IMPERIUM CAPITAL

momentum

Finding Pockets of Value

Weekly Digest

5 February 2018

– *Stephen Nguyen, CFA*

Despite markets selling-off in recent days, it is worth reminding ourselves of the phenomenal returns across asset classes over the last year, particularly risk assets. The global economic backdrop remained highly supportive for equities with almost every major economy enjoying improving economic growth coupled with low and stable inflation. Emerging market equities added over 41% in twelve months ending January 2018, a significant outperformance of the still impressive 26% return posted by developed markets in US dollar terms. US equities produced plenty of headlines, with every major index hitting new all-time highs: the S&P 500 enjoying the longest run without a drawdown of 3% or more since World War II (although this ended last Friday, 2nd February 2018) with positive returns for the last 15 consecutive months. Bond markets continued to trade irrationally and exuberantly; with some low rated companies in Europe able to issue debt at negative yields. In aggregate there is still over EUR 8 trillion of bonds trading with a yield below zero.

As markets continue to rise, investors are faced with numerous challenges, particularly in terms of asset allocation. In this environment, it is increasingly difficult for investors to find value. As the saying goes; "price is what you pay and value is what you get". All too often investors ignore the starting valuation, despite the critical importance of the price one pays for an investment. There are many methods for assessing the value of investments but one method we like for its simplicity and reasonable predictive power of future returns is the Cyclically-Adjusted Price-to-Earnings ratio, or CAPE. This is simply the price divided by the average of the last ten years' earnings. The CAPE of the S&P 500 currently sits at just above 30 times compared to a long term average of around 18 times. History would suggest that at this level, returns over the next 10 years are likely to be subpar. Indeed, the CAPE has only been at this level twice in the last 100 years, although the economic and fundamental backdrop for US stocks looks supportive, there is a risk that the valuation multiple investors are willing to pay may contract back to normal historical levels. Market trends can persist for prolonged periods but asset prices cannot defy the gravity of valuation forever.

We are focused on achieving long term outcomes for our clients rather than attempting to predict the next short term trend. While many markets appear expensive, we are still able to find pockets of value. Equities outside of the US, particularly in emerging markets, offer opportunities; emerging market debt and liquid alternatives are other examples. Both UK and Continental European equity valuations are still reasonable and with rates remaining low, valuations have continuing support, while earnings also have further room to recover from their post-crisis low. Emerging market equities remain attractive, even after a strong year, as do emerging market bonds despite their recent rally, particularly at the front end of the curve. Lastly, another area we continue to favour is liquid alternative strategies, which tend to be non-directional and exhibit low correlation to traditional asset classes therefore offering added diversification benefits alongside reasonable return prospects.

The **Marketplace**

- Brent crude fell 3% to $68 a barrel
- Gold was down 1.4%, standing at 1335
- Global equity indices slump in biggest sell off since 2016
- Bitcoin drops below $8000, a 60% drop in under 2 mths

Market **Focus**

US

- The Dow Jones fell 3.3% finishing the week at 25,521.
- US 10 year treasury yields edges towards 3%.
- The NASDAQ fell 3.74% to 6,760.3.
- The USD fell against every major currency on the back of Trump's State of the Union address which was particularly vague on foreign policy.
- The S&P index fell to 2,762, a 3.9% fall.
- US unemployment rate is the lowest since 2000 at 4.1%. Nonfarm payrolls rose by 200,000.
- Oil output in the US puts it on course to beat Saudi Arabia as the world's top producer, returning to levels not seen since the 1970s boom.
- The VIX volatility index shot up by over 30% in a week to 18 on the back of market sell-offs.

UK

- Manufacturing PMI unexpectedly fell to 55.3 in January from 56.2 in December due to price pressures and lower demand. A reading over 50 still signifies overall expansion in the sector.
- The FTSE finished the week down 2.9% at 7,443.4.
- Lawmakers will be able to review a partially leaked Brexit economic impact study after the government initially refused. Conservatives in new internal battle over membership of the EU customs union.

Europe

- Euro-area inflation slows as ECB ponders policy stance: Consumer prices rose 1.3% in January a target of 2% could be seen as a justification for further stimulus. A slow labour market recovery seen as the reason.
- German government coalition talks still continuing after missing their target date.
- Manufacturing PMI for the Eurozone was 59.6 for January slipping from 60.6 in December. This was in line with expectations and paints a robust picture of the sector. Composite PMI rose to 58.8 from 58.1 in December.
- The Eurostoxx 50 index fell 3.4% to 3,523.

Asia

- The Nikkei dropped the most in 14 months to 22,682, a 4% drop
- Japan PMIs up, Chinese down/flat
- The Hang Seng fell 1.7% to 3,22,601

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

Asset Class/Region	Currency	Currency returns			
		Week ending 2 Feb. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	-3.8%	-2.2%	3.4%	22.8%
United Kingdom	GBP	-3.0%	-1.2%	-3.2%	8.2%
Continental Europe	EUR	-3.0%	-1.9%	0.5%	11.3%
Japan	JPY	-0.8%	1.5%	2.6%	26.0%
Asia Pacific (ex Japan)	USD	-2.5%	-1.5%	5.1%	35.2%
Australia	AUD	1.2%	1.4%	0.9%	13.2%
Global	USD	-3.4%	-1.9%	3.3%	23.3%
Emerging markets equities					
Emerging Europe	USD	-1.5%	-1.0%	9.0%	28.1%
Emerging Asia	USD	-3.1%	-1.8%	6.0%	42.2%
Emerging Latin America	USD	-3.1%	-1.8%	11.1%	26.8%
BRICs	USD	-3.7%	-2.3%	8.9%	44.8%
MENA countries	USD	0.4%	0.2%	5.5%	4.6%
South Africa	USD	-8.0%	-3.5%	-0.8%	29.6%
India	USD	-3.8%	-3.1%	1.8%	30.8%
Global emerging markets	USD	-3.3%	-1.9%	6.3%	37.5%
Bonds					
US Treasuries	USD	-1.0%	-0.7%	-2.1%	0.2%
US Treasuries (inflation protected)	USD	-1.0%	-0.8%	-1.7%	0.9%
US Corporate (investment grade)	USD	-1.0%	-0.8%	-1.8%	4.3%
US High Yield	USD	-0.7%	-0.4%	0.2%	6.0%
UK Gilts	GBP	-0.8%	-0.4%	-2.5%	1.2%
UK Corporate (investment grade)	GBP	-0.8%	-0.5%	-1.4%	4.4%
Euro Government Bonds	EUR	-0.4%	-0.2%	-0.6%	1.6%
Euro Corporate (investment grade)	EUR	-0.3%	-0.2%	-0.4%	2.4%
Euro High Yield	EUR	-0.5%	-0.2%	0.1%	6.2%
Japanese Government	JPY	-0.1%	0.0%	-0.2%	0.9%
Australian Government	AUD	0.2%	0.0%	-0.5%	2.9%
Global Government Bonds	USD	-1.0%	-0.8%	0.5%	6.5%
Global Bonds	USD	-0.8%	-0.7%	0.4%	7.0%
Global Convertible Bonds	USD	-1.7%	-0.8%	2.8%	9.9%
Emerging Market Bonds	USD	-1.0%	-0.8%	-1.3%	4.8%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 2 Feb. 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	-3.3%	-3.0%	-7.1%	-3.4%
Australian Property Securities	AUD	-0.8%	-0.8%	-4.1%	1.9%
Asia Property Securities	USD	-3.4%	-0.9%	6.5%	29.5%
Global Property Securities	USD	-3.3%	-2.2%	-1.1%	13.6%
Currencies					
Euro	USD	0.2%	0.4%	3.7%	15.6%
UK Pound Sterling	USD	-0.3%	-0.2%	4.7%	12.7%
Japanese Yen	USD	-1.5%	-0.7%	2.2%	2.4%
Australian Dollar	USD	-2.0%	-1.3%	1.8%	3.7%
South African Rand	USD	-1.2%	-1.1%	3.0%	11.2%
Swiss Franc	USD	0.6%	0.3%	4.7%	6.6%
Chinese Yuan	USD	0.4%	-0.2%	3.3%	8.5%
Commodities & Alternatives					
Commodities	USD	-1.4%	-0.3%	2.9%	5.9%
Agricultural Commodities	USD	0.0%	0.0%	2.0%	-6.5%
Oil	USD	-2.8%	-0.7%	2.6%	21.3%
Gold	USD	-1.4%	-0.4%	2.2%	9.8%
Hedge funds	USD	-0.6%	0.1%	2.5%	8.0%

Source: Bloomberg. Past performance is not indicative of future returns

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