

Sort your liquidity profile out

Weekly Digest

2 July 2018

– Richard Stutley, CFA

When considering portfolio liquidity I am reminded of my driving instructor's advice about the impending test: 'it's not difficult but it's easy to get wrong'. Many of the potential pitfalls are out of your control – for example less than perfectly rational decisions by other market participants can have serious implications for your investments – but, fortunately, some factors are in your control. There are two simple rules I like to keep in mind when thinking about liquidity: firstly, avoid lobster pots and secondly give yourself a long enough time horizon.

Other market participants are an important consideration when making an investment. This is because, ultimately, every asset class has limited liquidity. Some markets are very liquid whereas others are less so. Unfortunately some asset classes are easy to get into but very difficult to get out of, characteristics shared with lobster pots. A crustacean caught in a trap will likely meet an unfortunate end and investors trapped in an investment may also find themselves similarly committed to the fate of an asset class they had hoped to be able to sell.

In most instances our investments are commingled with others. You can't predict their decisions and if they demand their money back at the wrong time, you may be faced with the prospect of either being stuck with the investment as it is 'gated' to redemptions or forced to sell the asset at a poor price.

Often people's desire to sell an asset class is a consequence of price movements and the fact that people experience 'losses' when prices go down. There are, however, differences between permanent losses, which

by definition cannot be made back and paper losses – or mark to market losses – which are painful but the 'loss' can prove transitory. There is no difference if you have to sell an investment when it is underwater, however.

Mark to market losses are important because in order to understand what a portfolio is worth today, the most readily available source of information, and the most objective, is to look at prevailing prices in a well-functioning market. This is called marking the investment's price to the price available in the market. While reasonable, most investors think market prices can, at times, move a long way away from what is reasonable or fair. We know that prices can deviate from fair value therefore. We also know that even a broken clock is right twice a day. Hence, the answer is to give oneself enough time for prices to move from undervalued to fair. This means, particularly with volatile assets like equities, give yourself time to sell things. Time is a great gift for investors and represents the most effective way to reduce the impact of short term market noise.

Avoiding lobster pots and ensuring that investors have a sufficient time horizon to realise returns are very useful ways to ensure that investors have the right liquidity profile. This, ultimately, underlines the importance of excellent investment due diligence because gaining a full and fundamental understanding of the investment is the best way to avoid lobster pots. In terms of time horizon, the more volatile an asset class the more important it is to think about a phased entry and exit rather than having an inflexible future date in mind on which you have to liquidate regardless of market price.

The Marketplace

- The EU strikes a migration deal
- Brent Crude oil rallied 5.1% to \$79.42
- Gold fell 1% to 1255 per ounce
- Canada implements retaliatory US tariffs

Market Focus

US

- Falling U.S. stockpiles and Iran sanctions partly explain the 5.1% rally in Brent Crude last week. The US has encouraged its allies to stop importing oil from Iran by the 4th of November deadline.
- The advance goods trade deficit beat expectations at USD 64.8bn versus a USD 69.0bn consensus.
- US consumer confidence fell more than expected in June to 126.4, down from 128.8 in May and below expectations of 128.0
- Canada has implemented retaliatory tariffs on \$12.6bn worth of US goods, imposing a 25% tariff on metal products and a 10% tariff on 250 other goods
- US equities were down 1.3% in the week, the NASDAQ notably falling by just over 2%

UK

- The GfK consumer confidence index fell to -9 in June, a drop of 2 points from May and below market expectations of -7.

- UK equities fell 0.4% in the week while UK Gilts gained 0.4%

Europe

- EU leaders have negotiated a package of measures on migration at the EU summit, proposing increased border security and the distribution of migrants across all member states.
- France's consumer confidence index fell to 97.0 in June down from 99.0 in May, and below market expectations of 100.0
- Eurozone inflation rose to 2.0% in the year to June- a slight uptick from 1.9% in May, partly due to the recent surge in Brent crude. However, core inflation (excluding food and energy) fell to 1% from 1.1% in May
- Continental Europe equities fell 1.2% in the week, weighed down by uncertainty about global trade and political wrangling over immigration

The rest of the world

- China's Purchasing Manufacturing Index (PMI) slowed to 51.5 in June from 51.9 in the previous month
- The exit polls from Mexico's presidential election show the left-wing candidate, Lopez Obrador, winning 53% of the votes
- Global emerging markets fell 1.5% this week, with the Shanghai Composite Index losing 1.5%, partly in light of US-China trade concerns

Asset Class/Region	Currency	Currency returns			
		Week ending 29 June 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-1.3%	0.6%	2.4%	13.9%
United Kingdom	GBP	-0.4%	-0.2%	1.4%	7.7%
Continental Europe	EUR	-1.2%	-0.6%	-1.3%	0.7%
Japan	JPY	-0.7%	-0.8%	-3.7%	8.8%
Asia Pacific (ex Japan)	USD	-1.9%	-3.8%	-4.2%	8.8%
Australia	AUD	-0.3%	3.3%	4.3%	11.1%
Global	USD	-1.2%	0.0%	0.4%	10.9%
Emerging markets equities					
Emerging Europe	USD	2.1%	-0.6%	-8.4%	6.1%
Emerging Asia	USD	-2.3%	-4.7%	-5.1%	9.6%
Emerging Latin America	USD	1.6%	-3.1%	-11.2%	0.3%
BRICs	USD	-2.3%	-4.5%	-4.6%	15.4%
MENA countries	USD	0.5%	0.7%	9.0%	8.4%
South Africa	USD	0.1%	-4.3%	-15.5%	5.9%
India	USD	-1.8%	-1.5%	-4.3%	8.2%
Global emerging markets	USD	-1.5%	-4.2%	-6.7%	7.9%
Bonds					
US Treasuries	USD	0.4%	0.0%	-1.1%	-0.8%
US Treasuries (inflation protected)	USD	0.4%	0.4%	-0.1%	2.1%
US Corporate (investment grade)	USD	0.4%	-0.6%	-3.3%	-1.0%
US High Yield	USD	-0.5%	0.4%	0.2%	2.7%
UK Gilts	GBP	0.4%	-0.6%	0.4%	2.0%
UK Corporate (investment grade)	GBP	-0.3%	-0.5%	-1.9%	0.4%
Euro Government Bonds	EUR	0.5%	0.8%	0.5%	1.6%
Euro Corporate (investment grade)	EUR	-0.3%	0.0%	-0.6%	1.1%
Euro High Yield	EUR	-0.9%	-0.5%	-1.8%	0.7%
Japanese Government	JPY	0.0%	0.1%	0.7%	1.0%
Australian Government	AUD	0.3%	0.5%	1.9%	2.6%
Global Government Bonds	USD	0.2%	-0.3%	-0.9%	1.5%
Global Bonds	USD	0.2%	-0.2%	-1.5%	1.2%
Global Convertible Bonds	USD	-0.9%	-0.7%	-0.1%	2.3%
Emerging Market Bonds	USD	-0.5%	-1.0%	-6.1%	-4.4%

Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	0.6%	4.2%	0.5%	2.1%
Australian Property Securities	AUD	-2.1%	0.5%	0.3%	4.3%
Asia Property Securities	USD	-2.4%	-3.6%	-2.8%	6.8%
Global Property Securities	USD	-0.6%	0.3%	-0.9%	6.3%
Currencies					
Euro	USD	0.2%	0.1%	-2.9%	2.2%
UK Pound Sterling	USD	-0.4%	-0.7%	-2.4%	1.6%
Japanese Yen	USD	-0.7%	-1.8%	1.6%	1.1%
Australian Dollar	USD	-0.5%	-2.3%	-5.4%	-3.6%
South African Rand	USD	-2.5%	-7.8%	-9.9%	-5.0%
Swiss Franc	USD	-0.3%	-0.7%	-1.8%	-3.6%
Chinese Yuan	USD	-1.7%	-3.2%	-1.7%	2.6%
Commodities & Alternatives					
Commodities	USD	1.5%	-1.5%	5.7%	19.7%
Agricultural Commodities	USD	-0.8%	-6.9%	-0.7%	-3.7%
Oil	USD	5.1%	2.4%	18.8%	67.5%
Gold	USD	-1.0%	-3.6%	-3.9%	0.8%
Hedge funds	USD	-0.4%	-0.4%	-1.0%	2.1%

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