.8%
Emerging Asia	USD	1.7%	-1.1%	28.6%	21.2%
Emerging Latin America	USD	1.6%	1.8%	21.4%	14.9%
BRICs	USD	1.9%	0.3%	27.3%	23.1%
MENA countries	USD	-0.5%	0.2%	4.6%	11.5%
South Africa	USD	3.3%	0.8%	16.3%	3.3%
India	USD	1.3%	-2.2%	28.8%	19.9%
Global Emerging Markets	USD	1.6%	-0.5%	24.8%	18.2%
Bonds					
US Treasuries	USD	0.0%	0.8%	2.9%	-1.6%
US Treasuries (inflation protected)	USD	-0.3%	0.5%	1.9%	-0.4%
US Corporate (investment grade)	USD	0.2%	0.3%	4.8%	1.7%
US High Yield	USD	0.0%	-0.7%	5.4%	8.3%
UK Gilts	GBP	-0.3%	1.4%	2.0%	-3.6%
UK Corporate (investment grade)	GBP	-0.1%	1.0%	4.2%	0.5%
Euro Government Bonds	EUR	-0.1%	0.8%	0.0%	-3.2%
Euro Corporate (investment grade)	EUR	0.0%	0.5%	1.9%	0.6%
Euro High Yield	EUR	0.2%	0.1%	5.3%	7.4%
Japanese Government	JPY	0.1%	0.3%	-0.1%	-2.2%
Australian Government	AUD	-0.1%	0.4%	2.9%	-1.4%
Global Government Bonds	USD	-0.1%	0.7%	6.6%	-3.2%
Global Bonds	USD	-0.1%	0.5%	6.6%	-1.2%
Global Convertible Bonds	USD	-0.2%	-0.9%	7.9%	4.6%
Emerging Market Bonds	USD	0.6%	0.7%	7.5%	2.0%

Source: Bloomberg

Weekly Digest

Week ending **20 August 2017**

Asset Class/Region	Currency	Currency returns			
		Week ending 18 August 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	0.0%	-2.5%	0.7%	-4.7%
Australian Property Securities	AUD	2.3%	2.1%	-4.1%	-10.4%
Asia Property Securities	USD	-1.2%	-1.3%	19.1%	12.0%
Global Property Securities	USD	0.1%	-1.6%	9.2%	1.5%
Currencies					
Euro	USD	-0.6%	-0.5%	11.7%	3.5%
UK Pound Sterling	USD	-1.2%	-2.5%	4.1%	-2.3%
Japanese Yen	USD	-0.4%	0.9%	6.9%	-8.7%
Australian Dollar	USD	0.5%	-0.6%	10.3%	3.2%
South African Rand	USD	2.1%	0.6%	4.0%	1.6%
Swiss Franc	USD	-0.4%	0.1%	5.5%	-1.2%
Chinese Yuan	USD	-0.1%	0.9%	4.2%	-0.5%
Commodities & Alternatives					
Commodities	USD	-0.5%	-1.5%	-4.3%	-2.5%
Agricultural Commodities	USD	-1.9%	-5.3%	-4.3%	-5.2%
Oil	USD	1.2%	0.1%	-7.2%	3.6%
Gold	USD	-0.1%	1.5%	11.6%	-4.9%
Hedge funds	USD	0.1%	-0.6%	2.9%	4.3%

Source: Bloomberg

Important notes

This document is only intended for use by the original recipient, either a Momentum GIM client or prospective client, and does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient. The original recipient is solely responsible for any actions in further distributing this document, and in doing so should be satisfied that there is no breach of local legislation or regulation. This document should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this document is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, Momentum GIM does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

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

Momentum Global Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom, and is an authorised Financial Services Provider pursuant to the Financial Advisory and Intermediary Services Act 37 of 2002 in South Africa.