

Weekly Digest

Week ending 24 July 2016

Bursting the benchmark bubble

Benchmarks are references against which a process is measured. In everyday life it could be the means to assess the efficacy of a process or the degree of sporting success, but in investments a benchmark is usually a return which an investor aims to beat. There are a wide and varied range of benchmarks that investors aspire to outperform. Traditionally an investment benchmark is a reference index such as a relevant equity or bond market. This has a number of advantages such as being widely known, investable, measurable and representative of an asset class or a composite of asset classes. They should provide a yardstick for an investor both in terms of returns and also risk. If a benchmark is relatively low risk, for example, it seems fair to assume that a fund managed against that benchmark would also be relatively low risk. This is not always the case, however, and investors that dramatically outperform their benchmarks in relatively short order should call into question the appropriateness of their benchmark. A slow, progressive, cumulative outperformance of a benchmark over a long period of time seems more reasonable. They are undoubtedly a useful tool for assessing manager performance but the problem with benchmarks is that they do not speak to investor needs. A benchmark really just reflects how a market or composite of markets performed over a relevant period of time and this could be a great, terrible or indifferent outcome for a particular investor.

As a result, there is a train of thought today that argues benchmarks are becoming increasingly irrelevant for investors. Benchmarks will always be a useful way of contextualising returns and risk of a fund but, arguably, they have never really been that relevant for investors. An individual user of financial services is surely more concerned about the outcome that their investment achieves in the context of their personal goals rather than in terms of an arbitrary reference index. Perhaps this was recognised less in the past because the distinction was less important. In previous decades many people had defined benefit – or final salary – pensions. In that environment very few investors were actually reliant on their savings in the sense that they knew that however well or badly their personal investments

went, their retirement would be looked after by someone else and their pension's performance was someone else's problem. Now most investors don't have that luxury. Instead their pension is their own responsibility and as a result they cannot rely solely on benchmark driven investing. This is because this sort of investing is ignorant of investor needs and therefore may deliver returns in excess of their requirements, which is rarely a problem, but they could also fall well short, which could be disastrous at retirement. In a world where clients are investing for their long term financial wellness and it is their problem and theirs alone, the potential randomness of a benchmark when compared to a client's needs arguably makes them irrelevant.

Despite this, benchmarks are unlikely to disappear into obscurity any time soon. Firstly it will take a number of years for people to move on from their familiarity with the status quo. Even relatively progressive investors like to have a benchmark of sorts to cling on to as they are familiar with assessing fund performance in that way. Furthermore, benchmarks do have value in the institutional arena where professional investors are choosing managers because of their particular quirks vis-à-vis a particular reference index. But for individual investors the relevance and efficacy of benchmarks as a measure of managers must be called into question. Surely most individuals who have a rough idea of their personal time horizons, risk budget and required return would prefer a manager to think in those terms on their behalf? That is why Momentum is an outcome based investor: our first priority, when managing our strategies for our investors, is to determine what selection and combination of asset classes and managers we believe gives us the best probability of achieving the outcome in question whilst taking as little risk as possible. The central focus doesn't concern tracking error or active share or any other measure which is based off an arbitrary benchmark, but rather we spend our time fixating on producing the outcome that our investors employ us to deliver. While our returns are not immune from market noise, being less focused from short term benchmark chasing gives us the opportunity to have perspective and invest over the long term for the right reasons.

The Marketplace

- Failed coup impacts Turkey's financial markets
- European Central Bank maintains monetary policy position
- Weak PMI data from the UK following Brexit
- IMF downgrades global and UK growth forecasts
- Japanese stimulus expectations continue following trade data

Market Focus

Europe

- The European Central Bank's (ECB's) governing council kept the bank's main refinancing rate at zero in their monthly meeting last week, with the deposit rate maintained at a negative 0.4%. The monthly value of bond purchases via Quantitative Easing was also kept at EUR 80bn. Expectations are for the ECB to loosen monetary policy further after August's meeting.
- European equities rose for the week, with the MSCI Europe ex-UK index up by 0.7%.
- Turkish markets were hit following the failed attempt to overthrow the Turkish government on the 15th July. The Borsa Istanbul 100 index fell 13.4% last week, whilst the yield on 10-year Turkish government bonds rose by 0.91 percentage points to 9.8%.

UK

- The International Monetary Fund (IMF) on Tuesday cut their forecast for UK GDP growth in 2017 from 2.2% to 1.3%. Apart from Nigeria the UK's 2017 growth forecast received the sharpest downgrade of the sixteen economies assessed. However, the UK economy is still forecasted to grow more than Germany, France and Italy next year.

- Results for the UK's purchasing managers index (PMI), a strong indicator of economic activity, came in below expectations on Friday. The manufacturing results fell 3 points to 49.1 whilst the services results fell 4.9 points to 47.4. The overall print at 47.7 was the lowest level since April 2009. Any reading below 50 represents a contraction in activity.
- UK equities rose by 0.9% last week, whilst sterling depreciated 0.5% against the dollar.

Japan

- Japan's monthly trade data showed export shipments falling 7.4% year-on-year, whilst imports fell 18.8% year-on-year. The results strengthened the calling for increased fiscal and/or monetary stimulus announcement at the Bank of Japan's meeting this week. Expectations of forthcoming stimulus helped push Japanese equities 0.8% higher over the week, whilst the yen fell 1.2% against the dollar.

Global

- Commodities as a whole fell 2.5% last week, led by Brent crude oil which fell 4.0% to USD 45.7 per barrel.
- The IMF also cut global growth forecasts for both the remainder of 2016 and 2017 by 0.1% to 3.1% and 3.4%, respectively. Forecasts were based on the assumption that the UK leaving the EU would not result in any major new trade barriers between the two markets, and that there would be no serious financial disruption as a consequence of Brexit.

James Klempster, CFA & Oliver Bickley

Asset Class/Region	Currency	Currency returns			
		Week ending 22 July 2016	Month to date	YTD 2016	12 months
Developed Market Equities					
United States	USD	0.6%	3.7%	7.3%	4.5%
United Kingdom	GBP	0.9%	3.5%	10.6%	4.8%
Continental Europe	EUR	0.7%	3.5%	-4.9%	-12.3%
Japan	JPY	0.8%	6.6%	-13.2%	-18.1%
Asia Pacific (ex Japan)	USD	0.2%	4.6%	7.1%	-3.2%
Australia	AUD	1.3%	5.1%	6.2%	2.7%
Global	USD	0.4%	3.3%	4.0%	-1.4%
Emerging Market Equities					
Emerging Europe	USD	-3.9%	0.8%	10.7%	-9.0%
Emerging Asia	USD	0.2%	4.4%	6.8%	-4.4%
Emerging Latin America	USD	1.6%	5.5%	32.4%	3.0%
BRICs	USD	0.7%	4.8%	9.5%	-8.4%
MENA countries	USD	-0.1%	2.8%	2.0%	-17.6%
South Africa	USD	1.5%	6.1%	22.7%	-8.4%
India	USD	-0.1%	3.7%	7.0%	-5.1%
Global Emerging Markets	USD	0.2%	4.5%	11.2%	-4.3%
Bonds					
US Treasuries	USD	0.1%	-0.3%	5.5%	6.2%
US Treasuries (inflation protected)	USD	-0.3%	0.0%	6.5%	4.7%
US Corporate (investment grade)	USD	0.3%	1.0%	8.7%	8.8%
US High Yield	USD	0.3%	3.1%	12.4%	5.6%
UK Gilts	GBP	0.1%	0.4%	12.7%	15.0%
UK Corporate (investment grade)	GBP	0.4%	3.0%	10.5%	11.8%
Euro Government Bonds	EUR	0.2%	0.0%	5.7%	7.4%
Euro Corporate (investment grade)	EUR	0.3%	1.4%	5.5%	5.6%
Euro High Yield	EUR	0.4%	2.1%	5.8%	4.0%
Japanese Government	JPY	-0.3%	-0.7%	7.0%	8.8%
Australian Government	AUD	0.5%	0.6%	6.8%	8.2%
Global Government Bonds	USD	-0.4%	-1.6%	8.9%	10.3%
Global Bonds	USD	-0.3%	-0.9%	7.4%	8.2%
Global Convertible Bonds	USD	0.0%	1.1%	0.4%	-0.8%
Emerging Market Bonds	USD	-0.5%	1.0%	13.4%	13.8%

Asset Class/Region	Currency	Currency returns			
		Week ending 22 July 2016	Month to date	YTD 2016	12 months
Property					
US Property Securities	USD	1.8%	3.4%	16.6%	20.2%
Australian Property Securities	AUD	1.9%	4.9%	19.2%	21.1%
Asia Property Securities	USD	1.9%	4.2%	7.4%	-0.9%
Global Property Securities	USD	1.4%	3.3%	12.5%	10.9%
Currencies					
Euro	USD	-0.4%	-1.1%	1.1%	0.4%
UK Pound Sterling	USD	-0.5%	-1.5%	-11.0%	-16.0%
Japanese Yen	USD	-1.2%	-2.8%	13.4%	16.8%
Australian Dollar	USD	-1.5%	0.2%	2.4%	1.2%
South African Rand	USD	2.0%	3.0%	8.3%	-13.2%
Swiss Franc	USD	-0.4%	-1.1%	1.5%	-2.8%
Chinese Yuan	USD	0.2%	-0.6%	-2.8%	-7.1%
Commodities & Alternatives					
Commodities	USD	-2.5%	-3.6%	6.9%	-13.1%
Agricultural Commodities	USD	-1.9%	-2.2%	2.7%	-5.5%
Oil	USD	-4.0%	-8.0%	22.6%	-18.6%
Gold	USD	-1.1%	0.0%	24.6%	20.9%
Hedge funds	USD	0.4%	1.4%	0.4%	-4.8%

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