weekly digest

momentum

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Bigger than the Roman Empire

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It is common belief that bigger is better, but at Momentum we do not always endorse that. One of our functions is to choose which managers to trust our clients' capital with: manager selection is not a scientific process, there is not a unique set of rules to "evaluate them all" and parameters to analyse are countless. Among these, we consider size (be it of the strategy, the investment team or the firm) to be a meaningful factor.

> *It is common belief that bigger is better*

At the peak of its power in 117 AD, the Roman Empire had grown to encompass an area of over 5 million square kilometres, included more than 20% of the world's entire population with territories comprised of what today are 48 states ranging from England to Egypt and from Portugal to Iraq. However, such a vast, diverse and widespread territory was hard to control, not to mention managing problems such as integration, stability and borders' defence. Rome had grown too much for its strength to remain unaffected; the Empire lost control and slowly collapsed, surrendering to barbarian invasions, civil wars and plagues. This excessive size doomed one of the strongest empires ever and it is our opinion it can often be a detractor to the performance of investment strategies as well.

> *rigorous capacity management is necessary*

As assets invested in a strategy grow, it becomes harder for managers to be as nimble as they need to as they face higher indirect trading costs such as market impact and liquidity issues. Additionally, large assets strongly limit the ability to invest in smaller companies or to properly express views in certain sectors or regions. Therefore, overgrown funds are not able to replicate the same investment process that attracted assets in the first place and they inevitably end up drifting towards more liquid securities or looking more benchmark-like. Clearly every strategy is unique and investment conditions change continuously, so capacity can only be estimated on an ad-hoc basis and never without uncertainty, but rigorous capacity management is necessary to avoid performance erosion and style drift. When evaluating investment teams, what we generally find to be most effective are small teams with sufficient resources whilst avoiding the dispersion and the lack of direct responsibility that we often observe in oversized teams. Focus is key and when information is spread across too many people, decision makers struggle to have a complete understanding while analysts miss the bigger picture. Concerning firms, we simply do not believe there are any firms that can be the best at everything. Rather, there are many smaller asset managers specialised in specific asset classes or strategies as much as in the larger companies there could be a small number of highly valuable teams. Our ability to invest in as many managers as we want enables us to pick just the "best of breed" within each component of our portfolios.

> *just the "best of breed" within each component of our portfolios*

> *Focus is key*

These are no hard rules, rather guidelines we have often found to be adding value in the investment process. We typically build higher conviction in specialised firms, where portfolio managers are also analysts with alignment to long-term performances rather than assets under management. How to measure and quantify the above characteristics is not an easy task and one must not be too simplistic when trading size off with the many advantages of being instead large (among many, a better structure for passive solutions and large scale products), but it is an important factor that we believe having a significant impact on investment returns despite being often overlooked or misunderstood by others.

Market Focus

- Markets tumble as US-China trade conflict continues to dominate sentiment
- Softer-than-expected US jobs report
- Brent crude rose 2.4% after OPEC announced it would cut production by 1.2 million barrels a day
- Gold rallied 2.1%, ending the week at $1246.6 per ounce

US

- The ISM manufacturing index rose to $59.3 from $57.7 in October amid a surge in new orders from an 18-month low
- On Friday, the US jobs report was softer-than-expected; non-farm payrolls rose by 155 thousand in November, following a downwardly revised 237 thousand in October and well below expectations of 200 thousand. The unemployment rate held steady at 3.7% while average hourly earnings rose 0.2% from the prior month, compared with forecasts of 0.3%
- Optimism over the trade war deadlock being lifted grew early in the week following comments that China had agreed to increase agricultural imports from the US and eliminate tariffs on US auto imports. In return, the US agreed to postpone, for 90 days, plans to increase the China tariff rate from 10% to 25%. However, as the week progressed trade optimism evaporated weighing on US equities
- US large-cap equities fell 4.6% on the week, with the tech sector declining 4.0%. The yield on the 10-year Treasury fell back below 3.0%, ending the week at 2.8%

UK

- UK equities fell 2.8% in the week ahead of the key parliamentary Brexit vote that was scheduled to take place on the 11th December. However, Prime Minister May has today delayed the vote on the Brexit deal to avoid a significant defeat in Parliament
- The European Court of Justice have ruled that the UK can revoke Article 50, and thus unilaterally withdraw notice of their intention to leave the EU
- The UK Services PMI fell to 50.4 in November, lower than the expectations of 52.5 amid heightened Brexit uncertainty and subdued business spending. A figure below 50 indicates a contraction

Europe

- German manufacturing orders rose unexpectedly in October, increasing 0.3% versus an expected drop of 0.4%. This represents a third consecutive month increase.
- In France, President Macron cancelled next year's planned increase in fuel taxes to calm protests. However, for the third weekend in a row yellow-vest protested on the streets of Paris demanding more concessions from France's leaders
- European equities hit a two-year low on Thursday and ended the week down 3.3%

Rest of the World/Asia

- Crude prices rebounded following OPEC and non-member nations like Russia agreeing on a production cut of around 1.2 million barrels per day
- On Thursday, the CFO of Huawei Technologies was arrested in Canada on charges of conspiracy to defraud banks and clear payments to Iran. It was reported Canadian officials had acted at the request of the US and fear has grown that this could potentially jeopardize a fragile trade war truce between the US and China
- The Hong Kong stock exchange fell 1.7%
- Japanese equities wiped out recent gains falling 2.8% last week

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

Asset class/region	Currency	Currency returns			
		Week ending 7 December	Month to date	YTD 2018	12 months
Developed markets equities					
United States	USD	-4.6%	-4.0%	-0.2%	1.2%
United Kingdom	GBP	-2.8%	-3.2%	-8.1%	-3.4%
Continental Europe	EUR	-3.3%	-3.0%	-8.5%	-8.9%
Japan	JPY	-2.8%	-2.0%	-9.0%	-7.3%
Asia Pacific (ex Japan)	USD	-1.4%	-1.2%	-12.7%	-8.5%
Australia	AUD	0.3%	-0.7%	-2.5%	-0.8%
Global	USD	-3.7%	-3.1%	-4.9%	-2.9%
Emerging markets equities					
Emerging Europe	USD	2.0%	3.3%	-7.7%	-2.3%
Emerging Asia	USD	-1.8%	-1.4%	-14.3%	-10.3%
Emerging Latin America	USD	-0.3%	0.3%	-6.1%	-1.0%
BRICs	USD	-1.9%	-1.3%	-11.4%	-7.0%
MENA countries	USD	1.2%	1.5%	6.8%	9.7%
South Africa	USD	-1.1%	-3.2%	-25.1%	-14.2%
India	USD	-3.8%	-1.5%	-7.8%	-3.5%
Global emerging markets	USD	-1.3%	-1.0%	-13.4%	-8.7%
Bonds					
US Treasuries	USD	1.0%	1.2%	-0.4%	-0.3%
US Treasuries (inflation protected)	USD	0.7%	1.2%	-1.3%	-0.7%
US Corporate (investment grade)	USD	0.8%	0.7%	-3.2%	-2.7%
US High Yield	USD	-0.1%	0.0%	-0.1%	0.2%
UK Gilts	GBP	2.6%	2.3%	0.7%	1.6%
UK Corporate (investment grade)	GBP	0.8%	0.6%	-2.7%	-1.6%
Euro Government Bonds	EUR	0.4%	0.7%	0.3%	-1.1%
Euro Corporate (investment grade)	EUR	-0.1%	-0.1%	-1.6%	-2.3%
Euro High Yield	EUR	-0.6%	-0.7%	-4.1%	-4.0%
Japanese Government	JPY	0.1%	0.3%	0.3%	0.5%
Australian Government	AUD	1.0%	1.2%	4.3%	3.5%
Global Government Bonds	USD	1.1%	1.5%	-2.0%	-1.6%
Global Bonds	USD	0.9%	1.2%	-2.4%	-1.9%
Global Convertible Bonds	USD	-0.8%	-0.2%	-3.8%	-2.8%
Emerging Market Bonds	USD	0.8%	1.6%	-6.1%	-5.7%

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

Currency returns					
Asset class/region	Currency	Week ending 7 December	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	0.4%	1.4%	3.2%	3.8%
Australian Property Securities	AUD	4.7%	1.4%	2.6%	1.0%
Asia Property Securities	USD	1.3%	1.8%	-3.8%	-0.2%
Global Property Securities	USD	0.5%	0.8%	-2.0%	0.7%
Currencies					
Euro	USD	0.7%	0.4%	-5.2%	-3.4%
UK Pound Sterling	USD	-0.2%	-0.6%	-5.9%	-5.2%
Japanese Yen	USD	0.8%	0.9%	-0.1%	0.0%
Australian Dollar	USD	-1.2%	-1.2%	-7.7%	-4.2%
South African Rand	USD	-1.5%	-2.3%	-12.3%	-3.3%
Swiss Franc	USD	0.7%	0.4%	-1.8%	0.1%
Chinese Yuan	USD	1.2%	1.2%	-5.3%	-3.8%
Commodities & Alternatives					
Commodities	USD	1.9%	2.2%	-1.6%	3.3%
Agricultural Commodities	USD	1.3%	1.7%	-2.7%	-2.0%
Oil	USD	5.0%	5.0%	-7.8%	-0.9%
Gold	USD	2.1%	2.1%	-4.6%	-0.4%
Hedge funds	USD	-0.6%	-0.4%	-5.5%	-4.4%

Source: Bloomberg.

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