

# Weekly Digest

Week ending 22 October 2017

## Bitmad

Question in the office: ‘who wants to tackle cryptocurrencies?’ and cue everyone taking a step back. The portfolio managers are nervous about wading into this debate; they are not technology experts. Should anyone want to debunk this article therefore please, if possible, don’t start by saying, ‘you don’t understand technology’. Instead, help all of us technophobes by providing a simple, reasoned case in favour of cryptocurrencies.

What the managers’ understand of the technology – block chain – that underlies these crypto currencies sounds fascinating. A rules-based authentication system, with no central authority. In terms of money, this creates the potential for a diversified, more inclusive ledger and removes the need for, and hence the power of, a controlling oligopoly of large banks. This sounds like good news for the consumer who is likely to benefit from cheaper, more efficient clearing processes and hence a better service.

The value of some of the better known crypto currencies has been on a tear so far this year: Bitcoin +500%; Ethereum +4,000%(!). No investor likes to miss out on these types of returns. So, the all-important question: is there more to come?

We buy things because they make us happy. In order to understand what happiness or ‘utility’ we derive from a Bitcoin, we need to ask ourselves what it does.

‘Beauty is in the eye of the beholder’ they say. There is no single or ‘correct’ price for art; if we derive a lot of utility from a painting we experience as being beautiful, then we will pay a lot of money for it. Does Bitcoin have this same aesthetic value? Maybe it does for some. Maybe it also has some value as a status symbol.

Let’s say for the point of argument that we don’t derive a lot of utility simply from having a Bitcoin. Does it then have value in use? What are you going to do with a unique series of 0 and 1s? You can’t eat it; you can’t shelter under it; you can’t fashion anything out of it.

Bitcoin’s worth then comes from its use as a medium of exchange. Money helps solve the key problems facing buyers and sellers – how do I divide my produce; how do I move it so that I can trade with that person at a great distance to me; how do I store value for use at a future date? When exchanging real goods and services for money, you want to make sure that this money will still be worth something when you come to use it. With the pounds in the portfolio managers pocket, there is an authority which has a commitment to ensuring they are still worth something in 5, 10, 20 years’ time. Namely 90%, 80% and 50% less than they are worth today, virtue of a target inflation rate of 2% per annum. Now this authority may be the biggest robber in town, to use a popular characterisation of governments, but what is the managers alternative? Proponents of Bitcoin say that its price will stabilise but so far the managers have seen it go up by 400% this year, fall by 30%, then go up again by 70%. It seems a bad idea to exchange real goods and services for something that may or may not be able to buy them back in the future.

The economy needs fractional lending and credit creation in order to stimulate production. Given – what the managers’ hope will be – a growing economy, the amount of money in circulation also needs to grow, otherwise a fixed money supply represents an ever growing quantity of goods and services and we have deflation. This is why fractional lending is so important, and why we have an interest rate to control the price of money and hence its supply. Having these functions seems unavoidable to me in any kind of voucher system, electronic or otherwise, and yet they seem to be sorely missing from cryptocurrencies.

So, if Bitcoin has little use as a medium of exchange, all of its utility comes from selling at a higher price to what you bought it, preferably a multiple of times higher. And look at the strength of the trend? There can be a lot of information distilled in trends... Hence, as with everything, it is a question of risk aversion. The portfolio managers would not buy something or buy into a trend where the underlying good offers me no utility, other than the expectation that someone will pay more for it tomorrow. You may be different.

## The Marketplace

- Oil rose 1% on the week with Brent standing at USD 57.9
- Gold fell 1.6% to \$1,275
- Initial Coin Offerings (ICOs) in cryptocurrencies top \$3 billion this year
- Major currency volatility at three-month lows

## Market Focus

### US

- The S&P 500 continues its run of record breaking weeks closing at 2,575, up 0.9%
- Apple shares fell by 2.4% last Thursday on the back of 'disappointing' iPhone 8 orders
- 10 year Treasury yields closed the week flat at 2.4% after a very up-and-down few days
- Another record breaking week with The Dow Jones index ended the week at 23,329, up 2%
- The Nasdaq finished up 0.3% another record breaking week
- New chairman of the fed to be announced. Jerome Powell is the favourite and seen as the candidate most likely to maintain the status quo
- The senate voted 51-49 in the budget resolution motion – a positive move towards further planned tax reforms

### UK

- Sterling declines as confidence in a rate rise fades
- Unemployment fell by 52,000 between June and August. Jobless figures remain at a 42-year low

- Inflation running at 3%, climbing at the highest pace in five years –predominantly on food and transport
- The FTSE closed at 7,523, up 0.2% on the week
- A 'road map' between the European council and the European commission to be prepared by December to address the future relationship with the UK.

### Europe

- The Eurostoxx had a flat week, closing at 3,605
- Spain plans to suspend Catalonia's autonomy, ousting the regional president. Catalan parliament to meet today with their response
- Also an overall flat week on the Dax, closing at 12,991
- The ECB confirmed it will halve monthly bond purchases from EUR60 billion to EUR 30 billion next year

### Asia

- The Nikkei was up 2% at 21,696
- The Hang Seng finished the week down 0.6% at 28,305
- Xi Jinping gave twice in a decade party congress speech - warns of severe structural challenges that China faces to become a major superpower but claims that by 2050 china will become "a global leader in terms of comprehensive national strength and international influence"
- China's CPI for September was in line with expectations at 1.6% year on year

*Richard Stutley (CFA) & James Jones*

Asset Class/Region	Currency	Currency returns			
		Week ending 20 Oct. 2017	Month to date	YTD 2017	12 months
<b>Developed Market Equities</b>					
United States	USD	0.9%	2.3%	16.3%	22.0%
United Kingdom	GBP	-0.3%	2.1%	8.8%	11.1%
Continental Europe	EUR	0.0%	0.7%	12.9%	18.4%
Japan	JPY	1.3%	3.3%	16.2%	28.9%
Asia Pacific (ex Japan)	USD	0.0%	3.9%	31.9%	25.3%
Australia	AUD	1.6%	4.0%	8.0%	13.5%
Global	USD	0.4%	1.8%	18.1%	21.8%
<b>Emerging markets equities</b>					
Emerging Europe	USD	-1.4%	1.0%	15.7%	25.2%
Emerging Asia	USD	-0.1%	4.3%	37.5%	28.9%
Emerging Latin America	USD	-1.2%	0.5%	27.3%	15.8%
BRICs	USD	-0.5%	3.7%	37.9%	29.6%
MENA countries	USD	-0.1%	-1.5%	-0.6%	12.3%
South Africa	USD	-2.7%	4.5%	17.1%	16.1%
India	USD	0.5%	4.1%	31.0%	21.3%
Global Emerging Markets	USD	-0.5%	3.5%	32.3%	25.4%
<b>Bonds</b>					
US Treasuries	USD	-0.5%	-0.3%	2.1%	-1.2%
US Treasuries (inflation protected)	USD	-0.6%	-0.1%	1.7%	-0.7%
US Corporate (investment grade)	USD	-0.4%	0.1%	5.3%	2.5%
US High Yield	USD	0.3%	0.5%	7.5%	8.2%
UK Gilts	GBP	0.3%	0.3%	0.1%	-0.9%
UK Corporate (investment grade)	GBP	0.3%	0.4%	3.0%	2.9%
Euro Government Bonds	EUR	-0.2%	0.2%	-0.2%	-2.4%
Euro Corporate (investment grade)	EUR	0.0%	0.4%	2.2%	1.1%
Euro High Yield	EUR	0.3%	0.7%	6.8%	7.7%
Japanese Government	JPY	-0.1%	-0.1%	-0.4%	-1.8%
Australian Government	AUD	0.1%	0.5%	2.4%	0.0%
Global Government Bonds	USD	-0.8%	-0.4%	5.3%	-0.8%
Global Bonds	USD	-0.6%	-0.3%	6.0%	1.0%
Global Convertible Bonds	USD	-0.4%	0.4%	9.6%	7.7%
Emerging Market Bonds	USD	-0.3%	0.0%	8.6%	3.8%

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Asset Class/Region	Currency	Currency returns			
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<b>Property</b>					
US Property Securities	USD	-1.3%	0.7%	3.4%	3.6%
Australian Property Securities	AUD	1.5%	1.6%	-3.7%	-0.9%
Asia Property Securities	USD	0.2%	3.0%	25.0%	18.3%
Global Property Securities	USD	-0.8%	1.1%	13.0%	10.9%
<b>Currencies</b>					
Euro	USD	-0.4%	-0.2%	12.0%	7.8%
UK Pound Sterling	USD	-0.8%	-1.5%	6.8%	7.7%
Japanese Yen	USD	-1.3%	-0.7%	3.2%	-8.3%
Australian Dollar	USD	-0.8%	-0.2%	8.7%	2.6%
South African Rand	USD	-2.9%	-0.9%	0.2%	2.1%
Swiss Franc	USD	-0.9%	-1.4%	3.6%	0.9%
Chinese Yuan	USD	-0.7%	0.3%	5.1%	1.9%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	-0.6%	0.5%	-0.9%	1.8%
Agricultural Commodities	USD	-1.4%	-0.4%	-4.1%	-3.9%
Oil	USD	1.0%	0.4%	1.6%	12.4%
Gold	USD	-1.6%	-0.2%	11.1%	1.2%
Hedge funds	USD	0.0%	0.4%	4.8%	6.1%

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