momentum

05 March 2018

The Momentum Train

Stephen Nguyen, CFA

Regular readers may remember that my last blog entry talked about value investing. The time before that I spent some time discussing quality investing. So, to round things off, I thought I would share my thoughts on momentum investing (not to be confused with our company name and brand).

Last week, London was hit by the 'Beast from the East', that brought with it unseasonably low temperatures. Predictably, transport ground to a halt in the face of a few centimetres of snow. Snow is a useful analogy for momentum investing: imagine a snowball rolling down hill, gathering more snow as it goes, which in turn causes it to roll faster, and so on. In the same way, we observe virtuous cycles in companies' performance: i.e. winners keep on winning.

> *"imagine a snowball rolling down hill, gathering more snow as it goes, which in turn causes it to roll faster, and so on"*

As with most styles (or factors), there are various approaches to momentum investing. The simplest approach is price momentum. Rather than the intuitively appealing option of buying something that has fallen in price (and therefore 'surely must go back up'), price momentum involves buying things that have already gone up in price "buy high, sell higher". The other approach to momentum investing is to focus on company fundamentals, principally earnings growth; one is looking to identify companies whose earnings are growing at an accelerating rate, twinned with positive earnings surprises/ revisions. Typically most momentum strategies pay attention to both of these factors. The emphasis on earnings growth is the reason why the name 'momentum' investing is often interchangeable with 'growth' investing.

> *"buying things that have already gone up in price "buy high, sell higher""*

Why does this style of investing work? The answer lies in human behavioural biases which are remarkably consistent through time. The phenomenon can be explained firstly as an under-reaction effect: information tends to take longer than expected to become fully priced-in due to anchoring and conservatism by investors. We also observe herding among investors as a result of 'FOMO': the fear of missing out. Awareness of other peoples' success can spur investors to jump on the back of rising trends and a natural propensity to extrapolate a trend further into the future exacerbates the effect on winning stocks to keep on winning.

The momentum premium can also be explained from a risk based perspective. Risk based arguments posit that the extra return is compensation for taking on the additional risk associated with momentum stocks which are typically deemed to be more volatile and carry a higher propensity for crashes. Both are plausible and intuitive explanations for the momentum effect. What is more important to the 'practical' investor however, is that this phenomenon has existed in financial markets for decades and is likely to remain as behavioural biases (and risks) tend to repeat over time.

> *"this phenomenon has existed in financial markets for decades and is likely to remain as behavioural biases (and risks) tend to repeat over time"*

Momentum investing has been dubbed the "idiot's strategy". In reality, identifying catalysts for virtuous trends takes a lot of skill, as does recognising when the momentum has faded. Momentum investing is a high turnover, time-heavy approach which requires the ability to assimilate news flows and data in a timely fashion in order to understand exactly when conditions change.

Momentum investing has been the standout equity style over the past decade. But like everything, trends come and go; eventually momentum's momentum will fade. As a result, we advocate a balance of styles within investors' equity allocations.

Market Focus

- Brent crude fell 4.4% last week to $64.6 a barrel
- Gold fell by 0.7% to 1320.3
- Global equity indices fall
- Global trade war looms following US metals protection announcement

US

- The Dow Jones fell 3% finishing the week at 2453.8
- Trump plans to apply a 25% tariff on steel and 10% tariff on aluminium on imports as part of his hawkish 'America first' trade policy with apparently no exceptions- drawing global condemnation
- US stocks had their worst month in two years
- The NASDAQ was down 1.2% to 6811
- Jerome Powell gave an upbeat assessment in his first testimony as the new Fed Reserve Chairman including a $1.5 trillion tax package and the lifting of government spending caps
- Consumer sentiment rose to 99.7% from 95.7% in January, the second highest level since 2004. Current conditions gauge rose to 114.9 from 110.5 in January
- The S&P index fell 2% to 2691.3

UK

- Maplin follows Toys R Us into administration as the UK high street picture remains challenging. Sports Direct mulls a potential takeover of Debenhams
- The FTSE fell by 2.4% on the week to stand at 7069.9
- PMI for services rose to a four month high at 54.5 in February , up from 53 in January
- Brexit talks in peril as EU draft deal seen as unacceptable. Theresa May gave another speech using more compromising language in a bid to set out the UK's position more clearly
- Mark Carney signals he wants to regulate cryptocurrencies and that they should be held 'to the same standard as the rest of the financial system'

Europe

- Manufacturing PMI fell to 58.6 in February. 2018 has seen the steepest rate of decline in two years though the overall growth picture remains strong
- Italian elections: a success for the populist anti-establishment parties including the Five-Star movement and Northern League. A new government is not expected to emerge for a few weeks EU promises to 'react firmly' to US trade protection measures
- The Euro Stoxx 50 index fell 3.4% to 3324.7

Asia

- China's response to US steel protectionism was officially muted, though insiders believe retaliation is on the cards
- The Hang Seng fell 2.25 to 30583
- The Nikkei fell 3.3% to 21181.6

Past performance is not indicative of future returns.
Source: Bloomberg, returns in local currency unless otherwise stated.

Currency returns					
Asset class/region	Currency	Week ending 02 March	Month to date	YTD 2018	12 months
Developed markets equities					
United States	USD	-2.0%	-0.8%	0.9%	14.6%
United Kingdom	GBP	-2.4%	-2.2%	-7.4%	-0.7%
Continental Europe	EUR	-3.6%	-3.4%	-4.6%	1.9%
Japan	JPY	-2.9%	-3.4%	-6.0%	11.5%
Asia Pacific (ex Japan)	USD	-2.1%	-1.2%	0.5%	25.7%
Australia	AUD	-0.8%	-1.3%	-1.4%	7.2%
Global	USD	-2.3%	-1.3%	-0.4%	15.2%
Emerging markets equities					
Emerging Europe	USD	-3.4%	-2.0%	5.0%	25.5%
Emerging Asia	USD	-2.5%	-1.1%	1.1%	31.8%
Emerging Latin America	USD	-3.0%	0.0%	9.0%	21.8%
BRICs	USD	-3.3%	-1.0%	4.5%	35.4%
MENA countries	USD	-1.1%	0.0%	3.1%	2.1%
South Africa	USD	-5.3%	-2.3%	0.2%	28.5%
India	USD	-0.8%	-0.4%	-2.6%	22.0%
Global emerging markets	USD	-2.8%	-1.1%	2.2%	29.0%
Bonds					
US Treasuries	USD	0.1%	0.1%	-2.1%	0.4%
US Treasuries (inflation protected)	USD	0.4%	0.3%	-1.7%	1.1%
US Corporate (investment grade)	USD	-0.2%	-0.3%	-2.8%	2.7%
US High Yield	USD	-0.2%	-0.5%	-0.7%	3.4%
UK Gilts	GBP	0.6%	0.4%	-1.4%	-0.1%
UK Corporate (investment grade)	GBP	0.3%	0.2%	-1.8%	1.6%
Euro Government Bonds	EUR	0.3%	0.1%	0.0%	1.5%
Euro Corporate (investment grade)	EUR	0.0%	-0.1%	-0.4%	1.8%
Euro High Yield	EUR	0.1%	-0.1%	-0.4%	4.4%
Japanese Government	JPY	-0.1%	-0.1%	0.1%	1.0%
Australian Government	AUD	0.7%	0.5%	0.3%	3.5%
Global Government Bonds	USD	0.3%	0.6%	1.2%	8.2%
Global Bonds	USD	0.1%	0.4%	0.5%	7.9%
Global Convertible Bonds	USD	-0.7%	-0.3%	2.1%	8.8%
Emerging Market Bonds	USD	-0.1%	-0.2%	-2.9%	2.0%

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

Currency returns					
Asset class/region	Currency	Week ending 02 March	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	-2.0%	0.1%	-11.6%	-10.4%
Australian Property Securities	AUD	0.3%	0.2%	-7.1%	-5.0%
Asia Property Securities	USD	-1.3%	-0.4%	-0.1%	18.1%
Global Property Securities	USD	-1.7%	-0.2%	-5.8%	5.6%
Currencies					
Euro	USD	0.0%	0.8%	2.4%	17.2%
UK Pound Sterling	USD	-1.5%	-0.1%	1.8%	12.3%
Japanese Yen	USD	0.9%	1.1%	6.6%	8.4%
Australian Dollar	USD	-1.0%	-0.5%	-0.8%	2.5%
South African Rand	USD	-3.1%	-1.3%	3.8%	10.1%
Swiss Franc	USD	-0.3%	0.6%	3.8%	8.0%
Chinese Yuan	USD	-0.1%	-0.2%	2.6%	8.6%
Commodities & Alternatives					
Commodities	USD	-1.0%	-0.2%	1.3%	6.0%
Agricultural Commodities	USD	1.8%	0.2%	5.7%	-2.5%
Oil	USD	-4.4%	-2.1%	-3.7%	16.9%
Gold	USD	-0.7%	0.1%	1.1%	7.0%
Hedge funds	USD	-1.4%	-0.3%	-0.3%	3.5%

Source: Bloomberg. [e] Estimate Past performance is not indicative of future returns.

For more information, please contact:
Anastasiya Volodina
Distribution Services
E: distributionservices@momentum.co.uk
T: +44 (0)207 618 1806

Important notes

This document is only intended for use by the original recipient, either a Momentum GIM client or prospective client, and does not constitute investment advice or an offer or solicitation to buy or sell. This document is not intended for use or distribution by any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient. The original recipient is solely responsible for any actions in further distributing this document, and in doing so should be satisfied that there is no breach of local legislation or regulation. This document should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this document is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, Momentum GIM does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at The Rex Building, 62 Queen Street, EC4R 1EB. Momentum Global Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom, and is an authorised Financial Services Provider pursuant to the Financial Advisory and Intermediary Services Act 37 of 2002 in South Africa.