IMPERIUM CAPITAL

momentum

Weekly Digest

Week ending **29 October 2017**

Property jitters…

Same old topic but the portfolio manager thought it was time to revisit UK property and explain why, despite the negative headlines in the press since the Brexit vote, they are happy to be contrarian.

In an environment where most asset classes are expensive and government bond yields are close to all-time lows, the managers believe that UK Real Estate is relatively attractive and provides good diversification benefits, hence deserving of a place in our multi-asset portfolios. They have been marginally increasing their allocation as other asset classes become overvalued. Of course there are still concerns around Brexit and how it's going to impact assets, but the managers believe this is already priced in to an extent and that the market is reasonably healthy. West End, City and Dockland locations are probably the most vulnerable with a high percentage of tenants who might have to relocate jobs to Continental Europe, while some fringe areas of London might also come under pressure from a ripple effect. However, the impact on regional cities is likely to be much more moderate as tenants in these areas are less exposed to the global economy or relocation risks.

Whereas pre-Brexit forecasters were predicting strong rental growth in all areas of the market, this is unlikely to come through now. The market has been stable, but some rents in the West End have actually come down. However, the portfolio managers believe that this is mostly taking tension out of the market rather than the start of a broader fall. In fact, it's still very difficult to find an office to let and companies often need to pre-let in new developments, a sign that there is not an oversupply. Finally, despite the negative headlines, the market is still trading. Volumes are down post Brexit but still higher than a few years ago. Overseas buyers are still in the market, especially for larger lot sizes while domestic buyers are more cautious.

A key to benefitting from the attractive relative valuation and to avoid the major pitfalls of Brexit is to select good managers. The portfolio managers prefer to use underlying managers who are able to avoid overpaying for properties and who are able to create value through active asset management.

With property yields historically low, they believe that it's important to "sweat" the assets; the ability to refurbish and re-let space, move tenants around to better adapt to their needs, or extend leases, will make a big difference to an investor's total return. They also like managers who have been able to sell some of their more core or mature assets and recycle capital to take advantage of new opportunities. The portfolio managers have avoided strategies with a large allocation to London and the South East and have instead sought exposure to the regions where we believe the risks are lower and the valuations more attractive.

Another important point is to make sure investors access UK property in the right manner. The portfolio manager have always disliked open-ended funds that invest in bricks and mortar and have never bought these because of a mismatch between the liquidity offered to investors and the underlying assets. It simply takes months to sell a property on the market and in the case of large withdrawals, as they saw during the previous downturn or after Brexit, those funds simply can't meet redemptions and have to gate their investors. As a consequence, they have historically preferred to access property through investment trusts. Although potentially having to tolerate some share price volatility, the pool of capital in those investment trusts is permanent; so the trust will never be forced to sell into a falling market and crystallize losses in order to meet other investors' redemption requests. It also allows managers to think more long term while offering daily liquidity to investors. Of course, this is not an ideal structure and it comes with its own issue around the ability to buy or sell stocks without impacting price, but the manager strongly believe that this is a better option than open-ended products if you need liquidity and don't want to be at the mercy of other investors' decisions.

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

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The **Marketplace**

- US equities hit record highs
- The European Central Bank announces QE taper plans
- UK and US GDP growth beats expectations
- US House of Representatives votes in favour of 2018 budget
- German business sentiment hits record high
- Brent crude oil prices rose 4.7% during the week

Market **Focus**

US

- The Dow Jones and NASDAQ composite hit record highs during the week, rising 0.5% and 1.1% respectively.
- GDP growth beat expectations, with 3.0% annualised growth in Q3 versus 2.6% expected.
- Personal consumption growth also beat expectations, rising 2.4% versus 2.1%.
- The core PCE price index rose 1.3% during Q3, well below the Federal Reserve target of 2.0%.
- Having recently passed Senate, the House of Representatives voted in favour of the 2018 budget, paving the way for tax reforms.
- The US Dollar index rose 1.3% during the week, supported by strong GDP growth figures and a less hawkish than expected European Central Bank meeting leading to a weaker Euro.

UK

- UK GDP growth in Q3 beat expectations, rising 0.4% versus a 0.3% consensus, increasing the likelihood of a base rate rise.
- Supported by the better than expected GDP growth data, Sterling rose 0.8% on a trade weighted basis on Wednesday, ending the week up 0.4%.
- Brexit talks remain stagnant, with still no agreement surrounding the UK's financial obligations to the EU.
- UK equities fell 0.2% in Sterling terms during the week.

Europe

- Political tensions continued to escalate in Spain as Catalonia's regional parliament voted in favour of independence.
- The European Central Bank (ECB) announced plans to taper its quantitative easing (QE) program, with monthly bond buy-backs being reduced from EUR 60 billion to EUR 30 billion in January. The ECB also stated interest rates would remain unchanged well beyond the end of QE.
- Despite several political uncertainties in Europe, the German Ifo Business Climate Index rose to record highs, reflecting confidence in the European economic recovery.
- Eurozone manufacturing PMI was above consensus at 58.6 versus 57.8 expected, hitting a 10 year high.
- Brent crude rose 4.7% in US Dollar terms, closing above $60 for the first time since July 2015. This move was partly supported by comments made by the Saudi Crown Prince stating he would back an extension of OPEC production cuts beyond March 2018.

Jeromine Bertrand (CFA) & Oliver Cooper

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Asset Class/Region	Currency	Currency returns			
		Week ending 27 Oct. 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.2%	2.5%	16.6%	22.7%
United Kingdom	GBP	-0.2%	1.8%	8.5%	11.5%
Continental Europe	EUR	0.8%	1.5%	13.8%	19.9%
Japan	JPY	2.3%	5.8%	18.9%	30.8%
Asia Pacific (ex Japan)	USD	-0.7%	3.2%	31.0%	26.4%
Australia	AUD	-0.1%	3.9%	7.9%	16.5%
Global	USD	0.0%	1.8%	18.1%	22.4%
Emerging markets equities					
Emerging Europe	USD	-1.9%	-1.0%	13.5%	22.9%
Emerging Asia	USD	-0.3%	4.0%	37.2%	30.2%
Emerging Latin America	USD	-2.6%	-2.2%	24.0%	12.4%
BRICs	USD	-0.9%	2.8%	36.7%	29.6%
MENA countries	USD	-0.9%	-2.4%	-1.5%	8.6%
South Africa	USD	-2.7%	1.6%	14.0%	13.0%
India	USD	1.9%	6.1%	33.5%	24.8%
Global Emerging Markets	USD	-0.8%	2.7%	31.2%	25.4%
Bonds					
US Treasuries	USD	-0.2%	-0.4%	1.9%	-0.9%
US Treasuries (inflation protected)	USD	0.0%	-0.2%	1.7%	-0.3%
US Corporate (investment grade)	USD	-0.1%	0.1%	5.3%	3.1%
US High Yield	USD	-0.1%	0.4%	7.4%	8.4%
UK Gilts	GBP	-0.3%	0.0%	-0.1%	0.3%
UK Corporate (investment grade)	GBP	-0.2%	0.2%	2.8%	3.9%
Euro Government Bonds	EUR	0.5%	0.7%	0.2%	-0.7%
Euro Corporate (investment grade)	EUR	0.5%	0.9%	2.7%	2.2%
Euro High Yield	EUR	0.2%	1.0%	7.0%	7.9%
Japanese Government	JPY	0.1%	-0.1%	-0.3%	-1.8%
Australian Government	AUD	0.2%	0.7%	2.6%	0.4%
Global Government Bonds	USD	-0.6%	-1.0%	4.7%	-0.4%
Global Bonds	USD	-0.6%	-0.9%	5.4%	1.2%
Global Convertible Bonds	USD	-0.4%	0.0%	9.2%	7.9%
Emerging Market Bonds	USD	-0.4%	-0.4%	8.2%	4.2%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 27 Oct. 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	-1.6%	-1.0%	1.7%	6.4%
Australian Property Securities	AUD	0.3%	2.0%	-3.4%	2.9%
Asia Property Securities	USD	-1.1%	1.9%	23.6%	16.0%
Global Property Securities	USD	-1.5%	-0.5%	11.3%	11.9%
Currencies					
Euro	USD	-1.6%	-1.8%	10.2%	6.2%
UK Pound Sterling	USD	-0.6%	-2.1%	6.1%	7.8%
Japanese Yen	USD	-0.5%	-1.2%	2.7%	-7.6%
Australian Dollar	USD	-2.1%	-2.3%	6.4%	0.9%
South African Rand	USD	-3.5%	-4.4%	-3.3%	-2.1%
Swiss Franc	USD	-1.5%	-3.0%	2.0%	-0.5%
Chinese Yuan	USD	-0.5%	-0.2%	4.6%	2.1%
Commodities & Alternatives					
Commodities	USD	1.4%	1.9%	0.5%	3.0%
Agricultural Commodities	USD	0.9%	0.5%	-3.2%	-4.8%
Oil	USD	4.7%	5.0%	6.4%	19.8%
Gold	USD	-0.8%	-1.0%	10.2%	0.1%
Hedge funds	USD	-0.3%	0.3%	4.7%	6.4%

Source: Bloomberg

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