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global investment management

Global Matters | Weekly

Annual Compendium 2021

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With us, **investing is personal**

Foreword

When we started writing our weekly Global Matters articles back in 2015, we had an ambition to change the way that we communicated with our rapidly expanding, global client base. We wanted to provide easy to digest and topical notes which relayed the latest thinking from our investment team to clients, whilst also offering insight into our approach and showcasing the diversity of thought that the individual personalities in our team bring to the table.

The Global Matters weekly readership has picked up greatly over the past six years and once again we mark the end of the year by sharing a compendium of 2021's articles. Across dozens of blogs, which incorporate a mix of investment insight with topical twists, this charts our journey through what has been another most extraordinary year.

Our team has also grown this year, following the acquisition and integration of Seneca Investment Managers. As well as injecting fresh thinking and invaluable insights, including regular contributions to the Global Matters articles, our new Liverpool based colleagues have fit in seamlessly and our team is stronger than ever.

While the pandemic hardly eased up on a global scale in 2021, its impact on the world economy and livelihoods reduced and for many this has been a year of much needed recovery. A little over a year on from 'Vaccine Monday', which transformed the outlook and prospects for a steady return to normality, and stock markets have regained much of the ground lost during the worst of the pandemic, in some cases breaking new highs, supported by soaring corporate earnings and a hugely supportive policy backdrop.

As we've discussed in these articles throughout the year, financial markets are in the process of adjusting to a more challenging stage of the cycle ahead, where policy is starting to tighten at the margin and growth is slowing, albeit expected to stay well above the long-term trend in most countries next year. Many countries are experiencing their highest levels of inflation in decades, with ongoing supply chain disruption a key contributing factor, and most central banks now acknowledge that this surge in prices is no longer just 'transitory'; their policy responses will have a critical bearing on investment returns next year, across different asset classes, geographies, sectors and styles. We remain optimistic about the outlook for equity markets next year although we would expect volatility to be higher – that will present opportunities for long term investors, but we believe careful and effective portfolio diversification is important. We continue to advocate and implement a 'diversify your diversifiers' approach to building our defensive portfolio allocations.

We would like to use this opportunity to thank all our clients for their support. We never lose sight of the imperative role that you play in our business. The reason why your clients trust us is because you trust us.

From the whole team we wish our readers all the best in 2022, which we hope will live up to its potential as a year of continuing recovery around the world.

Momentum Investment Team

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Outlook for 2021

Glyn Owen

The surge in markets in late 2020, triggered by the positive vaccine news, Biden's success in the US election and the favourable settling of the UK-EU trade negotiations, continued into the new year. Equity markets made a strong start while government bond yields rose. However, optimism waned as January wore on, concerns rising about Covid mutations, the pace of vaccine roll-out, especially in the EU, and the economic damage caused by tightened and extended lockdowns across many parts of the world, most notably Europe. By month end, expectations for a sharp economic recovery had been pushed out to later in 2021. Sentiment was also impacted by the bizarre antics of retail traders in the US driving heavily shorted stocks to nonsensical heights in an attempt to inflict damage on hedge funds, an investment tactic that could only lead to misery for many of those involved.

By month end most equity markets had lost all the ground made in the first 3 weeks, the notable exception being China, the only major economy to record growth last year, which built on its outsize gains in 2020 with a further advance of 7%. As a result, the MSCI World index fell 1% in the month, while China's rise, along with strength in other Asian markets, drove the MSCI Emerging Markets index to a 3% gain. A similar pattern was seen in government bonds, the yield on US Treasuries initially rising sharply on hopes for economic recovery, boosted by prospects of a Biden led fiscal spending spree, before retracing some of the ground as confidence weakened. This still left the JPM Global Government bond index in negative territory for the month, -1.3%, in turn putting pressure on credit markets. However, rising inflation expectations pushed US TIPs to a small positive return, +0.3%, continuing their strong performance of 2020.

The most important political development was the failure of the Republicans to win either of the re-run Senate seats in Georgia, thereby conceding control of the Senate to the Democrats, albeit by virtue of the vice-President's casting vote, and thereby ushering in the 'blue wave' in Washington. This increases the probability of Biden's American Rescue Plan, entailing pandemic support of a further $1.9tn, almost 10% of US GDP, getting passed by Congress without substantial dilution. It also bolsters the chances of Congressional approval for further major spending on infrastructure, climate change and growth initiatives in Biden's Recovery Plan, to be announced in coming weeks. Fiscal packages of this extraordinary scale will be instrumental in providing stimulus to economies emerging from the scars of the pandemic, taking over the prime role of policy support from central banks; here, there is limited room for manoeuvre, with most policy rates at or very close to the lower bound and balance sheets already bloated by massive quantitative easing programmes.

The most extraordinary event, however, was the attempt by retail traders in the US, acting mainly through the WallStreetBets forum and Robinhood trading platform, to inflict damage on hedge funds, focussing particularly on those with substantial short positions in stocks. The traders' stock of choice for a short squeeze was GameStop, which soared twenty-fold in January to reach a market cap of $34bn at its peak, with short sellers scrambling to limit losses by closing positions. To cover those losses, funds then sold long positions, and market volatility briefly soared, the VIX index rising in a matter of days from the low-20s to a peak of 37. According to Goldman Sachs' prime brokerage unit, hedge funds' gross exposure was cut at the fastest rate since October 2014. While this could all be described as market noise, unlikely to have a lasting impact, there could be underlying issues of concern, including excess liquidity giving rise to irrational behaviour and bubbles, as well as the social and regulatory implications of small scale investors exposing themselves to such high risk, and question marks about the size and suitability of short selling. For investors entrusted with managing other people's wealth, it highlights the critical importance of sticking to fundamentals, avoiding high risk and speculative short term position taking, ensuring transparency and liquidity, and not being thrown off strategic course by sudden market-moving events with limited implications for underlying economic conditions.

As the second wave of the pandemic and worries about mutations damage confidence, disrupt activity and result in extended lockdowns, the first quarter of the year will be tough for many economies. However, recovery has been delayed, not cancelled, and it is notable that economies under lockdown or severe restrictions in mobility are holding up better this time than in the first lockdowns of 2020; furthermore, corporate profits are generally performing ahead of expectations even in this tough environment. The roll-out of vaccines will soon result in eased restrictions and a gradual return to near-normality. While some sectors, such as international travel and related industries, will face longer term headwinds, much of economic activity will recover rapidly, boosted by huge pent-up demand and policy support measures. Corporate profits are set to recover substantially over the next 18 months. This provides a strong backdrop for equity markets and risk assets generally in 2021 into 2022. While periods of volatility are inevitable, especially given the moves over the past few months and the high valuations in some asset classes and sectors, and risks around inflation and possible central bank policy shifts call for diversification of portfolios, we believe opportunities in risk assets are good for the year ahead.

18 January 2021

An industry in constant evolution

Robert White, CFA

It is generally accepted that 2020 saw changes in the way we use technology that are likely to persist even after the pandemic ends. Many changes to society and markets already appear self-evident today, and developing a full understanding of the implications will be important for active managers over the years to come. The Christmas break provided us with a chance to ponder more introspectively over the impact these changes may have on the investment management industry itself, and how best to serve our clients over long term.

Much has been written on how society will change following the pandemic and there are several examples of interesting shifts in consumer trends. My favourite example – albeit admittedly very niche – has been the explosion of interest in the 1,500-year-old game of chess since the pandemic. Despite the success of The Queen's Gambit on Netflix, who would have thought the game would become one of the fastest growing spectator sports on video streaming services such as Twitch[1].

Investment management has an even longer history; its roots go back 4,000 years to ancient Mesopotamia, although the first stock exchange wasn't established until the early 17th century in Amsterdam. The profession has of course progressed somewhat since then, maturing greatly through the 20th century as a new regulatory framework developed after the Great Depression, and academics developed more precise mathematical understanding of concepts such as diversification and value.

Although the use of such techniques greatly helps investors today, the experience of the pandemic has been a stark reminder that mathematics and volatility numbers do not always accurately account for all investment risks. Tail risk or so-called "black swan" events such as the pandemic are notoriously hard to incorporate in models, and when they occur, investors are much more focussed on the risk of permanent capital loss rather than any statistical measures of historic price dispersion. A key pillar of our philosophy at Momentum is exceptional client service; our investment staff are acutely aware that investing is a journey, and helping clients to remain invested through times of extreme uncertainty is often the most valuable service advisors can provide for their clients.

Another important issue has been the importance of sustainability in investing. During an international crisis such as this, investors are increasingly thinking about social issues as well as returns, and pressure on boards is increasing through greater numbers of successful shareholder resolutions on ESG matters[2]. The most progressive companies are reacting to this demand, and are mindful of the wellbeing of a broader range of stakeholders than they have been in the past. This is an area where active managers have been ahead of the curve, naturally being more engaged with corporate boards than passive investors that narrowly follow indices.

A final word should be said on the impact of technological innovation generally, as the investment management industry has been operating at the forefront of areas such as natural language processing within AI. The amount of data available today means that investors are constantly looking for an edge over peers through new developments in tech, and increasingly sophisticated computer-driven systematic strategies are becoming more popular. This is a trend we have already embraced at Momentum, blending systematic and traditional strategies to optimise performance for our clients over the long term.

A key pillar of our philosophy at Momentum is exceptional client service; our investment staff are acutely aware that investing is a journey, and helping clients to remain invested through times of extreme uncertainty is often the most valuable service advisors can provide for their clients

[1]*https://www.cbsnews.com/news/online-chess-makes-its-biggest-move/*
[2]*https://www.ft.com/content/844783f8-c9c4-4cda-960f-bec2543a5e12*

25 January 2021

StoreREIT telling: three key elements

Jackson Franks

For me writing has never been easy, in fact English was my least favourite subject at school. However, I enjoy a challenge and as I think about what to write this week, I take myself back to my English class at school to remind myself of what writing tricks I was once taught. What I remember most is how we were taught the basics of writing a story: each story must consist of a beginning – hooking the reader & setting the scene, a middle – a series of interesting and exciting events, and an end – tie up loose ends & satisfy the reader. As I wrote these characteristics down it suddenly looked very familiar. This is what we expect of and how we critique real estate managers. We look for the successful implementation of a story which follows the same characteristics; a beginning – raising capital & deployment, a middle - asset management initiatives, and an end – disposing of the asset(s) & redeployment of capital.

The beginning. The most crucial part in any story as it's the time to set the scene and hook your readers. As with a real estate manager it's the first insight we get at their deployment capabilities. Are they able to acquire buildings at an attractive yield with the potential to enhance that yield over time? Can they put together cost-effective initiatives to help achieve this and provide capital appreciation for their investors? These are the sorts of initial questions we critique when looking at real estate managers. If they manage to showcase their aptitude to answer these questions the book remains open and we continue to follow the story.

The middle. The manager has set the scene and acquired their portfolio. This is the stage in the story where the action takes place. We look at the manager's competence of successfully implementing their initiatives from turning a building into an asset. Such initiatives will include the manager's ability to let the vacant space, renegotiate existing leases, structure their debt, dividend controls and enhance any of their buildings through development opportunities (to mention a few). Moreover, we critique the validity of the manager's sustainability policy. Does the manager live by this policy, and is there evidence to confirm it, or is it written to tick a box? The built environment is currently responsible for 40% of global energy consumption, 25% of global water consumption and is emitting 33% of greenhouse gas (GHG) emissions. We expect our managers to contribute to the global initiative of reducing these levels through efficient water and power resource utilisation by observing the managers track record in all operational aspect of their assets.

The end. As with storytelling this is the stage at which we would expect the manager to tie up loose ends and satisfy their investors. The asset(s) would be nicely packaged by virtue of all their hard work throughout the asset management phase and to be sold at a yield which satisfies the investor. However, with real estate we want a sequel, and with that we judge the manager on their redeployment of capital. Can the manager begin the story again and do they have a track record of that story being as good as before?

Only when we are satisfied with all three elements will we consider an investment.

We look at the manager's competence of successfully implementing their initiatives from turning a building into an asset

Emerging Opportunities

Stephen Nguyen, CFA

2020 witnessed some of the toughest challenges – be it social, economic or political – that most of us have ever experienced. Around this time 12 months ago, the Covid-19 pandemic was gathering momentum, particularly in Asia before it spread further afield, and soon enough the world went into lockdown. As we slowly emerge from the shadow of the pandemic thanks to vaccine breakthroughs, mobility and global economic growth should gradually increase. Emerging markets (EM), led by the Asian powerhouses (primarily China, South Korea and Taiwan), are likely to lead the recovery helped both by them being the engine of global growth but also having managed the pandemic better than peers. Emerging markets outperformed global developed equities in 2020 for the first time in three years: could this be a sign of things to come?

The evolution of emerging markets has been significant over the past few decades, creating a much broader set of potential opportunities for investors. Both equity and debt markets have become much broader and deeper and EM indexes more diverse, thereby creating a much richer and more robust opportunity set. There are many other dynamics that emerging markets can benefit from, such as the growth of the middle class, advances in technology and improving corporate governance, which together are likely to encourage more flows into the region.

In the current low growth world, emerging markets offer much promise relative to their developed market peers. GDP growth is likely to outpace that in developed markets, particularly within the Asian region.

With eye-popping valuations in some parts of the US equity market, the question we receive from many investors is, are there any bargains to be had? We believe there are pockets of value such as cyclical areas of the market (traditional value stocks) which still have significant upside from here. Emerging market equities represent another area with exciting return potential as valuations are still reasonable despite strong performance in recent months. Solid and improving fundamentals led by the Asian countries (which account for almost 75% of the MSCI EM index), along with an increasingly positive focus on ESG issues and supportive flows into the regions, together produce a bright picture for emerging markets in the years ahead.

In the current environment of low to negative yields in much of developed bond markets, investors with a focus on income would be wise to look further afield, with emerging market debt (both hard and local currency) offering a decent yield premium. This yield advantage should help to insulate emerging market bonds from rising bond yields elsewhere should global growth recover as anticipated. Whilst spreads relative to US Treasuries have tightened significantly, we believe there is room for more compression as global economies recover. The potential for a weaker US dollar provides another tailwind for the asset class.

Exposure to emerging markets adds diversification, as it generally an anti-dollar trade which serves to balance the bias most portfolios exhibit as a result of owning dollar rich assets in the form of treasuries and stocks.

So how can we tap into this potentially faster growing and higher yielding region? Whether you are considering stocks or bonds, emerging markets offer a compelling opportunity as the global economy recovers. The next decision is to take the “active” or “passive” route: whether to buy a cheap passive fund or seek out the expertise of an active manager. I think there are plausible arguments on both sides, however emerging market exposure is not without risk. As with any investment, this selection choice and associated risk is best mitigated with thorough due diligence by a specialist investment team and combining this with a strong and robust portfolio construction process.

We are aware of the many risks that lie ahead, not least the roll-out and efficacy of vaccines and their availability to people living in emerging markets who are the engine behind this growth. We are very mindful of the strong gains delivered by risk assets in recent months leading to elevated valuation in some parts of the broader market. However, we see a rotation into value sectors and regions as offering the best longer term recovery potential, and emerging markets today merit increasing attention as part of your overall portfolio construct.

We see a rotation into value sectors and regions as offering the best longer term recovery potential, and emerging markets today merit increasing attention as part of your overall portfolio construct

To the Moon - YOLO

Lorenzo La Posta, CFA

Tuesday 26th January, it's early morning here in the UK and still night in the US when Aurelio, a friend of mine, texts me.

Aurelio: *"Dude, what is going on with Game Stop? Last week some people on Reddit said they were gonna shoot GME (ticker for Game Stop) to the moon, to $1000 per share! So, I bought a few at $45 on Friday…"*

I had not heard anything about Game Stop, so I start by checking the share price: it closed at $77 yesterday, +285% in the past two weeks! Ok, something's off. I spend a few minutes on r\wallstreetbets to get a grasp of what apparently is suddenly becoming a coordinated action in one of the largest online communities. I see people yelling stuff like "Let's get GME to the moon!", "We own you, hedge funds!", "HOLD TILL $1000 – AT LEAST" and loads of "YOLO" (i.e. you only live once). Some people are even posting screenshots of their six digit $-gains made over just a few days. I can get back to Aurelio now. He's no investment expert, yet he's smart enough to understand what's going on.

Lorenzo: *"Aure, it seems as if a bunch of people are trying to inflate Game Stop's share price. They are buying (and pressuring others to buy) high volumes of shares and out-of-the-money call options which, given GME's small size and low liquidity, should push prices higher. On top of that, there seems to be a high short interest (elevated number of short positions, that would gain from a share price fall) out there that might serve as catalyst. In fact, the higher the share price gets, the more hedge funds lose money on their short positions, which eventually will need to be covered, i.e. hedge funds themselves will be buying shares, which will exacerbate the price rally."*

A: *"So… like an avalanche?"*

L: *"Yes, avalanche. What Redditors are doing is pure speculation though, based on the hope that someone's going to want to buy after they do. The more hype they create around Game Stop, the more people are going to want to buy, the more the price goes up, the more hype this creates etc…so in practice it's a self-fulfilling prediction!"*

A: *"Then I'd better buy more, surely I will make more money!"*

L: *"Well…you might, but even avalanches eventually stop. You just need one little obstacle, one tiny reason for a momentary price contraction, for many of that crowd to lose hope in the rally and to start selling, causing a collapse pretty much thanks to the same dynamics that generated the rally in the first place. Hype and herds giveth, hype and herds taketh."*

Fast forward to two days later, it's the morning of the 28th and GME closed at $347.

A: *"Told ya it was gonna go to the moon. I've gained 8-fold."*

L: *"Happy for you mate! Selling it now?"*

A: *"No way, more people will buy! Redditors are suggesting to hold to at least $1000, because hedge funds have not closed their positions yet! They have been right so far. I will sell later on."*

Today it's Monday 8th February, the share price closed last Friday at $72. I have not heard from Aurelio since.

One thing I have learned at Momentum is that investing is not about sending assets to the moon, fighting against hedge funds or pulling price predictions out of thin air. Certainly, it is not about following random advice. All we trust is data, research, experience and while we can't control the risk we embrace, we certainly can decide which risk not to take.

Let's get GME to the moon!

More of the Same

Richard Stutley, CFA

The tale of Goldilocks and the Three Bears was a popular analogy in markets in the years post the Great Financial Crisis, used to describe the global economy as not too hot, not too cold, but just right. Extending the idea to today's central bank policy: too hot would be embarking on helicopter money or large scale debt forgiveness; too cold would be abandoning tools like quantitative easing, possibly in response to criticism of QE's role in fuelling asset price bubbles; just right, then, is a continuation of current policy and hence central bankers need to hold their nerve in the face of rising inflation and provide more of the same.

Central bank policy used to revolve around managing short term interest rates. While the Bank of Japan embarked on quantitative easing to fight domestic deflation in the early 2000s, it wasn't until the Great Financial Crisis that the policy was adopted more widely. Having expanded their toolkit to include focusing on the term structure of interest rates, last year many central banks, including the US Federal Reserve, also began targeting the credit structure of interest rates by buying corporate debt.

Quantitative easing has been criticised for driving up asset prices while appearing to have only a limited impact on inflation. Higher asset prices favour current owners of those assets, hence the policy is also blamed for exacerbating wealth inequality. Lower interest rates are designed to encourage greater demand for money and greater spending: individuals will decide where that spending is ultimately directed. Where money finds its ways into assets, including land and premises, the marginal cost of production rises and companies will raise prices accordingly, thus delivering the desired inflation. Hence rising asset prices are part of the transmission mechanism of monetary policy and their appearance shouldn't stop central banks from doing quantitative easing, now or in the future.

There are those who advocate more aggressive policies, like helicopter money: sending households cheques in the mail. While appealingly egalitarian, handing out money blindly in this fashion has its drawbacks, as the Reddit trading experience perhaps shows (read my colleague Lorenzo La Posta's excellent blog from last week if you would like to know more about what happened). Quantitative easing does not alter the risk-based way in which capital is allocated throughout the economy, merely the price at which it flows. Another option being contemplated is large scale debt forgiveness. Here again, there are problems with administering such a policy: should we forgive government debt or corporate debt? Which corporates deserve it? The success of the financial system rests on the faith of participants – why else would you accept a voucher as a means of payment? – and while participants have so far accepted quantitative easing and negative interest rates, writing off debt may well be the final straw. Hence our view is that central banks should continue using the existing tool kit rather than adding more levers at this stage.

The primary goal of monetary policy is ensuring price stability (somewhat confusingly, defined as some inflation rather than zero inflation/constant prices). Inflation expectations derived from government bond markets have been rising sharply, suggesting at first glance that current policy may be too loose. Short term rises are to do with base effects (prices had been crushed this time last year) and some supply issues, most importantly affecting the price of shipping containers, both of which appear short term in nature to us. So far central banks are saying the right things in terms of looking through these rises and longer-term expectations remain reassuringly anchored. We are following inflation expectations and measures of slack in the labour market closely and agree with policymakers' assessment that there are no signs of capacity exhaustion currently.

It is a case of so far so good regarding central bank policy and we advocate more of the same rather than a premature tightening of financial conditions. However, the law of unintended consequences still holds and hence we will be watching central banks closely for signs of a policy mistake.

Just right, then, is a continuation of current policy and hence central bankers need to hold their nerve in the face of rising inflation and provide more of the same

Coin Toss

Andrew Hardy, CFA

Digital gold or "index for money laundering[1]"? Fiat currency hedge or irrational mania? Bitcoin divides opinion more than most, but the bulls are in the ascendency at present and the 12-year old cryptocurrency is gathering many new followers as a result. Its 6-fold increase in price in the last year has been the driver; creating a FOMO (fear of missing out) effect whilst also increasing the size of its market, which reached $1 trillion over the weekend, to a level where institutions begin to consider it more seriously. While we expect that cryptocurrencies will become more mainstream over the coming years, we've never held Bitcoin in portfolios, nor do we have any plans to include it. I'll provide a few thoughts around this here.

Bitcoin cannot reasonably be considered as a reliable store of value, at least not yet. After twelve years of existence and accelerating adoption, its prospects for longer-term success are growing, but there's still every chance that it gets overtaken by other cryptocurrencies or technologies in time, or that increased adoption forces regulatory action by governments around the world. Indeed, the existence of so many competing digital currencies also undermines one of the key arguments made in support of Bitcoin: that of truly fixed supply. Amidst such huge uncertainty its price has proven to be exceptionally volatile as it can only be viewed as a speculative asset for now, which cannot compete with far more established asset classes like gold and inflation linked bonds for reliability in a portfolio context.

There have been some well publicised first-time buyers in recent months, including the UK asset manager Ruffer and Elon Musk's Tesla, but like with so many holders they've only invested a very small percentage of their cash. Very few businesses or portfolios have substantial allocations at this point, nor is it being widely used for transactions. Bitcoin and other cryptocurrencies still have a very long way to go before becoming at all entrenched. Energy consumption is one of the areas where on the face of it Bitcoin remains strikingly uncompetitive, especially in an increasingly environmentally conscious world, with estimates that the average energy required for just one transaction is equal to that of around 500,000 Visa transactions[2], due to the electricity used in 'mining' the coins.

This latest surge in price has come over a period when the value of many other risk assets have also soared, when there have been several other signs of exuberance in markets, and for Bitcoin has been accompanied by very high turnover, all of which hints at the gains having been driven by speculative forces. Bulls argue this reflects rising fears of fiat currency debasement, due to central banks pumping liquidity into markets, but if that was the case one would expect to see a rapid increase in inflation expectations also being priced into other markets. Monetarist economic theory supports higher inflation and currency devaluation in time, but actual results of over twenty years of unconventional monetary policy in Japan – which have failed to ignite inflation and led to a stronger currency – highlight it's by no means a given.

It was just over one year ago when most risk assets began a pandemic induced plunge. When Bitcoin bottomed a few weeks later around the end of March, at the same time as most equity markets, it had fallen over 70% from its previous high. If one believes in Bitcoin as a diversifier and store of value, one must question why it had so few friends back then but is so popular now at many multiples of that price. When there are no fundamental characteristics – assets, cashflows, recurring demand etc – to base price estimates around, or a management team to discuss the way forward with, it's easy to lose confidence during times of crisis, and be shaken out of a position, something holders need to consider given the huge volatility that is likely to persist in its price. In contrast, there are many other companies linked to accelerating digital and virtual activity who have seen their share prices leap higher at a similar rate since then, several of which we and many other investors did have the confidence to add to around the market lows, because it's possible to build confidence in a fair value range.

Of course, there are many valid arguments in favour of investing in Bitcoin, but it's clear to me that becoming a buyer today requires a massive leap of faith. All investments come with a degree of risk and require one to take a view on future scenarios, but in the case of Bitcoin it is much harder to know how it will perform in any environment or build confidence in estimates of long-term value. While cryptocurrencies are likely to become more mainstream, it is by no means assured that Bitcoin would be the long term winner; there have been many examples in recent decades where the earliest pioneers in new technologies eventually saw most of their market share taken by new competition. We will follow the maturing cryptocurrency markets closely and be on the lookout for appropriate investment opportunities, but for now we are very comfortable watching from the sidelines and instead focusing our attention on the myriad other technology related opportunities around the world.

[1] *Larry Fink, Blackrock CEO. October 2017.*
[2] *Statista data, provided by Deutsche Bank. February 2021.*

Are you sitting comfortably?

Richard Parfect

01 March 2021

As I write this there is a good news story of a B777 executing a successful diversion and emergency landing following the dramatic loss of one of its two engines. Somewhat unnervingly for passengers the remnants of the burning engine were clear to see. More seriously there was fuselage damage too, however the pilots' frequent rehearsed emergency procedures and risk controls prevented a catastrophic outcome.

Passenger unease is understandably common on aircraft, particularly if the aircraft enters clear air turbulence. Whilst even significant buffeting is normally well within design limits of the aircraft, passengers can become alarmed that something catastrophic will befall them. However, the best thing passengers can do is sit back, try and relax and trust in the professionalism of the pilots and engineers; the turbulence will pass.

As we near the anniversary of the UK economy entering lockdown and the associated collapse of markets around the world, it is almost unbelievable that markets have staged the swift recovery that they have. The market volatility (or turbulence) passed and recovery ensued. For markets such as the UK (which had already endured prolonged weakness post the Brexit referendum), some investors saw the logic of looking past the near term costs of lockdown and appraised the opportunity presented to them to purchase many years' worth of future profits for the bargain basement prices of 2020.

While markets do not follow any known laws of physics (not least because of human participation), investors who seek to remove emotion from their process or, better still, exploit the over-reaction of others, can profit from the principle of "mean-reversion". This is the basic premise that once the temporary effects of a transient event are removed (a war, a pandemic, the initial shock of leaving a trade-bloc); naturally adjusting and compensatory forces take hold and restore the system to something approximating to what went before.

Extrapolation of past and current observations is a natural human trait. However, unfortunately memories are short and many market participants place heavy emphasis on recent experience and much less weight on events several years (or decades) past. This is why people find it hard to sell when markets have been recently strong or buy when the markets are similarly weak.

Ever since the global financial crisis (GFC) when Lehman's failed, central banks have been trying to accelerate economic recovery by various "quantitative easing" means, which in simple terms collectively amounted to printing money. The recovery certainly materialised, but instead of it being felt in the real economy, it was centred around asset prices such as capital markets. The reaction of authorities to the COVID19 pandemic has seen a degree of money printing that has dwarfed that of the GFC response.

Most market participants have not seen a prolonged bear market in fixed income (credit) markets. Their natural horizon has been of central banks buying government debt to maintain low interest rates whilst a low level of inflation has afforded such largesse. Extrapolating indefinite low yields, of even sub 4% for so called "high yield corporate debt" and now negative yields for increasing amounts of sovereign debt, requires the continuation of many things, not least the persistent absence of inflation.

Doom-mongers have warned about the return of inflation for almost as long as quantitative easing commenced; and to date they have been wrong. However, such risks cannot be so easily dismissed now. There is a collective incentive for authorities to allow inflation to rise above target for a prolonged period, if for no other reason than to deflate the huge amounts of debt that has built up. Pent up demand and substantial accumulations of household savings from the last 12 months, as well as the loss of spare capacity in some quarters, could see a material over-shoot of inflation, which may prove to be less temporary than people expect.

The multi-decade rise in bond prices (and associated fall in interest rates) could finally be severely tested in a way that proves to be significantly longer lasting than the market effects of COVID19. We will then see whether the central banks are certain of their position on their economic flight plan and whether they have planned for an emergency diversion airport. Otherwise the resulting economic turbulence may find investors reaching for their parachutes.

Ever since the global financial crisis (GFC) when Lehman's failed, central banks have been trying to accelerate economic recovery by various "quantitative easing" means, which in simple terms collectively amounted to printing money.

Percy's not a pig

Alex Harvey, CFA

08 March 2021

A little over a fortnight ago history was repeated when NASA's Jet Propulsion Laboratory (JPL) successfully landed a rover on the Martian surface. After a near seven-month journey across 300 million miles of space, at a gentle cruising speed of nearly 25,000mph, the rover touched down on 18th February. Perseverance – or Percy for short – was lowered on to the surface by a sky crane, like its cousin Curiosity in 2012, in a feat of incredible human engineering. Of the now five successful JPL rover landings (yes, five!), this was the most accurate ever and was enabled through the experience gleaned over previous rover missions. It is remarkable to watch and with probably better resolution than my phone].

Believe it or not, there are similarities in what we do here at Momentum to what the rocket scientists do in Pasadena. We talk at length with clients about our outcome-based investment philosophy and how we build portfolios that are designed to make the journey as palatable as possible, enabling clients to stay the course. We hope not to subject them to the heavy G-force associated with space travel and do our best to smooth the client experience. We recognise that investing, like space travel, is not without hazards and occasionally, despite best efforts to navigate a comfortable journey, a shower of space junk (let's call it Covid-19) can throw you temporarily off course. We build safeguards into portfolios to help mitigate any loss of control with gold, treasuries, cash and alternatives all going some way to help smooth the rough edges. However, sometimes they might fail to fire – individually or together - and a combination (of diversifiers) is likely to do a better job of stabilising the module ahead of the next part of the journey.

Beyond the comfort factor, time is an important consideration. You don't want to be getting off at the mid-way point to Mars in the same way you may not want to exit a four-year strategy following a sell off two years in. The perils of jumping ship at that point may be less hazardous to an investor's health than for Nasa's passengers, but both are likely to feel disappointment, and neither will catch up with their fellow passengers who stayed on board.

Eventually the destination will be within sight (of a telescope perhaps). I've used the analogy several times recently that we as investment managers want to bring our clients as close to the proverbial 'X marks the spot' as we can. If we do that, whilst minimising the downside risk, we will have done our jobs well. But it doesn't happen by accident and like the teams at the JPL there is a lot of modelling and fine tuning to help align our strategies to that landing zone as their journey progresses. Percy's parachute certainly helped in ensuring the accuracy of the landing and whilst there are no power lines on the Martian surface in which to get entangled (and please keep it that way, Mr Musk), the risk of overshooting the planet altogether or crashing into the surface in a fiery descent are very real possibilities.

Turning the space exploration and investment analogy on its head for a moment, the tail risk for the former is success; so many things can go wrong, and you don't have the luxury of time to put them right. With an outcomes-based investment approach, the tail risk is failing to hit the target landing zone; time is the one constant you do have on your side and so many things can go right if you just let it. The recent success of the value investing style is a good example of how important it is to persevere with a strategy in which others have long lost faith, and let's not forget the rover named 'Value' has had several successful landings before. Success is never guaranteed, but perseverance brings with it the opportunity to learn from prior experience, make marginal improvements to previously less successful attempts, and build faith in a process. Crucial to the success that comes with perseverance is time. Without it, Percy isn't worth his bacon.

Believe it or not, there are similarities in what we do here at Momentum to what the rocket scientists do in Pasadena

15 March 2021

Why we are all hard wired to be bad investors

Gary Moglione

Investing our savings is an extremely important part of life that will have a strong influence on retirement, home ownership and the quality of our lifestyle. Therefore, you would expect us to have evolved to be efficient investors. Unfortunately, we are hard wired to be bad investors as many of our natural instincts force us to fall into a number of behavioural traps that result in poor investment returns.

The first one is herd mentality. This becomes more prevalent at points in the cycle when retail investors are highly active as investment tips get passed on in workplaces, pubs and dinner parties. Everybody has heard stories of people getting rich investing in Bitcoin or technology stocks that has made them motivated to get involved. A small number of high-profile stocks have posted stellar returns in recent years. As a result, valuations have been pushed up ever higher. Higher valuations should spark caution when investing but the reverse actually takes place. People talk about their gains to friends and family sparking more interest in a stock. This causes the share price to rise even further detaching it from intrinsic value. We have witnessed this many times before with the 'nifty fifty' period in the late 1970's and the tech boom in the late 90's. Dare I say we are in a similar environment at the moment.

Another negative behavioural trait is recency bias. This one has been very important in 2020 as a result of the COVID crisis. The global lockdowns created a unique environment of share prices for technology platforms rocketing while those of many businesses that require some form a human contact declined to extreme lows. This was a unique environment but logic tells you that the lockdowns could not be applied forever and historically pandemics, however extreme, eventually dissipate and we return to normality. Rather than taking a long-term view and taking advantage of the low valuations people invested as if the lockdown environment would persist forever. Just months later, as the vaccine rollout moves forward, we are now seeing a reversal of 2020 trend with tech leaders falling and the COVID impaired stocks rallying strongly. By going against their instincts and taking a long term more contrarian view in 2020 investors could have made spectacular returns selling the best performing stocks and buying impaired stocks at incredibly low valuations.

How do we keep these biases out of our decision making when investing? There is no clear answer to this but being conscious of our weaknesses is one step. A robust and well-developed investment process keeps your thinking focussed on the fundamentals. The ability of others on your team to challenge your thesis is also important to remove the blinkers and the potential for confirmation bias (i.e looking for evidence to support your initial instincts in your analysis).

I found that Daniel Kahneman's book "Thinking Fast and Slow" is useful in recognising how your brain makes decisions and how the basics can be applied to investing. The book outlines two types of thinking.

Type 1 – Fast, automatic, frequent, emotional, stereotypic, unconscious

Type 2 – Slow, effortful, infrequent, logical, calculating, conscious

Type 1 thinking is clearly impulsive and emotional. These are two traits that do not work well when investing. Type 1 thinking is used in around 98% of our decision making1 and does a fine job of both protecting us from danger and allowing us to go about our daily routines. However, type 1 thinking will encourage you to buy high because everyone else is and sell low because the market dislikes the stock, making you fearful of further losses. When thinking about investments it is important to engage your type 2 thinking. Make your decisions slowly and for the long term. Ensure they are backed up with sound and detailed research rather than simply a fear of missing out. Focus on the fundamentals and make your decisions based on logic not emotion. This is not a formula for guaranteed investment success but it will help you to be more self-aware and to avoid some of the behavioural traps we are pre-programmed to fall into.

Why we are all hard wired to be bad investors

22 March 2021

Bailey, Powell and Lagarde; the new eco-warriors?

Robert White, CFA

For all the column inches dedicated to central bank meetings this month, one potentially seismic change to monetary policy has slipped under the radar over the last few weeks. In the most recent UK budget, chancellor Rishi Sunak announced that the Bank of England should reflect the "importance of environmental sustainability"[1] in policy decisions, which includes asset purchases. The prospect of central banks determining which assets to support based on environmental credentials points to a significant increase in the importance of environmental, social and governance (ESG) factors for investors, and also raises questions about the appropriate role of central banks going forward.

Rishi Sunak's announcement has certainly not emerged from a vacuum; the Bank of England conducted a review of climate risks to the insurance sector in 2015, expanding this to the banking sector in 2018. Outside of the UK, Christine Lagarde has sought to make climate policy a key part of the ECB's strategic review and has already introduced new climate stress tests for Eurozone banks. Even the Fed is now flagging the dangers that climate change poses to financial stability in the US, although it remains a politically contentious issue in Congress.

Before the financial crisis, this sort of ambition from central bankers was near unthinkable; governors were expected to be independent of politics and predominantly focussed on controlling inflation. The rationale behind this remains sound; politicians are required to retain office every few years through elections, and so may have ulterior economic motives which are incompatible with long term price stability.

After two historic global recessions, the role of central bankers is now much broader. Not only have large quantitative easing programs become the norm, but so has buying direct corporate bonds and equity ETFs (the Bank of Japan is now the largest owner of Japanese stocks). Even the notion of political impartiality has been stretched, with the likes of Janet Yellen and Mario Draghi moving into high profile political roles shortly after their tenure as leaders of the two most important banks in the world came to an end.

Of course, the widening remit of central banks can rightly be justified by their mandate for ensuring financial stability. Increased flooding, droughts and storms are just some of the potential damaging effects of climate change, and it is difficult to argue that these will not create problems for the financial sector. Furthermore, the risk of delaying climate action now could create problems associated with a rushed, disorderly transition to a low carbon economy later. To some however, there is a question as to how much power should be in the hands of unelected technocrats. Are central bankers best placed to determine which companies are the worst polluters? Such decisions are not trivial, and there is plenty of nuance when you delve into the weeds.

Here at Momentum, we believe that you need much broader participation from a range of institutions to tackle environmental issues meaningfully. The change in mindset from central bankers is certainly welcome, but individual companies and investors also need to think in ESG terms. Active managers are particularly well placed in this regard as they have more involvement, knowledge, and influence over the companies in their portfolios. At Momentum, our business was among the first to sign the UN Principles for Responsible Investment back in 2006. We acknowledge that we are in a privileged position to act as fiduciary to our clients and stakeholders, and we take our ESG responsibilities seriously. With the most important global financial institutions now changing policy, it could be costly for investors to ignore.

For all the column inches dedicated to central bank meetings this month, one potentially seismic change to monetary policy has slipped under the radar

[1]*https://www.ft.com/content/f436d69b-2bf0-48cd-bb34-644856fba17f*

Fund Selection 101

Tom Delic

29 March 2021

The CEO of a business has many responsibilities, two of the most important being the strategic and operational oversight of the company. Another vitally important aspect of their role is capital allocation, an area that is often underappreciated by an investor but also poorly carried out by many CEOs. When researching a fund, it is often useful to view the fund manager as a CEO of a conglomerate, responsible for making investments in a portfolio of businesses, with none of the strategic and operational pressures, thereby making capital allocation of primary focus. Viewed through this lens, making an investment through a fund is a partnership with the fund manager, who you are entrusting to manage the capital of your clients in the best possible way. Just like the listed equity markets represent a huge variety of businesses that you can choose to own a piece of, a universe of funds represents a list of potential long-term business partnerships. Below is a summary of a growing body of studies that can help form a filter for the universe when picking who you should partner with.

First, let's look at how we would like a fund to be structured. A study of hedge funds in 2015 (Yin)[1], showed that fund managers have a strong incentive to grow assets under management, as the absolute dollar amount earned from management fees outweighed the benefit of earning an incentive fee on excess performance. Importantly, the diseconomies of scale were found to occur before fund performance deteriorated. As fund selectors, we therefore must look for a manager that not only commits to a fund capacity limit, but we must also consider if that maximum level is still too large for the manager's specific strategy.

Secondly, we turn to skin in the game, a term popularised by Nassim Taleb in his 2017 book of the same name. A 2017 study by Gupta and Sachdeva[2] found that funds with high inside capital outperformed those funds that largely relied on outside capital. Interestingly, the two also found that those managers with their own wealth at stake, were much more likely to limit fund flows, resulting in a persistence of excess returns.

In terms of portfolio strategy, perhaps one of the most well-known studies is by Martijn Cremers and Antti Petajisto (2009)[3], which gave birth to the now often quoted 'Active Share' statistic. In the paper, Cremers found that those funds which were most different from their respective benchmarks, significantly outperformed. In a follow up paper in 2017[4], Cremers also found that the best performing funds were those that had both a high active share and longer holding periods. These funds were in the minority, only accounting for 1.6% of total fund assets across the US equity mutual fund universe.

The above quantitative analysis is by no means exhaustive but can be used as a quick checklist when reviewing a new manager. These characteristics also provide important clues into the qualitative, or fuzzy aspects of manager research, which can't be boiled down to hard evidence. We are dealing with human nature after all, which makes a scientific method to fund analysis a useful contribution to the jigsaw, but some important pieces are missing to complete the picture. Assessing areas such as independence of thought, temperament, decision making under periods of poor performance, and integrity are just a few of the traits that are difficult to measure numerically, therefore requiring the fund analyst's judgement which is built from their experience of many interactions with fund managers.

Perhaps the final word should be on past performance, which when said aloud, feel like they now only belong in the frequently cited disclaimer. While most will measure the "short-term" in months, it can be much more beneficial to stretch your own definition of the short-term out further than the crowd's. If for example your period to measure short-term performance is 3 years, what would you consider to be long-term? A sensible approach can be to identify a manager who has outperformed over a full market cycle (e.g. peak to peak or trough to trough). If meeting your other quantitative and qualitative characteristics, your definition of short-term periods of underperformance (i.e. 1-3 years) could offer an attractive time to make an investment, as other investors are selling.

[1]Yin, Chengdong, The Optimal Size of Hedge Funds: Conflict between Investors and Fund Managers (November 24, 2015. [2]Gupta, Arpit and Sachdeva, Kunal, Skin or Skim? Inside Investment and Hedge Fund Performance (December 13, 2017). [3]Cremers, K. J. Martijn and Petajisto, Antti, How Active is Your Fund Manager? A New Measure That Predicts Performance (March 31, 2009. [4]Cremers, K. J. Martijn, Active Share and the Three Pillars of Active Management: Skill, Conviction and Opportunity (May 2017)

SPACtacular Surge

Christopher Butcher

12 April 2021

During a period of extreme volatility and a global pandemic, the initial public offering (IPO) market had a spectacular year in 2020 in terms of the number of new listings and proceeds raised, along with the rise in popularity for Special Purpose Acquisition Companies (SPACs) which have become one of the hottest investment trends on Wall Street.

Pandemic aside, 2020 has been referred to as the 'Year of the SPAC' in the US as the number that floated on the stock market reached an all-time high, with over $80bn raised across more than 240 SPAC listings1. This accounted for nearly half of all listings on the US market, a significant increase compared to 2019. The momentum has certainly carried over into the start of 2021. Supportive monetary and fiscal stimulus, ultra-low interest rates and global markets at record levels have helped the US IPO market produce its busiest quarter in over two decades as issuers rush to sell while investor demand is hot and valuations high. The SPAC trend also continued, with 296 SPACs going public in the first three months of the year, already raising more capital than in the full year of 2020.

But what are SPACs and why have they become so popular in recent years? SPACs are not like regular companies as they have no commercial operations when they IPO. They are commonly referred to as "blank-check companies" as they raise a sum of money with the purpose of buying a yet-to-be determined private company within a specified period of time, usually 24 months. If they do not make an acquisition and are unable to get shareholders to grant an extension, they are wound up and cash is returned to shareholders.

The SPAC surge has been fuelled by a wider realisation of the benefits for various stakeholders. SPAC investors get the opportunity to be part of the process, and the financial upside, of taking a company public, with some downside protection as a result of their option to redeem their capital prior to any acquisition. For private companies, the key incentives include the ability to become a publicly traded company a lot faster compared to the traditional IPO process, with more certainty as to pricing and control over deal terms.

However, investors should also be aware of the risks involved when investing in SPACs. Shareholder advocates are sounding alarms about misaligned interests, sponsor compensation, celebrity sponsorship and the potential for retail participation drawn in by the hype of a few successful, high-visibility SPACs such as Virgin Galactic in 2019.

The SPAC trend has predominantly been a US phenomenon, but is now catching on in Europe and Asia with increased interest from sponsors, investors and potential target companies. Regulators, including the Financial Conduct Authority (FCA) in the UK, are looking to reform rules on SPACs to attract new, fast-growing companies. Cazoo, the online used car seller, is an example of a UK tech business that has opted to sidestep the lengthy IPO process and list in the US through a SPAC in recent weeks.

As the reflation trade has taken hold this year, technology stocks have lagged the broader market and this has weighed on the performance of some companies that have recently listed, both via the traditional IPO process and SPACs. An index that tracks SPAC listings has dropped 22% from its February high, with worries mounting about valuations and a bubble in that corner of the market. The unprecedented surge in the SPAC market has coincided with, and has no doubt been supported by, huge liquidity injections from the Federal Reserve and other central banks around the world; as such an even higher level of scrutiny and due diligence is warranted before participating.

At Momentum, we look beyond the current "hot topic" when selecting our investments. We access private companies before the IPO stage through carefully selecting publicly listed investment trusts, which enables us to invest in exciting high growth companies earlier on in their development without creating a liquidity mismatch in our portfolios. Furthermore, we do so in a diversified way, and we conduct thorough due diligence to ensure that our managers have aligned interests with us and our clients. The SPAC trend is certainly an interesting market development, but one where we generally see greater risks than opportunities for investors at present.

Supportive monetary and fiscal stimulus, ultra-low interest rates and global markets at record levels have helped the US IPO market produce its busiest quarter in over two decades

[1] *https://www.spacresearch.com/*

First a green jacket, now a green light for Japan?

Michael Clough, CFA

19 April 2021

Two weekends ago Hideki Matsuyama became Japan's first male winner of one of golf's four major championships by claiming the Masters at the prestigious Augusta National Golf Club. Only three of the world's top 100 ranked male golfers are from Japan. The country is underrepresented in the upper echelons of the golfing world and it is often underrepresented in investors' portfolios too.

Today, Japan accounts for 7.5% of the developed world global equity market, much smaller than the 44% it once accounted for in the late 1980s[1]. Indeed, the equity market is still 24% lower than the peak reached over 30 years ago[2]. Back then the four largest companies in the world were Japanese (all banks). Now you're looking around the 50th largest before you find a Japanese name (Toyota) and past the 150 mark to find the first Japanese bank (MUFG Bank). The 'Lost Decades' is a phrase that refers to the period of low economic growth and low inflation (otherwise known as stagnation) that has crippled Japan's economy ever since that equity market bubble of the late 80s burst. Combine the scars from these events with a notoriously ageing society and less favourable corporate governance than many developed market peers and it is perhaps unsurprising that Japan hasn't been number one on investors' lists of late. But there are reasons to be more optimistic going forwards.

Former Prime Minister Shinzo Abe introduced his three arrows approach, which became known as 'Abenomics', in 2012 to help drive the economy out of its sluggish state, identifying loose monetary policy, expansive fiscal policy and structural reform as prerequisites. Whilst these were never going to be quick fixes, Japan's current Prime Minister Yoshihide Suga has made clear his intentions to ensure the policies of his predecessor endure. His pro-deregulation stance should also be supportive.

Monetary policy in Japan has been ultra-loose for years, involving negative interest rates, massive bond purchases, yield curve control and equity purchases. Whilst the central bank recently amended its approach towards equity ETF purchases to only intervene during market falls rather than steadily increasing its holdings, they still committed up to ¥12trn ($110bn) of equity investments each year[3]. Whilst these approaches have failed to ignite inflation to date, they remain hugely accommodative.

The impact of fiscal policy has been mixed over the years and a rise in consumption tax in 2014 and 2019 did little to spur on growth and inflation but government intervention through the coronavirus pandemic has been massive. Across three different stimulus packages throughout 2020 the government injected the equivalent of almost $3 trillion into the economy, accounting for over 50% of GDP, the highest of any G20 country (the US is at 26% of a $20trn economy)[4].

On structural reform, one key component has been improving corporate governance, something that has long been criticised in Japan. Hefty cash piles may be indicative of a misallocation of capital, one facet of corporate governance that policy is designed to address. There is greater focus now on shareholder returns through higher dividend distributions and share buybacks. Historically the dividend yield of Japanese equities has lagged that of the global equity market. Now it offers a small yield premium, despite a lower payout ratio compared to peers, suggesting there is room for this premium to grow.

The Japanese equity market is also well placed to benefit as economies reopen from pandemic related restrictions. Whilst energy exposure is very limited, the index has significant allocations to other cyclical sectors including industrials, automotives and financials which should do well as economic recovery takes hold. Current valuations at the index level might not get the deepest value investors too enthusiastic but a forward price earnings ratio of 17x is cheaper than both Europe and the US.

Risks do remain of course. Whilst Japan has kept coronavirus fatalities well below that of other developed economies, there has been a surge in cases in recent weeks and the country's vaccination rate is one of the lowest globally. The issues around ageing demographics must also still be addressed. However, there are certainly reasons to be cheerful. Hideki Matsuyama took home the green jacket at Augusta National. Perhaps now is the time for investors to give Japan the green light.

[1]*https://www.investmentoffice.com/Asset_Management/Observations/Indices/Japanese_Stock_Market_Bubble_in_the_late_1980s.html.* [2]*Bloomberg.* [3]*https://www.boj.or.jp/en/announcements/release_2021/k210319a.pdf.* [4]*https://www.statista.com/statistics/1107572/covid-19-value-g20-stimulus-packages-share-gdp/*

ESL - what not to do

Jackson Franks

As an avid Watford football club supporter, the announcement of a newly formed European Super League (ESL) on the 18th April felt like a break-up. The dream of one day getting to see my club play at the highest level had disappeared overnight. For those who didn't see the news, twelve of the "biggest" European football teams broke away to form the ESL, of which six were English. The newly formed competition was designed to challenge the existing UEFA Champions League bringing more games between the largest European clubs. My disappointment didn't last long as three days later most founding members ended their involvement, despite a guaranteed place in the league for its entirety and a not so small c.$300m founder's fee. So why did the ESL end as quickly as it started? To me the answer is simple, not understanding their clientele. The ESL was not an evolution of the sport but instead was a fundamental change in three commonly used core principles: (1) mandate - best performing clubs changed to the so called biggest clubs (2) philosophy - positive or negative implications based on performance changed to no implications and (3) process - open competition changed to a closed competition.

At Momentum, we pride ourselves on understanding our clients' needs through engagement and market research. Our focus is on designing, building and managing outcome-based investment solutions, delivered through multi-asset portfolios and tailored client vehicles. Although our core principles may evolve over time the fundamentals of our principles will remain the same: (1) mandate - provide investment solutions, (2) philosophy - outcome-based investing and (3) process - designing, building and managing investment products.

One investment vehicle in which we manage is the Momentum Africa Real Estate Fund, also known as MAREF[1]. MAREF is a closed ended pooled vehicle whose mandate is to finance and develop commercial real estate within sub-Saharan Africa excluding South Africa. The fund's investment philosophy is to provide global Grade A standard properties to the continent at the lowest possible rental rate for its occupiers, whilst delivering its return objective to its investors.

Operating in sub-Saharan Africa comes with heightened risk factors. Understanding our investor's requirements and risk tolerance through open dialogue enabled us to build a robust process which mitigates their risks whilst enabling the fund to aim to hit its return objective. These risks include, (1) secured title and zoning of land, (2) costing and design, (3) pre-letting 60% of gross lettable area (GLA) and (4) securing debt funding. At the outset of any project, an extensive due diligence is conducted on the title and zoning of land. In sub-Saharan Africa the land registries are not as established as the developed world and are only now in the process of being digitalised. The importance of ensuring the land is secured and zoned is vital before investing our client's capital due to a higher risk of land claims. MAREFs appointed developer, Eris Property Group (EPG), that is MGIM's sister company, decommission risks 2 and 3 above. EPG underwrite the delivery and the capital cost to MAREF and therefore the total project cost presented to investment committee is the final cost. If the cost were to go above the presented amount, it would be at the cost of EPG not MAREFs investors. Consequently, the costing and design will be at stage 4 before a project is presented to MAREFs investment committee. Mitigating risk 1, 2 and 3 above enables MAREF to source third party debt funding. MAREF is mandated to gear a project up to 60% of the total development cost, and once sourced ensures the project is fully funded from day 1. Only once these four key risks have been mitigated does a project get presented to the investment committee for approval.

Understanding your client's requirements and objectives whilst communicating your mandate, philosophy and process is key to establishing a successful working relationship. Now the ESL knows what their clients don't want, I wouldn't be too surprised to see a newly presented version of the ESL in years to come.

Understanding our investors requirements and risk tolerance through open dialogue enabled us to build a robust process which mitigates their risks whilst enabling the fund to aim to hit its return objective

[1]*MAREF is an African commercial real estate development joint venture between MGIM and EPG. The Fund is closed for new investments. More details can be found on the Momentum website. https://momentum.co.uk/channels/institutional-investor/real-estate.*

A Value Renaissance

Mark Wright, CFA

The Renaissance marked the transition from Middle Ages to modernity in 15th and 16th century Europe. A fairly significant event! We now appear to be witnessing another renaissance – a Value Renaissance. Whilst probably not as significant in the history of world civilisation, similarities do exist in the origin of the two.

The European Renaissance began after the Crisis of the Last Middle Ages, a series of catastrophes that rocked Europe, including the Great Famine and infamous pandemic – the Black Death. Combined, these reportedly wiped out half of Europe's population1. Whilst still tragic for too many, thank goodness Covid-19 has not proved as deadly!

A little over 6 months ago on Monday 9th November, US pharmaceutical giant, Pfizer, and German based, BioNTech, announced successful results from a Phase 3 study of their vaccine with more than 90% efficacy against the Coronavirus.

This led to the biggest reversal in fortune for value versus growth in a long time. On the day of Pfizer and BioNTech's announcement, value outperformed growth by 4.4% on a global basis - a 10-sigma event2; or in other words, a level of outperformance not even expected to occur once every billion years3 (the Earth was formed 4.5 billion years ago4). This, of course, assumes returns are normally distributed, which they are not, but I'll leave that for another day.

Aside from brief periods of modest outperformance as the global economy emerged from the fallout of the Global Financial Crisis and then again from the depths of the European Sovereign Debt Crisis, value has not trumped growth since the mid-noughties5.

For the best part of a decade, growth has outperformed value, supported by a global experiment conducted by central banks in which many savers have been charged for depositing cash (negative interest rates) and government spending is supported by the money printing presses (quantitative easing). This outperformance of growth versus value accelerated in 2019 and 2020, leaving global growth stocks a staggering 134% ahead of global value stocks over the decade prior to the Pfizer/BioNTech vaccine news5.

Why can we be so confident that it's values time to shine?

Firstly, just as the sacking of Tony Dye at Phillips & Drew Fund Management in March 2000 served as the canary in the coal mine for the collapse of the Dot Com boom, several high-profile value managers were fired, left the industry or chose to close shop last year.

US based, value focussed AJO, announced it was shutting its operations on 31st December 2020, not that long after Mark Barnett lost the mandate to manage the Edinburgh Investment Trust and Keystone Investment Trust due to underperformance. Famously contrarian and value oriented, Alastair Munday, also threw in the towel and exited the industry to pursue a career in teaching.

Secondly, value had underperformed growth for so long, it quite simply had to end at some point – it could not have continued forever. Extreme moves in the prevailing direction of a trend usually precede a reversal of that trend and that is exactly what we witnessed last year – two thirds of the outperformance of growth came through in just 10 months of 2020 prior to the Pfizer/BioNTech vaccine announcement.

Thirdly, it has been observed that value as a factor typically performs strongly during periods when government bond yield curves are steepening i.e. when the yield on 10 year government debt minus the yield on 2 year government debt is increasing, and they have been doing just that for over a year now. Crucially, they are not yet as steep as they have been in past cycles, suggesting a supportive backdrop for value investors for some time to come.

Lastly, we are witnessing it first-hand in the funds we manage on your behalf. The direct UK equity portfolio in our UK domiciled funds has a value bias and has rallied over 50% post the positive vaccine news which compares to a mere 17% gain for the FTSE All Share6. Similarly, many of the value oriented third party equity managers that we invest in have sharply outperformed regional benchmark indices.

The value rally won't last forever, but whilst it does, we intend to enjoy the ride.

The European Renaissance began after the Crisis of the Last Middle Ages, a series of catastrophes that rocked Europe, including the Great Famine and infamous pandemic – the Black Death

[1]*Crisis of the Late Middle Ages - Wikipedia.* [2]*Bloomberg – MSCI All Country World Value Index vs MSCI All Country World Growth Index 31/12/96-30/04/2021.* [3]*68–95–99.7 rule - Wikipedia.* [4]*In Depth | Earth – NASA Solar System Exploration.* [5]*Bloomberg – MSCI All Country World Value Index vs MSCI All Country World Growth Index.* [6]*StatPro, COB 6th November 2020 to COB 31st March 2021.*

Diversify your diversifiers

Alex Harvey, CFA

Genghis Khan is considered by many to be perhaps the greatest conqueror of all time (sorry, Guillaume de Normandie), and ruled over an empire that at its peak spanned as far west as modern-day Poland and as far east as the Russian Pacific seaboard. Mongolia today is a 'fraction' of that size but still in the world's top 20 largest countries and would knock Kazakhstan down into 10th place if you included the Mongolic autonomous region of the People's Republic of China[1]. As the least densely populated country in the world it fits the population of Wales into a land mass the size of Western Europe. It's that empty.

I was fortunate to have visited this beautiful landlocked country three years ago and journey overland through the Gobi desert and beyond. As is customary we travelled in a convoy, not because we were important (far from it!) but because if you break down out there, no one is going to find you. The lack of mobile reception was part of the 'Detox draw' but with that comes no search and rescue. That 10yr old land cruiser might have served you well in the past but it can still go wrong (and it did). In the vast empty Mongolian plains, you need a back-up plan.

The same can be said for modern portfolio design. For years investors have relied on the classic '60/40' portfolio (consisting of 60% equities and 40% bonds) which has provided investors a handsome return - and diversification - through the great 30-year bond bull market. Going forward however the maths just doesn't stack up; a 30 year annualised return of 5.2% but a yield today of sub 1%[2]. As we see increasingly these days bonds are not the antidote to a sell off in equities, they can be the cause. Recent wobbles in equity markets have followed moves higher in bond yields and some of the most sensitive names to this creep higher are the growthier tech companies whose future earnings growth feels the negative effect of a higher discount rate more acutely. With a handful of these 'FAANG'ier[3] type names driving index performance due to their size and concentration, it is unsurprising that the rate effect has become more pronounced.

Indeed, it was arguably ever lower rates that helped lift the information technology sector weight, within the US equity market, to its post 2001 TMT highs in the first place. At 0.34[4] the three-month bond – equity correlation is currently at its highest level for over five years, having only briefly been higher in the last twenty. 'Correlation does not imply causation' goes the saying but the effect is evident today. Add to this several testing liquidity episodes in the last few years for US Treasuries, the world's most liquid 'risk free' asset, and investors would be wise to hedge their diversification bets.

At Momentum we have long advocated embedding a truly multi asset exposure into client portfolios and funds. Our multi asset, multi style and multi manager approach builds in additional diversification levers that help to smooth the investment journey that we create for our clients. Credit, convertibles, inflation linked bonds, infrastructure, property, gold and alternatives are among the asset classes we use to build portfolios, whilst value, quality and growth exposure provides style diversification. Our modelling shows that over the last 20 years a broad strategic asset allocation increases the diversification benefits of a 60/40 portfolio by over 70%[5]. Some currency exposure is naturally embedded within both allocations but an explicit exposure to a perceived haven currency like the Japanese Yen could further improve the portfolio effect. The inflated returns from Developed Market sovereign bonds in recent decades may give false comfort to those banking on the same for the future. Yes, bonds are an important part of a multi asset portfolio but today arguably provide more of a 'return free risk' than a 'risk free return'. By diversifying your diversifiers you can reduce your risk of coming unstuck in the proverbial investment desert.

As we see increasingly these days bonds are not the antidote to a sell off in equities, they can be the cause

[1]*Source: Wikipedia ;* [2]*Source: JP Morgan Global Government Bond index;* [3]*The FAANG index refers to Facebook, Amazon, Apple, Netflix and Google. They represent 17.4% of the S&P500 index by market value today;* [4]*The diversification benefit for a multi asset portfolio was 2.6% compared to 1.5% for a risk equivalent global 60/40 portfolio;* [5]*Source: MGIM*

Be smart, be decent: empower women

Lorenzo La Posta, CFA

24 May 2021

I think we, as human species, have proved how advanced and smart we are in many ways: we have sent people into space, observed the smallest atoms, cured diseases and invented pizza. Yet, many people still fall foul of one of the most extreme idiocies: sexism. There is no justifiable or objective reason behind the discrimination based on the absence (or presence) of the Y chromosome, so, in a world of cognitive human beings, such a thing should not exist at all. Yet it does, and I can't really understand why, because gender discrimination is not only terribly wrong, but also plain stupid.

This is too vast a topic, that unfortunately permeates many areas of societies and people's lives, so I want to focus on just one component of it: the workplace and economic discrimination between males and females. I promise, no sterile critique. Rather, I'm here to quantify some of the economic consequences of gender inequality.

To summarise what one part of the problem is, today[1] on average women all over the world tend to earn less than men, being typically underrepresented in senior positions within firms and overrepresented in low-paying jobs. Also, women are underrepresented in national parliaments and local governments, despite effectively half the world's population being female. If some progress has been made in the past 20 years or so to reduce these and the many more existing inequalities, there is still a long way to go until full parity.

Regardless of where you live or what gender you identify with, gender equality is a fundamental human right and promoting it should need no additional incentivisation. Yet, I promised to be practical.

According to US government data[2], boosting female labour equality could add as much as $1.5 trillion to US GDP each year. In fact, increasing female labour participation by 15 million people and closing the wage gap, would add as much as 12% to labour income that would in turn translate to around a 7% increase in GDP. So, even taking a few steps in favour of labour force inclusivity and pay equity would bring substantial advantages for the entire population. Everyone, men and women, would benefit from gender equality.

According to the World Bank[3], the economic cost of gender inequality has been about $160 trillion for the entire globe. On average, each one of us is missing out on around £23,620 in wealth, because of the barriers that women face to fully participate in the work force and earn as much as men. Currently women account for only 38% of their country's human capital wealth, compared to 62% for men. The largest losses are observed in larger and more developed economies, such as North America, Europe, the Pacific and Eastern-Central Asia so I, as a European worker, am missing out on much more than average!

These two examples of clear, quantifiable consequences of gender inequality should convince even the more stubborn (and I'm being nice here) people that promoting equality is not only the very least one could do as a human being, but is also very advantageous for everyone, even for those who do not directly suffer from discrimination. I want to borrow from the United Nations in saying that "Gender equality it is not only a fundamental human right, but a necessary foundation for a peaceful, prosperous and sustainable world".

Gender discrimination is not only terribly wrong, but also plain stupid

[1] *United Nations Sustainable Development Goal n.5 ;* [2] *US Bureau of Labor Statistics and Goldman Sachs Asset Management, as of January 31 2021;* [3] *The World Bank Group, "Unrealized potential: the high cost of gender inequality in earnings"*

Macro Matters

Richard Stutely, CFA

07 June 2021

When I raise the issue of the importance of macro, I tend to get the same responses, which fall into two categories:

1. It can't be done; no one has a good record predicting macroeconomic variables like GDP growth.

2. Why bother? Even if you had perfect foresight of what these variables were going to be, you wouldn't be able to predict the market's reaction.

Addressing the second point first, the reason predicting macroeconomic variables is desirable is that they have a bearing on your future payouts from any investment: if GDP growth is weak or negative, company sales are likely to be lower; if inflation is high, the squeeze on real incomes is likely to have a similar effect by reducing consumer discretionary spending; if interest rates go down, holders of government bonds stand to profit, other things being equal.

The biggest factor affecting the performance of most companies is not the size of the wider economy, but whether anyone actually wants to spend money on their product. Hence while every company has a sensitivity to macroeconomic variables as described above, that is not to say that idiosyncratic risk is not key. At times, the macro is dwarfed by these company specific factors, at which point macro doesn't matter, but this will not be true at all times and for all companies. Ignoring cyclical businesses and companies with less than perfect finances in order to avoid having to think about the outlook for growth and interest rates, curtails one's investment universe.

Predicting key variables like growth, interest rates and inflation is extremely difficult, even for professional forecasters[1]. However, establishing reasonable bounds for key variables is more achievable. For example, are central bank rates of 10% in the US likely next year? We are realistic about our forecasting abilities but we do not assume that anything between plus and minus 10% carries an equal probability. We pay close attention to historical norms. The hurdle to moving away from these norms is high, given that this time is rarely different. In many instances history reveals the natural level of key variables, to which they revert over time by virtue of the natural stabilisers that exist within economies.

As with all big problems, the key is to reduce it into something manageable, which for us means a set of four scenarios. Currently we believe the most likely outcome for the global economy is a strong rebound in growth, with higher attendant inflation than during the pre-pandemic period. In each of these scenarios we don't immediately assume asset class x will go up and asset class y will go down. Instead we think about what is likely to happen to the key variables that influence investment returns. For example, by trying to understand what is likely to happen to company sales in a range of scenarios, we can then interrogate the price we're being asked to pay for equities today. This means we can tolerate a recession without running into cash, if we think the price we're paying for equities and credit adequately compensates us for this scenario.

The key distinction is between a top down investment approach akin to an investment clock, and using macro as an input to a bottom-up, valuation driven approach. We don't believe in investing on the basis of macro, but nor do we ignore it. Macro variables don't tell you what investment returns are going to be: they contribute to the payouts you are going to receive in future, at which point you need to decide what you are going to pay for those payouts today.

We don't believe in investing on the basis of macro, but nor do we ignore it

[1] *T Stark, 'Realistic Evaluation of Real-Time Forecasts in the Survey of Professional Forecasters', Federal Reserve Bank of Philadelphia Research, philadelphiafed.org, 2010*

This time may be different

Andrew Hardy, CFA

14 June 2021

"As violent as a mugger, as frightening as an armed robber and as deadly as a hit man." Ronald Reagan's caricature of inflation in 1978 reflects a degree of fear at the time about this pernicious thief that is largely absent amongst today's policymakers. After several decades of low inflation, policymakers and investors have potentially become too complacent about the risks of higher inflation. Although there remains a wide range of potential outcomes in the coming years, we see a return of higher inflation as the biggest risk factor in markets; it would erode purchasing power, damage the real value of savings and wealth, and would have far-reaching implications for the construction of portfolios.

Recent investor surveys[1] also single out higher inflation as being the biggest perceived risk to market stability, with those related to the vaccine rollout or new variants slipping down the list. It's remarkable that we've reached this point already, within a year of the world slumping into the steepest and deepest recession since World War II, but concerns are justified by the unique circumstances; the nature of the recession, extraordinary levels of coordinated fiscal and monetary policy, and new priorities for policy makers.

That inflation will remain elevated in the short term is beyond question. As economies begin to reopen, huge levels of pent up demand will be unleashed, unlike after any 'normal' recession, into supply chains that are still suffering from dislocation and shortages. Also, base effects of comparisons to a year ago are very large, particularly given the extent to which commodity prices crashed (recall the price of WTI oil went negative!); from the pandemic lows in March 2020 the Bloomberg Commodity Index has rallied over 60%.

Focusing on the all-important US economy, while consensus expectations have already moved sharply higher, last week's Consumer Price Inflation (CPI) figures still surprised to the upside, at +5.0% year on year. Even Core CPI, which excludes more volatile food and energy items and is a better guide to underlying inflationary trends, printed at 3.8%, the highest level since 1992. Quite remarkable for an economy that is still a long way away from fully normalising yet.

However, the key question for investors is how persistent these elevated inflation levels will prove to be?

Central bankers have stuck to the view that the surge will be temporary, and inflation will fall back towards targets before long. But underlying principles at the US Federal Reserve are very different from previous cycles; late last year they moved to an average inflation targeting approach, affording them the flexibility to let the economy run hot for a period, and this year they have emphasised the need to see actual progress on the economic recovery rather than just forecast. As a result, they are only just now considering starting discussions around tapering easy policy[2].

After a period of massive money supply growth, which typically increases inflation, and with financial conditions easier than they have been for decades on some measures[3], this is highly unusual. In previous cycles the Fed and other central banks attempted to pre-empt inflation overshoots by increasing interest rates in anticipation of future conditions.

Meanwhile, governments are less concerned about inflation and debt sustainability than they have been in past decades, as demonstrated by President Biden's enormous fiscal stimulus plans. Instead, there is much greater focus on broader social goals and longer-term objectives, such as combatting climate change, rather than simply achieving stable economies.

Also, China has been exporting disinflation around the world for decades but is less likely to do so going forward. There, as in many other advanced economies, declining working-age populations will put upward pressure on wages which will feed through into goods and services. Last week China's producer price index showed a 9.0% year on year increase, the fastest pace since 2008.

This cocktail of circumstances and shifts significantly increases the risk of persistently higher inflation. Investors must worry about that, because history tells us that letting the inflation genie out of the bottle is a lot easier than putting it back in again, and because markets aren't pricing in a persistent rise; 10 year US Treasuries remarkably still yield less than 1.5%, meaning the real yield (subtracting inflation) stands at -3.5%, the lowest since 1980. If central banks fall meaningfully behind the curve, the ensuing rapid rise in rates and bond yields would inflict significant pain on a highly leveraged world economy and would likely undermine all risk assets.

However, the outcome is by no means certain. Output could rapidly respond to the surge in demand and keep prices in check, while longer term constraints, including demographics, digital disruption and competition, and new technology, could continue to bear down on inflation as they have done for decades. But for the first time in many years, the risks have shifted away from disinflation and towards the upside. We will be scrutinising developments, particularly for signs of price inflation feeding into real wage growth and longer-term inflation expectations, as these would be the most likely factors to force central banks into moving earlier and more decisively. Given the risks and the widening range of potential outcomes over the coming years, we believe portfolio diversification is more important than ever; investors should seek a balance of real assets to protect against inflation alongside more defensive assets which would perform well in a lower inflation environment.

History tells us that letting the inflation genie out of the bottle is a lot easier than putting it back in again

Source for market and economic data: Bloomberg Finance L.P. *[1] Bank of America, May 2021. Deutsche Bank, May 2021. [2] Minutes of the Federal Open Market Committee, April 27–28 2021. [3] Goldman Sachs US Financial Conditions Index.*

For what it's worth

Richard Parfect

What is it worth then? This is a question investors should be asking themselves all the time. However, the true answer is not always obvious. There are many ways to approach it and there is of course an easy "short cut" to establishing an answer; the stock market price. However, relying on such a public pricing mechanism implies a high level of faith on efficient markets and to believe there is no such thing as "the madness of crowds".

While it may be possible to assume markets are efficient for certain stocks much of the time; we believe, as active investors, that there are pockets of inefficiency throughout the market all of the time. Herd mentality and a reluctance to stand out from the crowd can lead to instances of a build up of excessive sentiment in either direction on stocks.

Benjamin Graham discussed how in the short term the stock market is a voting machine (sentiment) but in the long term it is a weighing machine (value). We certainly saw the stock markets short term failings in 2020 as COVID-19 brought company valuations down to levels that implied their futures were permanently impaired. The subsequent strong recovery reflects how the voting sentiment has swung the other way as investors play the "reopening trade". Share prices in the longer term (the weighing element of the market) will almost certainly be closer to (and above) the recovered prices than the distressed levels of 2020.

So, the short termism of markets presents a problem to investors as they see their holdings marked down in crises, however if they apply a more long term mindset, that presents a (buying) opportunity. Indeed, we are now starting to see parties enter the UK equity market with a clear view on the longer term return potential of listed companies; as a number are now facing bids from either trade buyers (competitors) or private equity.

In order to have confidence to act on those short term opportunities, then investors need to apply some fundamental analysis to the investment proposition; an inexhaustive list would include assessments on: intrinsic asset value and their future income/dividend generating potential supported by profit expansion (which in turn relies on revenues and margins). These are fundamental and important quantitative and qualitative questions to answer by digging into the company, its management and their philosophy.

However, restricting one's framework to companies that are already established on a revenue or even profit generating path, can result in some missed opportunities. It can be argued that investing in pre-revenue generating companies is the preserve of "growth investors"; however if there is clear visibility in a company to profitable revenue generation and sensible assumptions can be put in place for that, then it should be possible to appraise whether the quoted market price is a fair value for those future returns. Nevertheless, it is important to distinguish here the difference between companies that have a credible product or technology platform that needs commercialisation at scale, from those that are more "blue sky" and uncertain.

Valuing such companies can be more subjective and requires a more qualitative and in depth understanding of the company than a pure spreadsheet analysis will reveal. This is perhaps most apparent in the disruptive breed of owner-managed businesses raising "cross-over" private capital before they list on public markets. Similarly, sectors like healthcare can see companies valued, both by private and public markets, at material discounts to what they are intrinsically worth.

The clearest indication of what a company is worth is ultimately what someone is prepared to pay to own it out-right. A recent example would be Kymab, which was a private company held within Schroder UK Public Private Trust (SUPP). It develops monoclonal antibody therapeutics for use in oncology and immune disorders amongst other indications; technology that is transformative for medicine. It was recently purchased outright by the global pharmaceutical company, Sanofi, for up to $1.5bn[1]; which is a price per share 4x the level of where it had been formally valued within SUPP.

In summary, it is important to understand that listed markets will immediately tell you the price of everything, but in that snapshot of time it will inform you the value of nothing.

'Relying on such a public pricing mechanism implies a high level of faith on efficient markets and to believe there is no such thing as "the madness of crowds"

[1]*Source: Schroders UK Public Private Trust Plc*

Patience is a Virtue

Stephen Nguyen, CFA

Patience is essential to daily life and even more so if you are parents to young kids. When I was a child, I was often told to "be patient", which meant staying calm in the face of delay, frustration or adversity. We all have many opportunities in life to practice this virtue; being stuck in traffic, the ups and down of parenthood, or indeed, managing one's investments. By understanding the importance of having patience, we can maintain our focus on our long-term goals, and not let short term noise push us into taking unnecessary action. Time in the market is better than timing the market, as they say, as it allows investors to benefit from the power of compounding, which Albert Einstein once referred to as the 8th wonder of the world[1].

An investment portfolio needs to have a clearly defined goal and be built with relevant constraints in mind. One other aspect which is often overlooked is determining the appropriate time horizon, which we think of as the minimum timeframe investors should commit to in order to reduce their risk of experiencing a negative outcome.

There is no magic number on how long one should stay invested. All else being equal, the longer you stay invested the better your chances of achieving your goals. However, we acknowledge it is not always practical for investors to stay invested for 10 or 20 years, so instead we communicate a minimum recommended timeframe for each of our portfolios.

In determining the recommended minimum investment horizon for our funds, we balance considerations around both the funds' objectives and risk profile. Lower risk portfolios should not be as sensitive to market movements and typically would suit investors with a shorter timeframe, while a portfolio with a higher allocation to risk assets and a higher target return are more prone to short term drawdowns and hence require a longer investment horizon.

So how do we arrive at the minimum recommended horizon for our funds? We start at the core of the investment process, namely the strategic asset allocation (SAA). The SAA represents our optimised long-term asset class weightings which are constructed to deliver the highest probability of achieving the target outcome while balancing that against drawdown risks. This increases the chance of delivering a smoother journey for investors.

We analyse data from these SAAs over many years and study the range of returns over various timeframes along with the expected return to arrive at an appropriate minimum investment horizon. In our analysis, we observe that over shorter time periods of 1 to 3 years, the range of outcomes is very wide. Investors are more likely to experience a negative outcome should they not stay invested for at least the minimum recommended holding period. Particularly in any given 12-month period, the likelihood of a negative outcome is high given the inherent volatility of markets and the magnitude, can at times, be severe.

However, as the recommended holding period increases, the range of returns becomes narrower, and the probability of experiencing a negative outcome is greatly reduced after holding for around 5+ years for most risk balanced portfolios. The range of outcomes is at its narrowest from around 7 years onwards, meaning the likelihood of a negative outcome is further reduced and the variability around the objectives is minimised.

Being patient in the face of adversity is key to a happy life, and a healthy investment portfolio. The reality for investors is that extending your investment horizon will help you to achieve your financial goals. Good things truly do come to those who wait.

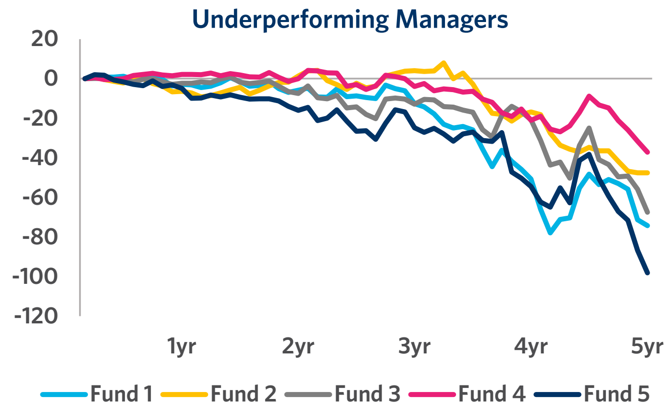
'Time in the market is better than timing the market'

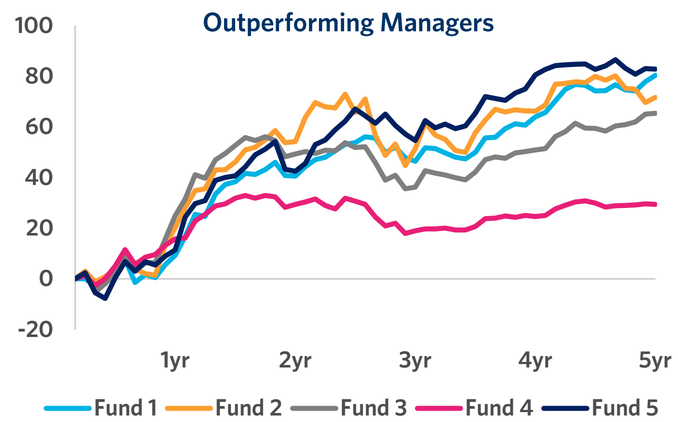
Source: [1]High Returns from Low Risk – a remarkable stock market paradox. Pim Van Vliet and Jan De Koning

Past performance is not indicative of future results

Gary Moglione

"Past performance is not indicative of future results" is a regulatory risk warning on most investment oriented material that everyone knows but not many people seem to actually implement into their decision making. A Fund Managers performance can dictate whether they become a hero or villain in the eyes of the public and the press. This then influences investment flows and ultimately determines whether the fund thrives or is liquidated. The charts below highlight the relative performance of two groups of US Equity funds versus the S&P 500 index. One group is amongst the worst performers with average underperformance of 64.9% over 5 years whereas the other group have posted almost a mirror image of 65.9% outperformance.





Source: Bloomberg Finance L.P., Momentum Global Investment Management

That's a huge 130% difference in returns between the averages of the two groups. Are there any key differences in the structure or processes that would help identify good managers and bad managers? As you may have guessed, the answer is no because there are no differences. Both charts show the same 5 US Equity value managers but in two subsequent five-year periods (Dec 94 to Dec 99 and Dec 99 to Dec 04). By the end of 1999 the underperformance of value managers was so severe that value managers were being sacked, replaced and retiring as they struggled with falling assets under management and the press questioned whether value investing worked in this new technology led environment. They were struggling to attract inflows as investors preferred the spectacular returns delivered by the world changing technology companies that growth managers had invested in. Sounds very familiar doesn't it? The next few months saw the bursting of the tech bubble followed by seven years of strong performance from value strategies. If you step back and look through history there have been constant, sometimes violent, swings between styles. The recent success of growth stocks has been one of the strongest and longest in history. It has been so great that investors under the age of 35 have really only seen one type of market throughout their career. Due to the longevity of this growth cycle, investing in yesterday's winners has been a profitable strategy for a long period but this will come to an end at some point. Inflection points can be so painful for investors that fail to appreciate the effect of a change in environment and sentiment. The market's strongest performers tend to change every decade and we have seen Nifty Fifty in the 1960s (Growth), Commodities in the 70s (Value), Technology in the 90s (Growth), Banks and Commodities (Value) in the early 2000s and then the FAANGs (Growth) in the 2010s. As with the swing in style preference there then are changes in the personalities perceived as investment gurus who then grow assets considerably based on a tailwind of style fuelled performance. We can see this in the past couple of decades with the rise and fall of value investors Neil Woodford and Mark Barnett (although they may have heightened their fall by holding illiquid assets when investing into a severe style headwind) only to be replaced in the last decade by growth investors such as Baillie Gifford and Fundsmith. History suggests the outcomes for these two high profile companies could be very different over the next decade compared to the previous one if their strong growth tilt persists.

The examples in the charts above are extremes in that I have chosen managers with a strong style bias and the performance periods straddle a significant inflection point this time around but the message is clear. Historic performance is worth looking at but can be misleading, take a longer-term view and take into account the type of environment the fund has been operating in. However, with inflation expectations rising there is the potential that the inflection point has already passed but we still need to be positioned for the next few years of a new cycle. Investors should be looking at their portfolio with a critical eye to see if they have been blinkered by the success of growth over the past decade and left with a strong, potentially unintended, style bias.

A Fund Managers performance can dictate whether they become a hero or villain in the eyes of the public

A black swan passes by

Robert White, CFA

12 July 2021

As a casual football fan and long-suffering supporter of the English national team, there was only ever one topic I could write about today. No, not the merits of the latest ECB strategy review (perhaps one for another time) but instead last night's dramatic European Championship Final between Italy and England. Given this was the first time the England men's team has reached a final for 55 years, it's been a pretty memorable tournament, despite them falling short at the final hurdle. Since their last footballing success, we've seen nine US bear markets, ten UK Prime Ministers and both multi-century highs and lows for US 10 year government bond yields[1]. In that context, the prospect of victory at a major tournament looks like somewhat of a Black Swan event.

Despite the defeat, one of many bright spots for England has been the redemption of manager Gareth Southgate who, as a player, famously missed a penalty in the crucial semi-final match against Germany in 1996 in the same tournament. While even the best players in the world have missed crucial penalties, that doesn't make the feeling any easier to stomach, and the heartbreak of England's unsuccessful penalty takers was plain to see last night. Unsurprisingly, it seems that nerves played a role on the big stage; only five out of ten penalties were converted in total, well short of the long-term average of 75%[2].

As is often the case with sport, parallels can be found in markets. Looking at the history of the S&P 500 index since 1927, we find that the index delivered positive monthly returns only 60% of the time, a surprising statistic perhaps for investors that believe equity markets only ever go up. This can create real disappointment for unlucky investors in the remaining 40% of negative months, but thankfully there are many ways to improve your market odds.

Firstly, markets give everyone the opportunity to have as many shots as you like before you become successful, as opposed to footballers who have just one attempt during a shootout. Rather than looking at monthly returns, we find the odds of success improve for investors who hold their investments for longer time periods. Looking at yearly returns, the odds of a positive return improve to 67%, and extending further to three years improves the odds to an impressive 79%, meaning investors have a better shot at making money over this time frame than the average penalty taker has of scoring.

Secondly, a key advantage for investors is that as well as the odds of winning being in your favour, the payoff when you win is larger too. The average yearly positive price return for the S&P 500 since 1927 was 18.5%, greater than the average negative return of -14.2%, and that's before you even include dividends. This is quite different from penalty shootouts, where misses live long in the memory of players and fans alike, and there is no opportunity to try again.

This tournament has been particularly special due to the presence once again of large crowds of spectators, an encouraging sign that the worst of the pandemic seems to be behind us. With the return of fans, we also saw the return of home advantage, an interesting behavioural phenomenon that benefitted both England and Italy throughout the tournament. As we've written before, behavioural factors also have an important impact on markets, and as active investors, we hope to use these inefficiencies to improve returns for our clients.

Despite the result, fans of both teams should take heart from a thrilling tournament this year, which so nearly didn't happen at all. And while the players cannot retake those crucial penalties, they will have a chance for redemption in 18 months. Here's hoping they won't have to wait another 55 years to reach a final.

Despite the defeat, one of many bright spots for England has been the redemption of manager Gareth Southgate

[1] *https://www.marketwatch.com/story/10-year-treasury-yield-plunged-to-its-lowest-in-234-years-says-deutsche-bank-11596214464*
[2] *https://instatsport.com/football/article/penalty_research*
All other data sourced from Bloomberg Finance L.P.

Value Investing Redux

Tom Delic

19 July 2021

Having been in consistent print since its first publication in 1949, Benjamin Graham's 'Intelligent Investor' has, along with 'Security Analysis', provided the philosophical foundation to thousands of successful investment practitioners over the decades. However, as Mark Twain said, *"A classic is something that everybody wants to have read, and nobody wants to read".* Open almost any page of those two texts however, and your mind will be enriched with the ideas and thoughts of Graham, and like most literature that has survived the test of time, you will soon realise why.

The concepts laid down by Graham over 70 years ago sets an investor up with a sound, rational, mental framework to deal with the vicissitudes of a hyper-active stock market, that swings between the emotions of a broken-hearted teenager and a toddler's first taste of chocolate. But what does Graham not say? Is the consensus view of value investing in line with the thinking of Graham or has time distorted and twisted the interpretation?

Leaning on the work of Eugene Fama and Kenneth French, investing is often reduced to nothing more than quantitative pigeonholing. A fund manager strategy or a point-in-time valuation ratio of a listed equity can then be boxed neatly into categories, pitted against one another in an endless race where investors are pressured to pick a side. Today, the consensus is "value" investing is losing the race, with "growth" investing in an unassailable lead. Perhaps though, there are no "style" sides and instead a footrace exists between investment and speculation, which can often feel like a marathon. This takes us back to Graham.

Graham's core tenets seek to teach us how to act like investors rather than speculators. The margin of safety concept sits at the heart of this approach and simply advises that the investor should only purchase securities where a gap exists between their conservative estimate of intrinsic value, and the price at which the security is being offered. In Graham's words, "the function of the margin of safety is, in essence, that of rendering unnecessary an accurate estimate of the future".

The example of Microsoft provides an illustrative example of Graham's concept in practice. From 1999 to 2012, Microsoft's free cash flow yield increased from 1.6% to 13.1%[1], with equity holders of the company suffering a -42% total return over the period[2]. The speculative era of 1999 had faded away and in 2012, an opportunity for a conservative investor was available.

Value investing today is assumed to be a blind investment in the optically cheap but in 'Security Analysis', Graham emphasises that "an investment operation is one that can be justified on both qualitative and quantitative grounds". A cursory glance at the data in 2012 would have shown you that despite the share price halving since 1999, the business was fundamentally strong, with consistent revenue and cash flow growth over the period[3] and Microsoft Windows remaining the dominant operating system in an ever-increasing world of computer usage.

as Mark Twain said,
"A classic is something that everybody wants to have read, and nobody wants to read"

[1,2 & 3] *Bloomberg Finance L.P.*

All eyes on the US

Michael Clough, CFA

"Should you be over or underweight the US equity market?" is surely one of the most asked asset allocation questions of the past 5-10 years. Over the 10 years to June end in US dollar terms, the US equity market outperformed the UK, Europe and Japan markets by 255%, 202% and 194%[1], respectively. There are good reasons for this outperformance. Most recently of course, the technology giants that dominate the US equity index were the chief beneficiaries from lockdowns as we all became dependent on, and some maybe addicted to, their services. However, it really has been a trend since the financial crisis that US companies have delivered sustained stronger earnings growth and better profitability than their developed market peers.

Data releases over the past few months have also been encouraging. The all-important services PMI indicator - a closely watched measure of expected future growth - exceeded 60 for four consecutive months to June, far above the 50 mark that separates expansion from contraction. Business confidence is certainly elevated right now and economic activity is evidently picking up too. The number of passengers screened at US airports has returned to pre-pandemic levels, despite collapsing over 96% at the worst point last year. Furthermore, whilst there is some way to go before employment fully recovers (non-farm payrolls are still about seven million shy of pre-pandemic levels) and there are continued concerns from some employers of a shortage of labour supply, the unemployment rate has dropped below 6% for the first time since the pandemic struck.

Whilst the fundamental backdrop appears positive there are risks, chief of which right now is inflation. Producer price inflation is running hot at 9.4% and whilst consumer inflation has jumped higher of late, if businesses can't fully pass these higher costs on to consumers, corporate margins could be squeezed rather aggressively. And, even if they can, then wage pressures might escalate, which would then pose a threat to margins. Another longer term risk is presented in the form of corporate tax reform with a new agenda seeking to claim more of the profits of multinationals. Whilst the reforms will take some time before taking effect, it does pose a risk down the road for the giant tech businesses in particular that operate globally.

Investors cannot forget valuations either. Historic data over the long term shows higher starting valuation multiples have led to lower future returns. Today the US equity market is on a forward P/E ratio of 22.6 times, a 23% premium to Europe and an even larger 44% and 80%[1] premium to Japan and the UK. US valuations are lofty but we do acknowledge the aforementioned negative correlation doesn't necessarily hold over the short term and that index valuations are skewed by a select and concentrated group of mega cap stocks providing opportunities for active investors beneath – don't forget the US equity market share of passive funds now stands at over 50%[2]! Another interesting dynamic is around the tax reforms and if governments do take more of the future profits from certain companies then it makes valuations look even more stretched today.

The stimulus we have seen in response to Covid is certainly worthy of a mention too. On the fiscal side, over the past 16 months we have seen a level of government support that is comparable only in the immediate aftermath of World War II. On the monetary side, the Federal Reserve has been purchasing $120bn of bonds per month which has served to push yields down and justify higher equity valuation multiples by virtue of a lower discount rate. The central bank has begun discussions around tapering the bond buying program and any rhetoric that sparks fears of tighter monetary policy sooner than expected to combat higher inflation poses a risk to equities. As a result, the Fed will be sure to signpost any policy changes as clearly as possible.

The economic recovery that is underway is likely to see a period of growth we haven't seen in decades. A consumer (which don't forget accounts for 70% of US GDP) supported by unprecedented government support, ready to unleash pent up demand with over $2.6 trillion[3] of excess savings will likely trigger an extraordinary spending boom. However, whilst the backdrop in the US is positive, it is in other regions too. The UK and Japanese equity markets are two examples where cyclical sectors and stocks form a higher weight in market indexes. These are set to do well in the years ahead, and this has started to be reflected in earnings expectations. Couple this with valuations that are at wide discounts and we feel these regions justify an overweight position. So, whilst we are constructive on equities overall, we maintain an underweight to the US today on valuation grounds, although less underweight than might otherwise be the case on valuations alone given the supportive backdrop (notwithstanding inflation risks) and opportunities for active managers to add value.

The economic recovery that is underway is likely to see a period of growth we haven't seen in decades

[1]MSCI indexes for UK, Europe and Japan. S&P 500 for the US. All performance, valuation and market data from Bloomberg Finance, L.P. Valuation data as of 22nd July 2021. [2]https://www.bloomberg.com/professional/blog/passive-likely-overtakes-active-by-2026-earlier-if-bear-market/. [3]https://markets.businessinsider.com/news/stocks/us-excess-savings-coronavirus-pandemic-power-economy-recovery-moodys-2021-4

A Summer of Competition

Jackson Franks

It's been a summer of competition here in the UK (and globally). Firstly, we welcomed back Wimbledon, then had the excitement of the football not quite coming home, followed by one of golf's majors and now the Olympics. Not to mention the bonus of a British and Irish Lions tour in South Africa, where a game of two halves gave the Lions victory in the first test. By the time this blog is released we will know the result of the second test so I will choose my words carefully by not trying to pre-empt a result. In the midst of these great sporting events there was one other competition that may have caught your eye, the billionaire's race to space. For those who have not yet seen the result Richard Branson's Virgin Galactic narrowly beat Jeff Bezos's Blue Origin by 9 earth days. Having said that, Jeff did go higher than Richard so who was the real winner? On a more serious note, over the last 10 years there has been $199.8bn of equity investment across 1,553 unique companies in the space economy, with $4.5bn being invested in the second quarter of this year[1]. So, for those who aren't willing to spend $250,000 on a ticket for four minutes (or $62,500 per minute) of weightlessness in space today, you may get a better deal in the years to come. But before you go and purchase your ticket, think about one small matter: the environment.

There is no doubt that the innovation and advances in technology within the space sector is evolutionary. Companies such as Jeff Bezos's Blue Origin and Elon Musk's SpaceX are visionaries, with a belief that their activities will help save Planet Earth, not destroy it. These commercial space flights are a source of income that enables these businesses to reinvest and expedite the process of reaching that goal. However, the question must be asked, do the benefits outweigh the environmental risks?

For some context, Richard Branson's Virgin Galactic endeavour mentions that the carbon dioxide (CO_2) emissions from its VSS Unity spaceship, the shuttle used for its commercial space flights, is the same as one transatlantic business class flight. The difference here is that one transatlantic flight is approximately 6,900 miles whereas the VSS Unity's round trip is nearer the 100-mile mark, resulting in an estimated 12kg per passenger per mile of CO_2 emissions compared to a transatlantic business class flight of 0.2kg per passenger per mile. The more concerning aspect of space tourism is the amount of black carbon, otherwise known as soot, being released in the upper layers of the atmosphere; the stratosphere. VSS Unity used a hybrid propellant comprised of a solid carbon-based fuel, hydroxyl-terminated polybutadiene (HTPB), and a liquid oxidant (nitrous oxide) to launch itself into space. This generates levels of soot which has an atmospheric warming impact over 460 times greater than CO_2 (per unit of mass).

Comparing the Blue Origin launch to the VSS Unity, Jeff Bezos insists that his space plane is greener. The Blue Origin was propelled into space using liquid hydrogen and liquid oxygen which produces no carbon emissions – just water vapour - so yes, it is cleaner. A lot cleaner. However, if we look at the 'embodied' carbon - the CO_2 emitted in producing a substance - the production of 1kg of liquid hydrogen generates the equivalent of 9.3kg of CO_2 emissions. There are renewable sources that are also able to produce the required liquid hydrogen, but this comes at a financial cost - 2 to 3 times more expensive than producing it using fossil fuels.

Although the above may sound worrying (and complex), especially with the significant increase in tourist carrying space launches expected over the next decade, these businesses, like us, must have sustainability targets. At Momentum, incorporated into our investment process, we conduct extensive work to understand our managers' credentials and their capabilities for assessing environmental risks in the companies in which they invest to ensure they are aligned with our own sustainability goals. So, with the first stage of the billionaire's space race over, perhaps attention needs to turn to the advancement of sustainability within the sector for the benefit of others and for our beautiful planet.

Over the last 10 years there has been $199.8bn of equity investment across 1,553 unique companies in the space economy

[1]*Space Capital: Space Investment Quarterly Dashboard Q2 2021.*

Value is in the eye of the beholder

Mark Wright, CFA

In her 19th century novel, 'Molly Bawn', Irish novelist, Margaret Wolfe Hungerford, is credited with paraphrasing a statement made about beauty by Athenian philosopher and founder of the first institution of higher learning in the Western world, Plato.

"Beauty is in the eyes of the beholder" is a phrase I've often found myself replying in retort – we are sadly not all blessed with looks that appeal to the masses! The concept of beauty has been a topic for debate preceding Christ and almost certainly precedes value investing, but I would suggest that it is not just beauty that is in the eyes of the beholder, but also value.

Chinese philosopher, Confucius, stated that "everything has beauty, but not everyone sees it". The UK equity market certainly has value, but it appears to only be corporates and private equity investors, rather than traditional investors in the UK public equity market that presently see it.

The first half of 2021 has seen 124 takeovers and purchases of minority stakes in UK companies by private companies, totalling some £41.5bn. This is the highest value recorded by Dealogic since the company started tracking deals in 2005. London listed companies have comprised 21 of that 124, with an equity value of £24.4bn1.

Four of those 21 London listed companies were, or still are, held in the direct UK equity portfolio we manage for our clients. A pleasingly high hit rate in what is a relatively concentrated portfolio of 24 holdings; we do not believe in diluting conviction with an unwarranted proliferation of holdings.

The first investment to be subject to takeover was Marston's in January when it was revealed that private equity outfit, Lone Star, had tabled an all cash offer at 105p per share; a 40% premium to the closing price on 28th January and a whopping 373% premium to the level at which the shares were trading in the depths of the market sell off last year. That said, it only valued the pub operator and brewer at £665m, a 10% discount to the company's net asset value prior to the pandemic. The Board dutifully rejected the offer.

Quickly following on from Marston's, the second was Arrow Global in early February when private equity group, TDR Capital, made a revised offer of 307.5p per share for the debt investor and fund management business. The premium was a healthy 33% to the prior day's closing price and a huge 406% premium to share price lows witnessed less than 12 months earlier.

The two most recent examples within the direct UK equity portfolio are within the Aerospace and Defence sector, namely Senior and Ultra Electronics. Senior ultimately rejected a final offer at 200p per share from the same private equity group that bid for Marston's, despite it being an appealing 69% premium to the undisturbed share price before Lone Star first made an offer in May and a massive 367% premium to the share price low in 2020.

Jim Henson, creator of The Muppets characters, comically said "Beauty is in the eye of the beholder and it may be necessary from time to time to give a stupid or misinformed beholder a black eye". Lone Star have certainly found themselves with a black eye or two!

Ultra Electronics has been bid for by Cobham at 3,516p per share, equivalent to a 42% premium to the prior day's closing share price. Cobham itself was victim to takeover less than two years ago when the public market failed to see the value in its equity, post the completion of a turnaround project of some magnitude by CEO, David Lockwood. We now expect Mr Lockwood to achieve similar results at Babcock International (one of our other 24 high conviction holdings). Babcock International is an engineering group that services the entire British fleet of nuclear submarines, as well as the majority of its naval fleet.

At times, the public equity market is very poor at seeing value and this is evidently the case with respect to the UK equity market currently. The UK's headline indices trade at substantial discounts to other international indices in both absolute terms and relative to each index's own history. We believe the direct UK equity portfolio we manage remains even more undervalued.

Why is it right now that the private equity industry can see value in the UK public equity market, but traditional equity investors cannot? Perhaps it has something to do with patience... whilst the average holding period of UK equity investments has declined from as long as 10 years in 1980 to just 8 months now2, holding periods within the private equity industry have been increasing recently to over 5 years3.

We do not assume any M&A will help generate returns when investing in what we perceive as materially undervalued UK equities, but similar to Russian mathematician, Ivan Panin, who is quoted as saying "For every beauty there is an eye somewhere to see it", we do believe that "For every value opportunity, there is a potential acquirer somewhere to see it".

"Beauty is in the eyes of the beholder" is a phrase I've often found myself replying in retort – we are sadly not all blessed with looks that appeal to the masses!

[1]*Record value of UK companies taken over in 2021 so far - and M&A set to continue (proactiveinvestors.co.uk).* [2]*Investment Statistics: Are Brits investing in stocks and shares? Finder UK.* [3] *Private equity holding periods reach all-time high in 2020 (privateequitywire.co.uk)*

Jassy: Jeff's Fresh Prince

Alex Harvey, CFA

16 August 2021

You will likely be aware that last month Amazon founder, Jeff Bezos, was blasted to the edge of space aboard New Shepard, a rocket designed to give fare paying customers an out of this world – and out of their seats – experience. His flight came just days after that of fellow billionaire businessman Sir Richard Branson whose company Virgin Galactic is also opening up a commercial venture. Surely Elon Musk can't also resist the ultimate ride? What fewer readers will know is that just a few weeks before Mr Bezos's pioneering flight he stepped down as CEO of Amazon, handing the reins to Andy Jassy, a 23-year Amazon veteran who in 2003 founded Amazon Web Services (AWS), its cloud computing business, and has grown it into arguably the biggest profit centre under the Amazon banner today. These two events were not directly linked, and Mr Bezos stays on as Executive Chairman, but it does shine a light on an important aspect of business operations and corporate governance: succession planning.

Most of the world's leading companies have a public figurehead who has charted the company's rise to where they are today. These pioneers have an emboldened vision and drive, often with a personality to match. Their influence today extends beyond the bounded corporate sphere into that of the public at large via social media engagement and self-promotion. No-one exemplifies this more today than Elon Musk, CEO of Tesla and spiritual leader to an army of devotees who follow his tweets. Mr Musk is younger than Mr Bezos but as his company grows and his interests pull him in different directions – above ground with SpaceX and below ground with The Boring Company - shareholders will increasingly focus on the executive team in place that maintains day to day operations at Tesla. Mr Musk also has a penchant for attracting the attention of media and regulators. His public musings can and do directly impact Tesla's share price and whilst shareholders have no doubt benefited from his leadership, he is not afraid to court controversy. After tweeting in 2018 that he had "funding secured" for a buyout of Tesla at $420 he was effectively forced to step down as Chairman, thereby separating the roles of CEO and Chairman. With the stock earlier this year hitting $900[1] investors might be forgiven for thinking that's no bad thing.

With corporate leadership often comes ownership, and this can be in size where founder CEOs like Messieurs Bezos and Musk are involved. Investors like to see 'skin in the game' and will welcome a degree of co-ownership with the senior executive team. Some of our investment managers actively seek out businesses, more often found in emerging markets, which are listed but retain a sizeable founding family stake.

Often these businesses will choose to groom a family successor and, in these instances, there is a balance to strike between alignment of shareholder interest and finding the best man or woman for the job as the business matures. Enhanced or preferential voting structures may limit an external investor's say in such matters. The gold-plated shares owned by Deliveroo founder, Will Shu, offer 20 votes a piece and ensure he retains control of the business, but big investors shunned the IPO and the stock fell.

Beyond the corporate level of the invested companies our funds own, we too at Momentum must ensure that our third-party managers have plans in place as senior, and often founding members, of their investment teams take a step back or retire. Our hunting ground tends to be smaller, younger, more niche investment companies and as such, the successful ones will face the same (but perhaps smaller) succession challenges that face Mr Bezos at Amazon. A successful boutique investment business by its nature is likely to have been founded by one or two investment pioneers, but will only flourish with a team to support them, and a new generation of leaders to ultimately take control of the business.

Within our own investment team as well, we are mindful of this balance. We like to 'grow our own timber' as we say, recruiting exciting young talent, some of whom joined after completing a university internship. Director of Investment Management, Andrew Hardy, carved out this route as did Portfolio Manager Richard Stutley. This helps ensure a pipeline of talent and cultivates a strong bond within the team, with more senior members on hand to mentor those starting out their careers. The founding member of Momentum in London, Glyn Owen, remains a key member of the team today in his position as Investment Director.

Succession is inevitable, but its success is not. Earlier tech pioneers like Microsoft show how this can done. Four decades and three CEOs later and it is one of the most valuable companies in the world today, second only to Apple. As others fight over bragging rights in space, the older and more philanthropic Mr Gates prefers to focus his energy closer to home these days, with planetary and human succession higher up his agenda. With age comes wisdom.

Most of the world's leading companies have a public figurehead who has charted the company's rise to where they are today

[1] Source: Bloomberg Finance L.P.

Experts'view on China

Lorenzo La Posta, CFA

23 August 2021

When you invest with so many high-quality fund managers, it's only natural to pick their brains every now and then. We have spoken to a few of them and collected their thoughts on the current situation in China.

As a background, around nine months ago, in November 2020, Ant Financial (Alibaba's fintech business) was ready to break records with a $37 billion IPO and an estimated valuation close to $300 billion. However, the Chinese regulators pulled the plug on it, officially because of risks around financial security. Since then, the clampdown has extended more broadly, reaching the wider internet and e-commerce sector, property developers, the ride-sharing company Didi Chuxing and the entire private education sector. Markets and more broadly investor sentiment has been under pressure and Chinese stocks are now trading at around 30% below their February peak[1].

Most of the managers we spoke to have a constructive view and, on average, their thoughts can be summarised in the following points.

Regulatory tightening cycles are not that unusual in China. In 2015, the coal and steel industries underwent a period of reform with China aiming to clean up those sectors. In 2018, younger industries such as peer-to-peer lending and online gaming were heavily regulated to align strategically important areas to existing social and economic plans. The entire healthcare industry has been an ongoing priority of the Chinese government for the past few years. So, in hindsight, a regulatory clampdown of the internet sector was just a matter of time and the only difference with the past is that such changes have affected the largest and widely held Chinese companies, such as Alibaba, Tencent, Meituan etc.

The recent changes are in part an overdue catch-up with matters such as privacy, data protection and anti-competitive behaviours, but also a part of the wider government plan of reducing reliance on western economies. China's geopolitical and social agenda necessitates directing more capital towards sectors seen as core for the country's industrial autonomy, such as semiconductors, robotics, energy storage and artificial intelligence so, perhaps, regulating (and making less appealing from an investor's perspective) consumer internet services could contribute to that.

Looking forward, the expectation is that the intensity and the severity of the internet regulatory crackdown will decrease but today is too soon to assume this tightening cycle is over. Clearly, rules put in place so far will not be rolled back and their impact on companies and business models still needs to be fully understood, but as uncertainty dissipates this could prove to be a very interesting entry point (from a valuation perspective) in a part of the Chinese equity market that for many years has offered outstanding growth.

The private education sector is in a worse place. Recent regulations are similar in nature to previous ones in that they come from a social need, but the consequences are a lot more severe. The government's objectives are both to reduce the cost of having children and to even out the education system across different regions and wealth levels. In March 2021 President Xi called the private tutoring sector "a chronic disease" and since then has put rules in place to essentially force companies out of mandatory school years. From their peak, the main private education companies lost more than 90% of their market value[2].

Overall, this was not an attack on the private sector. China needs and wants foreign capital, as proven for instance by the extensive growth of the Stock and Bond Connect programs. Some structures, such as US ADRs, might change or even disappear, but ultimately a strong, advanced private sector is vital for China's future as a technologically advanced economy. Regulation is often a short-term negative for equity prices and investor sentiment tends to fall under a lot of pressure, as it is the case today, when such large changes happen almost without anticipation. China's way of communicating has perhaps been opaque and sudden, but ultimately the country's long term investment case is little impacted: the equity market remains wide, deep and full of attractive investment opportunities for those investors who can actively select the best stocks. The fact that the market is now one third cheaper than it was six months ago is an obvious plus.

China needs and wants foreign capital

[1]As measured by the MSCI China Index in HKD terms, source Bloomberg Finance L.P.
[2]TAL Education and New Oriental Education, source Bloomberg Finance L.P.

Credit where credit's due

Richard Stutley, CFA

Bonds remain expensive today, with yields across the ratings spectrum having tracked core rates lower. While core rates have lifted off their lows from last year (US 10 year yields got as low as 0.5% in August 2020[1]), they remain unattractive at current levels. However, there remain areas of relative value within short duration high yield and dollar-denominated emerging market debt, as well as floating rate credit. Elsewhere, while there is limited upside from further spread compression, spreads are not at extremes, and hence there is no clear reason, from either a valuation or a fundamental perspective, why spreads should suddenly blow out. As a result, we retain meaningful allocations to those aforementioned areas of value, as well as some core investment grade credit.

For parts of the credit market (investment grade as well as sub investment grade/high yield debt) to be cheap, spreads would need to be significantly above historical norms in order to compensate for the risk that underlying interest rates move higher, and that is not what we see today. Dollar emerging market debt looks the best value at a headline level, with spreads at around 350 basis points[2]. They were below 300 for the full period between June 2005 and March 2008, which we think represents a level closer to fair value[3].

Credit fundamentals look reasonable, however. One of the lead portfolio managers at TwentyFour, our specialist credit manager, noted recently that the high ratio of upgrades to downgrades among US high yield issuers, combined with a falling default rate and shrinking volume of distressed debt, all combine to produce a strong fundamental backdrop for the asset class[4].

Corporate leverage is coming down, whilst interest coverage is at manageable levels. The picture has been helped by strong earnings and low funding costs. Arguably, this has made it easier for investors to keep buying the dip, which has supported equities and credit spreads. With over $300 million of new issuance in the US high yield market this year, twice what we saw at this stage in 2019, and no rise in overall leverage, it is clear that firms are taking advantage of the low rate environment to refinance and reduce their interest bills[5].

We spend most of our time analysing fundamentals like these, as well as valuations, but it is important to also keep an eye on shorter term signals and market dynamics. From a technical perspective, while government bond yields have been less and less appealing in absolute terms, stretched equity valuations have been likewise less attractive, and have resulted in some forced buying of bonds alongside central banks.

Further, the "war chest" of cash in money market funds that was built up early in the pandemic has been barely dipped into, with plenty of cash available to mop up any new net issuance of bonds. High yield markets in both the US and Europe have readily absorbed record supply this year[6], indicating plenty of interest for this debt, and spreads have continued to trade in a narrow range[7] despite the Fed's decision to wind down its Secondary Market Corporate Credit Facility.

We continue to like opportunities in certain parts of the credit market. As a term product (compared to equities, which one can hold in perpetuity), timing is more important when it comes to credit selection, and we continue to see reasonable conditions for our holdings today.

the "war chest" of cash in money market funds that was built up early in the pandemic has been barely dipped into

[1]US Generic Government 10 year yield, Bloomberg Finance L.P. [2&3] J.P. Morgan EMBI Plus Sovereign Spread, Bloomberg Finance L.P. [4]Chris Holman, 05/08/2021, "Don't Fight the Fundamentals on US High Yield". [5]Deutsche Bank, Dealogic. 27/08/2021, "Global Leveraged Finance Weekly Wrap". [6]Based on data going back to 2010. Deutsche Bank, Dealogic. 27/08/2021, "Global Leveraged Finance Weekly Wrap" [7]Bloomberg US Corporate Statistics Index, Bloomberg Finance L.P.

Fifty Shades of Green

Andrew Hardy, CFA

13 September 2021

Tomorrow sees the start of our annual client conference, Think-Tank, which runs for three mornings from Tuesday 14th to Thursday 16th September. From a virtual studio our team at Momentum Global Investment Management will host 13 speakers presenting on a range of specialist, investment focused topics. It's an outstanding lineup of world class investors taking to the virtual stage to share their outlooks on topics ranging from the macro to the micro, from inflation, Chinese policy risks and disruptive technologies, through to opportunities in commercial property and music royalties.

The conference provides rich insights into the themes and talent contributing to the portfolios we run for clients, and we hope that many of our regular readers will be joining us. Focusing in on one of those themes, Masja Zandbergen, Head of Sustainability Integration at Robeco, will present on the '50 shades of green', referring to the many different investment approaches taken with regards to ESG factors (environmental, social, governance) across the industry.

Europe remains at the forefront of efforts to regulate the management and marketing of ESG or sustainability-oriented investment products, through creating a clear taxonomy and ensuring greater disclosure of relevant features and risks. This began with the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in 2019, with much more substantive provisions introduced in March 2021. European funds must all now be classified as either Article 6, Article 8 or Article 9.

Article 6 funds do not include any specific reference to sustainability in their investment processes and cannot be marketed along such lines. Article 8 funds, on the other hand, often considered as 'ESG integrated' funds, have sustainability factors built into their investment processes, and can be promoted as having a better profile around environmental and/or social factors. However, these article 8 funds do not explicitly incorporate sustainability goals in their objective. Article 9 funds meanwhile have specific goals related to sustainability built into their objectives and are often considered 'impact' funds.

In order to be classified as an Article 8 or Article 9 fund, the manager must demonstrate clearly how the process is designed to systematically deliver on the stated targets or characteristics, and also provide ample ongoing disclosure of ESG related characteristics and risks. This creates a level playing field across the industry and reduces risks of 'greenwashing'; expect to see more examples like the recently announced probe into DWS, the German asset manager accused of misrepresenting the ESG integration in their products. Also, expect to see similar regulation rolled out across many other countries in time.

This should be welcomed as providing much more clarity for investors around the extent to which an investment product aligns with their sustainability preferences. But in the longer term, it's likely that the integration of sustainability fact will be expected across the board, becoming more of a hygiene factor, as due consideration is taken for all stakeholders, rather than just shareholders.

The United Nations (six) Principles for Responsible Investment (UN PRI) are a key part of the journey for the investment industry and are likely to remain so. These principles can be considered something of a universal compass as to best practice around key sustainability issues, while the seventeen Sustainable Development Goals (SDG) represent ambitious targets for the industry and the world more broadly to work towards. The challenge for the industry in the coming years is in moving beyond seeing this as a box ticking exercise, and instead embracing the spirit of these principles and goals. All firms and investors are at different points on this journey, but all can and will go further. Most would consider actively managed strategies to have a head start in this regard in determining the true shade of green for any investment, rather than just that which a company promotes.

How investment managers achieve ESG integration varies, and any number of methods are acceptable under SFDR, but at a high level it usually boils down to one or a combination of (a) exclusions (for certain industries or controversial activities), (b) focussed impact investments (renewable energy for example) or (c) assessing all investments on their ESG criteria (effectively ensuring ESG characteristics are understood and 'priced' rather than simply focusing on traditional investment metrics). Tune in to Masja on Wednesday for more information on this.

At Momentum we use a combination of those three methods across all our portfolios, leaning most heavily on broad based integration of ESG factors, with some exclusions and some impact investments (such as in the Gore Street Energy Storage Company, whose CEO Andrew O'Cinneide will also present at Think-Tank on Wednesday).

Having a more puristic view in the form of large sector exclusions and/or impact investments may be preferred by some investors, but we believe this approach brings certain drawbacks. Completely excluding certain sectors / industries means you don't have a seat at the table, making it harder to encourage progress, which can otherwise be achieved through engagement or rewarding improvement. Purely focusing on impact leads to a narrower investment universe and may make traditional return objectives harder to achieve.

Within our Luxembourg UCITS fund range, one existing global equity fund and one new multi-asset fund have been approved as Article 8 compliant. Through our parent company, Momentum Metropolitan Holdings, we are a long-standing UN PRI signatory, having been one of the early adopters in 2006. But as the 'fifty shades of green' suggest, the devil is in the detail. Tune in to Think-Tank to find out more, or visit our website (https://momentum.co.uk/responsible-investing) for more information on our own responsible investment practices, or reach out to your Momentum contact.

Melting Ice Cubes

Richard Parfect

20 September 2021

When the human mind is confronted with a completely unexpected situation or an event that has not been experienced before, then the brain immediately suffers what is known as a "startle effect". This was commented on by Sully Sullenberger; the captain of US Airways Flight 1549 that successfully ditched in the Hudson River in 2009 without the loss of a single life.

Pilots train for the loss of a single engine after take-off throughout their career; their mind is trained to expect it and repetitive training creates an almost "muscle memory" in terms of dealing with it. However, faced with complete double engine failure on climb out from LaGuardia with no apparent safe escape route to land on, Sully and First Officer Skiles's brains had to go through a process of recognising the double bird strike on their engines, diagnosing the problem, accepting the desperate situation and deciding on a course of action.

Initial recreations on flight simulations by the NTSB (US accident investigator) suggested a 50% chance of successfully returning to the airfield. However, that was assuming a completely unrealistic immediate diagnosis and response by the pilots. Once a more realistic 35 second delay was inserted into the simulations it was shown that a successful return to any airfield was physically impossible. Sully and Skiles were found to have made the correct decision to abandon the illusion of safety of an airfield return and instead to ditch in the Hudson (technically difficult, with unknowable survivability).

How is this relevant to business and investment? Well, the COVID-19 pandemic showed authorities to be suffering that "startle effect"; delays to lockdown implementation would be partly explained by an inherent denial of the situation. Initial expectations of a rapid return to normality were also subsequently dashed by events.

Business leaders were far from immune too. Whilst pre-planned disaster recovery action plans were a significant help in terms of rapidly enabling entire work forces to work remotely, the longer-term implications still appear to be too difficult, for some to comprehend.

In investment there is always a strong tendency to "talk up your own book". Just as one can anticipate the answer when asking a barber whether you need a haircut; it is probably not too surprising that landlords of large portfolios of office space will be dismissive of the prospect of a permanent change to work patterns. Similarly, some office tenants have been equally sceptical; David Solomon (CEO of Goldman Sachs), described home working as an "aberration".

Office working has its advantages where there is a specific purpose of physical attendance, however, to expect that society will return in full to routine pre-pandemic work patterns is like trying to put the genie back in the bottle. Workplace flexibility will become a key talent attraction and retention tool, in the same way as salary and medical insurance. As the work force is constantly fed from the bottom, over time the expectations of millennial workers will dilute and replace those at the top.

"ESG investing" is a movement that has gained enormous traction in the minds of business in the last couple of years. However, companies that attempt to turn the clock back and restore the business practices of life pre-COVID will be acting in direct conflict with the requirement to eliminate unnecessary CO2 emissions. This will become particularly acute as pressure increases for companies to sign up to the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD); which is designed to improve and increase reporting of climate-related financial information for conducting business.

In the property market we have seen the dangers of that "startle effect"; Andrew Jones, the CEO of LondonMetric (who recently spoke at our 2021 Annual Think Tank) has referred to the owners of high street retail property as holding "melting ice cubes". This was the case even before the pandemic took hold and e-commerce penetration in the retail sector accelerated. We could now see a repeat of the dramatic structural change witnessed in retail property, with an upending of the office market. Those landlords (and tenants) that recognise and accept this, will have a much greater chance of successfully adapting their portfolios, repurposing them to alternative uses or cutting their losses earlier rather than expensively hoping for a return to life pre-COVID. Hope, without a plan, is never a successful investment strategy.

When the human mind is confronted with an unexpected situation or unknown event the brain suffers what is known as a "startle effect"

Enduring Quality

Stephen Nguyen

27 September 2021

There are many ways investors try outperforming the market. Tilting the portfolio regionally, moving up and down the market capitalisation spectrum or exposing their portfolio to different investment factors (risk premia). Some factors are well known and easily defined whilst others are less so. In recent times, much has been discussed about the "great rotation" from growth to value. Growth and value companies are widely understood, however there is another factor, namely quality, that has been on the sidelines recently and is less clearly defined. With fears of a correction or pullback rising after such a strong rally in equities – is it time investors start to pay more attention to this cohort of companies which often exhibit lower volatility, and provide more defensive characteristics whilst being capable of delivering a steadier growth path?

Quality is possibly the most subjective factor you will come across and one that is likely to differ depending on who you ask. Unsurprisingly, most investors would claim that they are investing in quality businesses, yet the results can vary wildly across these strategies – so what is quality and how do we define it?

At Momentum we define quality businesses as those that have demonstrated a high and stable level of profitability over the long term. These businesses typically benefit from strong economic 'moats' (defendable competitive advantages) which enable them to sustain above average returns over longer periods. The businesses that fit these criteria generally have low capital intensity (with low reinvestment requirements), low leverage, strong cash flow generation and strong intellectual property such as brands.

The focus on stability typically excludes companies in highly cyclical industries and leads you to more resilient businesses which often have low sensitivity to the economic cycles. These businesses are known as great compounders which can generate returns persistently across different economic environments. They are not fully immune from market swings but nevertheless one can expect a quality firm to be well placed to weather periods of uncertainty.

Unsurprisingly, we have observed that portfolios of genuinely high quality businesses have generated strong excess returns over the long term.

The outperformance tends to be more pronounced during periods of heightened risk aversion, but the quality factor has proven it can keep up with the market or even outperform in rising equity markets too. Interestingly, the excess returns over the long run have not been associated with an increase in risk (as measured by volatility). This excess risk "premium" over the market is not widely understood.

So why are these stocks able to generate excess returns over the long term with less risk? This seems counterintuitive and a contradiction to the Capital Asset Pricing Model (CAPM) where extra returns should be accompanied by a *higher* level of risk. There are many possible explanations, of which the majority are behavioural. Firstly, overconfidence bias is one issue. Humans are generally overconfident in their ability to forecast the future, and quality (low volatility) stocks usually have more predictable cashflows which can negate this issue, leaving less scope for forecasting errors. The 'lottery effect' is another reason, as higher volatility stocks are often associated with lottery tickets (potential for a large pay-off but the probability is low) and investors are willing to overpay for this optionality. Quality businesses also tend to be less 'glamorous' and lower octane, which typically leads to lower incidence of unfavourable events compared to their counterparts (high volatility stocks). As a result, they don't tend to fall as much in market downturns relative to other companies and can compound returns at a greater rate over the course of multiple economic cycles. These possible explanations all point towards one thing: quality characteristics have been systematically undervalued by investors over time, relative to lower quality businesses, which has enabled them to outperform broad indices over the long run.

At Momentum, we have invested in quality strategies for many years and believe it plays a key role in all our portfolios, particularly as a diversifier to other style factors within the equity allocation. Quality stocks are a valuable tool for our outcome-based investing approach as their stable return profile and defensive qualities help to deliver a smoother journey for our clients.

Quality is possibly the most subjective factor you will come across and one that is likely to differ depending on who you ask

Past performance is not indicative of future results

Gary Moglione

04 October 2021

This week, an innocuous announcement from BP about temporarily closing a handful of its petrol stations due to a driver shortage caused panic buying and fuel shortages across the UK. In March, I wrote a blog called "Why we are all hard wired to be bad investors". This week's events are a good example of some of the behavioural inefficiencies highlighted. It is worth looking at the psychology of panic buying events and how these behaviours read across to stock market movements.

If we look through history, it is littered with panic buying events. Some are more understandable, such as food and medicine during the World Wars, Spanish Flu and COVID 19 pandemics, and some more surprising, such as ammunition in the USA when the public feared increased gun regulations. In 1973, a joke on the Johnny Carson show sparked a panic buying spree of toilet rolls in America that created four months of shortages. More recently, everyone will remember the great toilet roll grab in the early months of 2020.

There have been a few studies into panic buying events and many point to heightened anxiety at times of uncertainty. Some have compared it to the basic animal instinct of foraging in that we have an inclination to collect and store food, but we can broaden that instinct to wider products that represent our orderly society, such as fuel and toilet roll. Regardless of what the trigger is, the act of panic buying is driven by the emotions of fear and greed; fear of scarce resources and greed in the form of buying more than you actually need.

These behaviours are inherent in financial markets and can be exploited. At times of peak market stress and uncertainty, fear causes panic selling. Valuation becomes irrelevant as investors rush for the exit creating a powerful downward spiral. On the opposite side, greed becomes apparent at times of market euphoria. Similarly, valuation becomes irrelevant as more and more market participants become over-confident and rush to buy the latest success story. Warren Buffett has made a career from taking advantage of these behavioural inefficiencies. "Be fearful when others are greedy and greedy when others are fearful" is one of his many famous quotes that help to understand his thought process when investing.

In conclusion, the petrol shortages are a further reminder of our behavioural inefficiencies that lead to a loss of focus on the true value of assets. This results in investors overbuying and overselling at extreme points in the cycle. By focusing our attention on intrinsic value and making investment decisions based on whether the price is above or below that value we should be protected from our behavioural biases. Buffett's fear and greed mantra has always struck a chord with me. In my view, adhering to that principal is extremely difficult to implement as you need to work against your most basic instincts. However, if implemented successfully, the rewards can be exceptional. It is not easy to buy stocks during a crisis or sell into a euphoric market. As we cannot predict the future, our timing won't be perfect, resulting in plenty of self-doubt over the short and possibly medium-term results, but exploiting behavioural inefficiencies of humans frequently results in exceptional returns for long-term valuation focused investors.

"Be fearful when others are greedy and greedy when others are fearful"
Warren Buffett

Why we pay attention to seemingly small risks – lessons from 1986

Robert White, CFA

11 October 2021

When it comes to risk management, a little bit of paranoia is probably a good thing. This applies when managing your finances, but history tells us that it is even more critical in the field of aerospace engineering. On the morning of 28th January 1986, the crew of the Space Shuttle Challenger tragically fell victim to one such failure as their spacecraft disintegrated a mere 73 seconds after launch. The cause of the accident was a seemingly insignificant faulty part, namely the rubber O-ring which sealed together field joints used to connect sections of the rocket boosters. These O-rings were a mere 7.1 millimetres in diameter, yet the malfunction had the gravest of consequences. A silver lining to emerge from the disaster is that lessons have been learnt; the accident is used as a case study in engineering safety, and academics have applied its principles to fields as diverse as economics, finance, and even football.

The basic premise of the so-called "O-ring theory" is simple; seemingly small and insignificant parts within a complex process can cause the entire enterprise to fail completely. The economist Michael Kremer first formalised this theory in 1993 in his paper "The O-ring theory of economic development"[1]. This paper helps to explain why high skilled workers cluster together, as their combined efforts will yield far greater results than simply the sum of their parts; in other words, it is far more efficient to employ a small number of skilled workers than a large number of lower skilled workers, as the latter approach increases the probability of terminal errors. This theory has been used to explain the persistence of large wage and productivity differentials between rich and poor countries, and can also apply to the success of big tech companies in recent years.

Henning Vöpel applied the O-ring principle to a more surprising field, namely top-level professional football. In his 2013 paper "A Zidane Clustering Theorem", Vöpel argues that "the best midfielder is most efficiently allocated when combined with an ace striker, and vice versa"[2]. This is based on the same principle as Kremer's work, and effectively explains why Premier League clubs can justify spending hundreds of millions of pounds on the very best players when they already have extremely talented squads. Cristiano Ronaldo's addition to the Manchester United squad this season is a case in point; his addition adds more to Manchester United's output given that they already have world cup winning midfield maestro Paul Pogba, than it would if he had joined say, Yeovil Town (it would be interesting to test this out in practice, but somehow I don't think Yeovil would be overly keen to pay Ronaldo's reported £385k per week salary).

We can also apply these lessons to investment matters. When combining stocks, bonds or funds, one poorly chosen investment can derail an otherwise perfectly planned portfolio. There are many instances of this in history, whether it be in the foreign exchange markets where a single leveraged carry trade can blow up an otherwise successful business, or in illiquid private debt markets where liquidity squeezes can be terminal. This is why competent, regulated, financial professionals add value for clients. With proper due diligence and risk management procedures, well resourced teams can avoid the pitfalls of O-ring type failures, giving clients the highest likelihood of achieving their goals.

Perhaps the most shocking aspect of the Challenger disaster is that problems with the O-ring design were known before launch. There was sufficient evidence at the time to show that the failure rate at low temperatures was as high as 13%, but the analysis was only conducted with selective data[3]. Part of the recommendations of the Rogers Commission Report into the accident were about management structure, as there were concerns that project managers were overly pressurised to produce results given the political importance that space travel held at the time. The final lesson to take from this must surely then be that incentives matter. Giving smart people the freedom to assess information critically and consider all the risks is key to any organisation, and it is how we strive to operate our own business.

One poorly chosen investment can derail an otherwise perfectly planned portfolio

[1]https://www.jstor.org/stable/2118400. [2]https://www.hwwi.org/uploads/tx_wilpubdb/HWWI_Research_Paper_141.pdf
[3]https://priceonomics.com/the-space-shuttle-challenger-explosion-and-the-o/

Talk is Cheap

Tom Delic

18 October 2021

The ability to explain a concept or subject to someone else is a challenge. It requires you to both understand the topic you have been asked to discuss, but also communicate it in a way that is understandable to the listener or reader. Listening and reading are two of the most important activities in our industry. After all, we have two eyes and two ears, but only one mouth.

We also have one brain, and whether we care to admit it, by definition, our intelligence is likely to sit somewhere slightly above or below the average level for the human population. When reading a text or listening to someone speak, we often require that person to deliver the information in a way that is understandable to someone of average intelligence.

In the 1950s, American businessman Robert Gunning developed the Gunning fog index, which sought to quantify the readability of a body of text. The index measures the length of sentences and the complexity of words used, coming up with a score that can be compared to school grade reading levels. A fog index score of 12 is comparable to the reading level of an 18-year-old student[1] and is seen as a standard for texts intended for a wide audience.

The world of investor communications contains many forms, including annual reports, earnings call transcripts and periodic fund manager letters. If an index like Gunning fog classifies the readability of such materials as very high, this could be a clue that requires further investigation. Complexity of language may be used because the writer or speaker doesn't understand the topic as well as they think they do. Perhaps more disconcerting however, is the language is being used to conceal something from the reader or listener.

A recent research report from the quantitative team at Nomura found that the complexity of language used in earnings calls corresponded with investor returns. Those management teams that used complex language, as measured by the Gunning fog index, averaged a return of 9.5% per year, while companies that used simpler language averaged 15.4%[2].

While detecting deception in the investing world has mostly been concentrated in an assessment of the quantitative data provided by companies, a growing body of research is attempting to build on the insights gleaned from basic readability algorithms such as Gunning fog. Lina Zhou of the China University of Geosciences formalised some of this work into nine categories of deceptive linguistic cues[3], which have been successfully used to identify fraudulent financial statements[4]. Examples of these cues include distancing strategies such as the use of third over first-person pronouns (e.g., "they" instead of "we"), and obfuscation methods such as incohesive sentence formation. Together, the cues form a linguistic fingerprint that can help to identify the true intention of the words used in a communication.

An example in practice is the comparison between the annual CEO letters from two, albeit cherry-picked, companies. The thousand-word 2017 CEO letter from fraudulent German fintech business, Wirecard, scores over 19[5] on the Gunning fog index, a readability level classed as very difficult or confusing for the audience. Similar sized samples from Warren Buffett's much longer Berkshire Hathaway letter of 2020, scores around 13[6], slightly above the guidance for mainstream consumption.

Inevitably there will be exceptions to the above, where a complex communication is not concealing anything, and vice versa. Perhaps though, Nomura's research also highlights that speaking and writing to stakeholders with both simplicity and clarity, builds a foundation of trust between the parties that ultimately delivers better results. While our communication to clients doesn't directly influence the underlying assets we hold in portfolios for investors, clear and understandable interactions will build a level of trust that gives investors the confidence to remain invested during the more challenging moments that are faced over time.

Listening and reading are two of the most important activities in our industry. After all, we have two eyes and two ears, but only one mouth

[1]Wikipedia. [2]https://www.bloomberg.com/opinion/articles/2021-09-17/complex-language-on-earnings-calls-is-a-warning-to-investors.
[3]Zhou L, Burgoon J, Nunamaker J, Twitchell D. Automating linguistics-based cues for detecting deception in text-based asynchronous computer-mediated communication. [4]Humpherys S, Moffit K, Burns M, Burgoon J, Felix W. Identification of fraudulent financial statements using linguistic credibility analysis.. [5 & 6]www.gunning-fog-index.com

No Mr Bond(s), I expect you to fall

Michael Clough, CFA

25 October 2021

I recently went to see the latest James Bond film to watch Daniel Craig's last appearance as the British superspy. It was Craig's fifth outing since his introduction in 2006 and the latest release marked a rather explosive end of an era in the latest storyline of 007. In our slightly less glamorous world of investment management, might we be facing an end of an era moment too? Since 2010 inflation in G10 countries has averaged 1.5%, below the typical 2% central bank target. This year we have seen inflation move sharply higher and whilst much of the narrative has suggested these moves are transient in nature, events in the past few weeks have posed a valiant challenge to this view.

Firstly, the transient case. The sharp increases are the consequence of three forces: base rate effects with year-on-year prices higher this year given last year's economic collapse, a sharp resumption of activity as lockdown restrictions have eased (demand-pull inflation) and supply shortages in a range of industries squeezing the availability of goods (cost-push inflation). These have helped producer and consumer price inflation to hit 11.8% and 5.4% in the US this year, levels we haven't seen since 1980 in the case of producer prices. For Bond fans that's back to Roger Moore times but it's a move which his predecessor Sean Connery might call 'shocking, positively shocking'. Central bankers were largely aligned to the transitory view – the increases being the result of pandemic-related disruptions and before long deflationary forces, such as technological disruption, demographics and debt would take charge again and inflation would retreat, meaning no sharp tightening of monetary policy would be necessary.

However, the recent explosion in wholesale gas prices (up 400% this year at one point in Europe) resulting in higher household energy prices, along with higher oil, petrol and food prices will work their way into inflation numbers and could persist for some time. These effects have evidently fuelled the argument that inflation might indeed be less transient and they have forced Bank of England governor Bailey to announce that the central bank 'will have to act', referring here to raising interest rates.

Then you have the structural inflation case, which centres on the monetary stimulus since the onset of the Covid pandemic. Year-on-year (M2) money supply growth rose to just under 25% late last year, the highest ever observed, and remains elevated today. The underlying thesis is if there is suddenly more money chasing the same number of goods, or if money supply exceeds what is needed to finance economic growth, then prices must rise and they will remain high until money supply is brought under control. Critics will point to stubborn sub-target inflation after the post-GFC stimulus programs – partly explained by banks retaining a lot of the money created and thus less worked its way into the real economy – though monetary injections over the past 18 months have been far greater than back then. Wage inflation will also likely be key here. So far it hasn't followed recent input or consumer prices much higher but should it do so, conceivable given widely reported labour shortages, it will further strengthen the case for more entrenched inflation.

So, what do markets think? US expectations have remained reasonably well anchored - expected inflation for five years starting in five years' time (5y5y inflation) has moved to 2.6% per annum, above 2% but only 0.1% higher than the average of these expectations since 2010. The moves have arguably been more noteworthy in the UK and Europe, with 5y5y expectations in the former at their highest in the post-crisis era (4%) and in the latter they have just hit 2% for the first time since 2014. Generally, expectations have risen but runaway inflation is not anticipated. We certainly feel the risks of more persistent inflation have increased recently but on balance continue to believe a normalisation of the shorter-term dislocations should help to keep it in check.

As we wait to see who hits the screens as the next 007 we will have to wait and see what inflation numbers hit our Bloomberg screens in the months ahead. Nevertheless, as multi asset investors we want to construct portfolios that can deliver in a range of scenarios, in other words own assets that can shield and shine during episodes of higher inflation. Over the last year a general bias towards inflation linked bonds, largely US TIPS, over nominal government bonds has been supportive but even after recent yield increases they look expensive and we hold principally for portfolio ballast. Inflation linkage embedded within property and infrastructure assets is our preferred route, along with value equities and floating rate bonds.

We want to construct portfolios that can deliver in a range of scenarios, in other words own assets that can shield and shine during episodes of higher inflation

Source: All market data sourced from Bloomberg Finance, L.P.

Diversity of Time Horizons

Mark Wright, CFA

A commonly accepted definition for market efficiency is "the degree to which market prices reflect all available, relevant information". Given the speed with which news is now disseminated around the world, along with the rapid growth in algorithmic trading, one might expect markets to be reasonably efficient.

That is certainly one way to explain the wild oscillations in equity markets last year. These violent swings made the volatility associated with the Global Financial Crisis (GFC) look tame in comparison. In February and March last year, global equity markets took less than 5 weeks to erase all of the gains they'd grinded out over the previous 3 years. They then went on to reach all-time highs just a few months later in August, before bouncing higher again post 'Pfizer Monday' in November[1].

Are these extreme moves simply an efficient equity market rapidly incorporating into prices the changing economic landscape - the lockdowns that hurt corporate profits, the subsequent financial support from the governments and central banks, and then the economic boom thanks to the discovery of a new vaccine?

Probably, to some extent. However, arguably of greater significance is the myopic, irrational behaviour of market participants driven by fear (and then greed).

My colleague, Gary Moglione, touched on this in his article a few weeks back in which he cited one of Warren Buffett's most famous quotes that far too many investors forget, "Be fearful when others are greedy and greedy when others are fearful". I am going to introduce a new concept that we take advantage of called, "diversity of time horizons", a phrase coined by Lyrical Asset Management with whom we invest in North America.

I've outlined below some examples from our investment portfolio that demonstrate how irrational investors can be at times and the extent to which time horizons can diverge.

The direct UK equity portfolio we manage traded at about 5x forward earnings in the middle of March last year[2]. Granted, those earnings forecasts lagged reality at the time, but in the grand scheme of things, it meant the UK equity portfolio was effectively trading at around 5x times earnings that are achievable in more normal times. Sounds like a bargain and, indeed, it was.

Those valuations were so low that they could not have been the result of anything other than short-sighted, irrational investors, who considered only the imminent lockdowns and failed to look further ahead to the strong likelihood of central bank or government action. Not to mention neglecting to consider a return to more normal times from the discovery of a new vaccine.

Admittedly, the timing of any central bank or government financial support was uncertain, as was success on the vaccine front, but this is a great example of diverging time horizons and the sort of opportunity it can present for investors such as ourselves and our friends at Lyrical Asset Management.

Was it really unrealistic for the patient investor to assume that central banks and governments would take preventative action against the financial system imploding and the economy collapsing? Or that a new vaccine would be discovered within a few years which would aid a recovery in corporate earnings back to those achieved in more normal times? I don't think so.

Let us not forget, it wasn't much more than 10 years or so before the pandemic that central banks and governments were last put to the test during the GFC. There was also a vast amount of research being undertaken across the globe to find an effective vaccine against Covid-19; by 8th April 2020, there were already 115 vaccine candidates.[3] This was all information the market was aware of.

"Be fearful when others are greedy and greedy when others are fearful"

[1] Bloomberg Finance L.P. [2] Bloomberg Finance L.P./MGIM [3] The COVID-19 vaccine development landscape (nature.com)

08 November 2021

Match Day for Climate Action

Jackson Franks

It appears that each time it's my turn to write the blog we are at the start or in the midst of a major sporting event. This time round it's the autumn rugby internationals. For those who are unaware of the annual occasion, it's the time of year when the Southern Hemisphere nations leave their +20°C blue sky climates and head up North to the depths of darkness, rain, and wind. A month's long rugby tour against the Northern Hemisphere countries then ensues. For our British and South African readers, it's a highly anticipated tour this time round for the British Island's. The Springbok's face off against Wales, Scotland, and England, who will each seek retribution from losing the British & Irish Lions tour to South Africa earlier on in the year. However, the home nations should perhaps look to the climate activists who seem to be making head way in their retribution against Global leaders in attendance at COP26, who are showing signs of understanding the commonly used phrase; actions speak louder than words.

As an avid sports fan, the autumn internationals bring great excitement, however, one matter that can't be ignored is the amount of travel the eight Southern Hemisphere nations will embark on and therefore the environmental impact. Over 100,000 km will be travelled by air, and with planes emitting an average of c.115 grams of Co2 per passenger per km the impact to the environment will be sizable. Now, I am not saying the Autumn festival should be cancelled, but with professional sporting entertainment being a huge part of society globally, governing bodies across sports need to act.

Progress is being made and at COP26, over 280 sports organisations have pledged support to the UN's Sport for Climate Action Framework. The aim of the framework is for sporting events to achieve net-zero emissions by 2040. Headway has also been made in the English Premier League ("EPL") where this year we saw the world's first net zero carbon football game at an elite level when Tottenham Hotspur hosted Chelsea. Although this was a major step forward in the right direction, just a month later, Manchester United took a 20-minute flight to Leicester, a 100-mile trip. Their argument: to beat traffic! Governing bodies need to remain consistent in their approach for these targets to be met, so perhaps prohibiting air travel for matches in the EPL should be the next point on the Premier League climate strategy agenda.

To contextualise the impact that such a change could have, a study showed that EPL clubs produced 1,134 tonnes of Co2 emissions because of travel in the 2016/17 season, the equivalent of 2 flights per day for 365 days from London to Sydney (17,016km per flight). With England only 965km north to south and 485km east to west, the carbon footprint of the EPL is substantial. Alternative transportation should be sought, especially when passenger trains emit 35.1 grams per passenger per km, circa 70% less than air travel.

At Momentum, we are constantly looking to minimise our carbon footprint through our activities, whether its methods of transportation in meeting our clients domestically and internationally or the work we do to understand our managers' credentials and their capabilities for assessing environmental risks in the companies in which they invest. As part of our parent company, Momentum Metropolitan Holdings Limited, we have been a signatory to the United Nations Principles for Responsible Investment (PRI) since 2006 and more recently we have applied to be signatories to the UK Stewardship Code, having just published our first Stewardship Report **(Read our Stewardship Report)** Responsible investing is embedded in our process and impact on the environment is a fundamental factor in our decision making.

Headway has been made in the English Premier League where this year we saw the world's first net zero carbon football game at an elite level

15 November 2021

Embracing Uncertainty

Lorenzo La Posta, CFA

Today, uncertainty takes many forms. It revolves around inflation, supply chains, energy prices, interest rates, wages, growth and more. Is the current bout of inflation more than transitory, or will inflation indicators turn down towards the widely used 2% target any time soon? When will disruptions to global trade end? Will labour shortages and raw material supplies come back to normal? Is there such a thing as 'normal' anymore, or are we heading towards a 'new normal'? Is the recent surge in oil and natural gas prices going to hurt economies more or have we seen the worst? Are we going to survive winter without emptying out our wallets? How is all that affecting global growth? How much longer than expected (or hoped) will it take for economies to get back to full speed, given all these problems? How will central banks react to all these conditions? Are interest rates about to be increased rapidly and inexorably?

To this long (and not comprehensive) list of uncertainties, there are many possible answers and even more news headlines, thought pieces and opinions available out there. A lot of that is probably confusing noise. We do worry about all these questions but are conscious that it's important to distil the most significant and impactful information out of all that confusion.

In our scenario modelling and stress-testing, we highlight a few possible scenarios that we may encounter in the coming months and put down some assumptions on what interest rates, earnings growth, equity valuations etc would look like in each of these. Different combinations of inflation and growth dynamics determine very different market conditions and while we have a view on what scenario is more likely than others, we do not put all our eggs in one basket. It's important to account for the tail risks, for those events that are less likely but far more dangerous than others. Currently we see stagflation as the main tail risk: rising inflation and slowing economic growth would be the most damaging scenario for most asset classes. With rising interest rates on top of that, in this low probability scenario we would expect to see equities and government bonds lose ground. However, even in such a grim scenario, opportunities would appear; commodities (and their producers) could do well, regions like the UK and Japan would arguably fare better than the US, floating rate bonds would be well suited and inflation-linked bonds would probably outperform nominal treasuries.

We are outcome-based investors, in that our focus when building portfolios is providing our clients with the most efficient way to achieve their objective. We worry about two things: maximising the probability of achieving the desired outcome and providing a palatable journey towards it. Key to both things is having a diversified portfolio. No matter what economic environment you are in, diversification remains the best way to decrease overall risk (it is the only free lunch after all). We own commodities, floating rate and inflation-linked bonds for the stagflation scenario; emerging market equites, or real estate for a high growth, high inflation world; government bonds for a stagnation scenario, with little growth and decreasing inflation; and developed market equities and convertible bonds for another round of the 'goldilocks' scenario. Alternative assets, such as hedge funds, are useful across most scenarios as their uncorrelated nature means they can generate good returns across all environments, no matter what growth, rates and inflation levels prevail, so we do have a strategic allocation to those across all risk profiles.

Ultimately, we believe that investing is not too different from sailing a boat. To get to your destination, you need a good, solid vessel and a reliable crew sailing it. You need to point in the right direction, but also be able to change course as obstacles come and winds change. The vessel here is the strategic asset allocation, that must be risk-efficient, diversified and tailored to the desired outcome. The crew needs to take care of the tactical asset allocation, which is often a three-step process. Step one: understand what the possibilities and probabilities are. Step two: understand what the consequences of those events would be on the various asset classes. Step three: tilt the portfolio accordingly.

If today the world seems more uncertain than usual, with all that's happened over the past 18 months, we think sticking to a diligent and proven investment process is the best way to manage the risks that lie ahead.

The only certain thing in financial markets is uncertainty. And if you can't avoid it, you'd better embrace it.

Gradually and then Suddenly

Richard Parfect

22 November 2021

The physical act of literally seeing a danger can require a deliberate act of searching it out. For example an object such as a car or aircraft you are on a collision course with is often masked by the fact that the relative angle between you is constant, thereby it appears stationary. If the eye does not detect an angular change then it can be literally blind to it until the final moments before impact when its relative size in your field of view blooms to a large size, at which point evasive action can be too late. It is due to this optical phenomenon that to spot the danger we need to move our head around in our scan to create an angular change for the eye to spot.

Just like in Ernest Hemingway's novel "The Sun Also Rises", the character Mike Campbell was asked how he went bankrupt; "Two Ways" Campbell replies, "Gradually and then suddenly". Essentially the factors had been in place for a long time but their insidious effects only showed themselves in the final moments of his financial demise.

We are now witnessing a similar situation with this current "inflation shock". While Central Banks are hoping (with diminishing credibility) that it is short term and transient, we can point to a number of factors that have been present for many years but are only now revealing themselves. Whether, we are talking about an insufficient (in size and skills) workforce, the supply of which was artificially (and unsustainably) boosted by low cost immigration in the service economy, a demographic retirement bulge in lorry drivers, commodities that have been mis-priced against their hidden costs (e.g. carbon embedded within fossil fuels), a supply chain that was so stretched to maximise "efficiency" that it lacked any level of resilience to cope with shocks (blockages in the Suez canal, chip shortages for car manufacturers, insufficient warehouse space to accommodate "onshoring" of production and storage). All these factors have been present for many years, and while it may have taken COVID amongst other things to trigger the inflation shock but the foundations had already been laid.

Having been mindful of this risk through the years of Quantitative Easing and the build up of structural risks, we became increasingly concerned about inflation early this year. It is for this reason we had already built up a high level of knowledge and understanding within our Specialist Assets or, "real assets" as some commentators call them. This portion of our portfolio generates income streams, much of which is implicitly or even explicitly linked to inflation, but without having to pay the very high prices of government index-linked bonds. Diversifying across real estate (REITs), infrastructure, specialist financial and asset backed lending trusts and even private equity, has resulted in a portfolio of assets that are not intrinsically linked to headline short term GDP expansion or significant counterparty risks of default.

Our inflation defences are further bolstered by an allocation to physical gold and gold mining companies. The yellow metal has been valued for its wealth preserving qualities for millennia. While gold suffers the flaw of failing to pay an income; this is of little concern for the moment as governments and central banks grapple with how to combat inflation that will not necessarily respond to any future increase in interest rates. Financial Repression; the act of allowing inflation to run without hiking interest rates above it and thereby deflating the real value of government debt, could prove to be that stationary dot on the horizon.

Spotting dangers and threats can be a difficult skill; not least because they often hide in plain sight.

Opt Out

Richard Stutley, CFA

29 November 2021

It is hard to know what is going to happen. While people like to hear a single view about the outlook for the global economy, with plenty of point forecasts for key variables like growth and inflation, the future is in fact best expressed as a range of possible outcomes; see my colleague Lorenzo La Posta's blog from two week's ago ("Embracing Uncertainty") for a good explanation of what this looks like in practice.

If something is hard, most of us would like to opt out. One way to do this is by investing in secular growth stories: no matter which way the wind is blowing for the wider economy, these businesses continue to do well as they take market share from other areas and come to account for a growing proportion of spending.

Of course there are no free lunches, so typically you will have to pay up to access these growth opportunities. Our focus is on finding areas where this is not necessarily the case, due to a failure by market participants en masse to price the opportunity correctly. We are not thematic investors, by which I mean we do not pursue a potential growth opportunity at any price, but only after a detailed assessment of fair value. We may think the growth outlook for a company or sector is higher than average, but we'll only buy it if the price is right.

We think we've found two such areas in the case of energy storage and digital infrastructure. We have been scrutinising the ability of our holdings to pass on inflation, but secular growth themes are less sensitive to this key variable for the reasons discussed above. Both energy storage and digital infrastructure are well placed to benefit from rapid increases in demand brought about by shifts in consumer behaviour: the urgent need to decarbonise the global economy puts a greater emphasis on green energy, and battery storage technology is a key enabler of this transition.

Meanwhile we are seeing ever greater consumption of data, to assist us and the technology we use to become smarter and quicker (soon much of this technology will literally drive itself).

We access these areas through listed, closed-end investment companies. These monoline companies have straightforward balance sheets and publish a Net Asset Value (NAV), which helps to anchor the share price. As relatively small companies, they are inaccessible to larger investors and therefore end up being under-researched and underappreciated in our experience. We benefit from the smaller size of these companies, and this is often compounded by the underlying management teams focusing on small and mid-sized projects, which they can either acquire or develop at a discount to larger projects.

We can't invest exclusively in secular growth themes any more than we can invest exclusively in one country or sector: at all times it depends on what's in the price. However we are delighted on those occasions that we are able to opt out and focus on these kind of micro themes.

If something is hard, most of us would like to opt out.

06 December 2021

Death of the high street or just poor operators?

Matt Connor

Rapid growth of e-commerce, everchanging consumer habits and increasing competition have all been cited as culprits responsible for the 'death of the high street', but the real culprit is bad management.

The onslaught of the pandemic last year witnessed the highest number of store closures in the UK since the global financial crisis[1], taking down household names such as Debenhams and Topshop's parent company Arcadia Group in its wake. The pandemic isn't wholly to blame for the failure of these businesses though, it was more of an accelerant, bringing forward the eventual demise of these badly run businesses.

Debenhams, for example, had already entered a pre-pack administration in 2019 and had been teetering on the edge of insolvency for a while prior to that, shedding its store estate and recording its largest loss in its 240-year history in 2018[2]. Philip Green's Arcadia group suffered a similar fate to Debenhams, with the pandemic being the final nail in the coffin. Despite an ill-fated attempt to save the group with a Company Voluntary Arrangement (CVA), Arcadia entered administration eight months after the start of the pandemic, struck by the questionable management practices of Philip Green that BHS suffered a few years prior.

It is not all doom and gloom in the world of traditional retailers. Two of our holdings, Marks and Spencer plc (M&S) and Halfords Group plc have proved that age is just a number, and it is possible to adapt to the modern age, despite being formed in the 19th Century. Halfords has undergone a massive transformation over the last few years. It has overhauled its website, expanded its services business and most recently pivoted into the Software-as-a-Service (SaaS) market, by launching its Avayler delivery platform with ATD in the US; ATD will use the software to schedule work and delivery of tyres across 80,000 garages in the US.

The market has seemed to recognise these positive changes, with Halford's share price rising almost 30% in 2021 so far[3], combined with a full year profit upgrade and strong performance in the first half of Halford's financial year[4].

The turnaround of M&S has been long and arduous and one that has been tough to endure as shareholders since 2014. Action on shrinking its massive store estate, getting the online proposition right and entering into a joint venture with Ocado in 2019 have all helped to change M&S' fortunes, whilst some rivals such as Debenhams and John Lewis have faltered. Exceptional interim results last month accompanied by a 40% profit upgrade on already increased guidance saw the share price soar, contributing to the 75% increase since the start of the year[3]. Despite the astronomical rise, we still see a lot of potential in M&S, with a simple 'sum-of-the-parts' valuation revealing 75% upside to the current share price of 240p[5].

The market has failed to recognise value elsewhere in our portfolios, such as Ediston Property Investment Company, which specialises in retail parks and still trades on a discount to NAV despite strong performance across their portfolio. Their last quarter witnessed a 99.9% rent collection rate and NAV total return of over 4%. Footfall at retail parks remained resilient through the pandemic, with essential retailers as anchor tenants and the format enabling social distancing, as well as lending itself well to omni-channel retailing such as 'click and collect'.

As contrarian investors, unloved sectors provide us with a great opportunity to uncover undervalued investments that have been tainted by a negative view of a sector. Employing a bottom-up approach to investing allows us to discover quality, underappreciated investments at unjustifiable valuations.

The last decade or so has seen traditional retail undergo a structural change.

[1]House of Commons Briefing Paper – Retail Sector in the UK, 25 May 2021. [2]The Times - Debenhams posts biggest loss in its 240-year history, 25 October 2018. [3]Bloomberg. [4]Halfords Group plc – Interim Results FY 2022, 10 November 2021. [5]Sum of the parts valuation – Momentum Global Investment Management Ltd, 18 November 2021.

13 December 2021

Staying the Course

Alex Harvey, CFA

As we come into 2021's home straight, few moments can match the drama and rivalry that played out yesterday in Abu Dhabi as the Formula One season drew to a close. A nail-biting final lap decided the 2021 championship after the two key protagonists, Lewis Hamilton and Max Verstappen, started the race on equal points. Even those not of a petrolhead persuasion would be hard pushed not to have enjoyed the spectacle. The lesson of the day was to never give up. In the highly competitive sports arena, we've seen countless times how victory can be snatched from the jaws of defeat. Whilst investment is a different game altogether, similarities can be drawn between our industry and theirs.

The first point of note is that for every driver competing on the track, there is a pit crew of around 20 and a total race team on the ground of perhaps 70 or 80 people. And hundreds more back home. It is a team sport, and everyone has a role to play. Much like an investment business, the faces you see on the factsheets are just the tip of the iceberg and there is a huge team supporting the business beyond the more visible investment desk and sales team.

The car is the investment vehicle and for us that really means the investment process. I like to refer to our process as something of a 'universal chassis', with a shell designed to suit it for the relevant jurisdiction in which we are 'racing' – be that the UK, South Africa, the Middle East, South America or Asia. Conditions will be slightly different in each location and the cars need to be styled accordingly. Higher kerb clearance here, more downforce there. The objective remains the same though; to transport the investment vehicle's passenger – the client – to a shared investment outcome. The only difference perhaps at Momentum is that we may sacrifice speed for comfort, noting our emphasis on the importance of the investment journey.

As we saw in yesterday's race, you also have to take risk. Risk is not always rewarded, but over time considered and calculated risks should translate into improved performance. In Abu Dhabi it was Max Verstappen and the Red Bull team who took the risks (tyre changes) while Lewis Hamilton stuck to his game plan. [In fact, it was something of a free option for Verstappen but that is one for another day]. Ultimately that risk was rewarded as a unique set of circumstances (and a little bit of luck) played out, allowing Verstappen to overtake on the final lap. Tactical decisions were key to his success over the course of the whole championship, not just this race. We take a similar approach with our investment process, with tactical pivots around the long-term strategic investment goal.

There is also an incredible amount of cutting-edge technology that goes into Formula One today compared to yesteryear (albeit it was the best technology at the time). This drives innovation and shows how far we have come, notably with improvements to driving safety as well as speed. Similarities can be drawn with portfolio management today where risk can be calibrated quite precisely, although tyres do still blow out and cars do still spin off the road. Some things cannot be eliminated; you just have to plan for their eventualities.

As a 10-year-old I remember being plucked out of school one day to visit the McLaren factory in Woking, near where I grew up. It was for some publicity in the local newspaper, and I was fortunate enough to sit in a F1 car cockpit for photographs and to meet John Watson who had returned to the team for his last F1 race, driving the injured Niki Lauda's number 1 car. I also remember the striking red livery on the car from the Marlboro cigarette sponsorship deal. Echoing how attitudes and styles have evolved in the investment industry, McLaren's singular focus on Marlboro - and tobacco sponsorship more broadly - has given way to a more diversified blend of sponsors (and brands) including for McLaren the likes of Cisco (Webex), Stanley Black & Decker (DeWalt), Hilton and Dell Technologies. In another 37 years, perhaps electric engines will have replaced petrol ones, or the cars will float on a cushion of air rather than tyres. Who knows? What I think we can be sure of though is that they will still be racing, and people will still be investing. The journey will continue.

Whilst investment is a different game altogether, similarities can be drawn between our industry and the Formula One season

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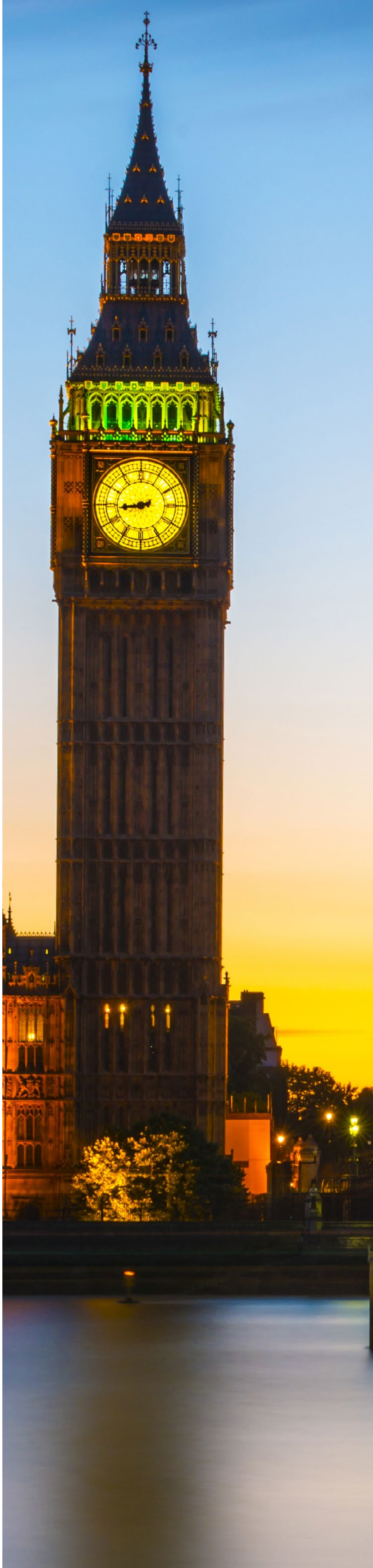

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