Hidden assets

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Recent years have demonstrated the flaws of a traditional 60/40 equity/bond portfolio. Such portfolios suffered one of their worst years on record in 2022, when accelerating inflation and rapidly rising interest rates proved a hostile environment for both global equities and global bonds. [1]Whilst the asset class mix arguably still serves well as a starting point in portfolio construction, we have long pursued greater diversification than that which a simple 60/40 portfolio composition offers.

In equities, we focus on complementary factors (value, growth, momentum etc) and seek boutique equity managers that invest in portfolios with high active share i.e. portfolios that differ substantially from regional or global benchmark indices. In addition, we have used alternative asset classes, such as infrastructure, property, royalties and specialist lending to avoid too much concentration in bonds. And even within our bond exposure, we have invested in niche strategies, such as short duration high yield, non-rated bonds and asset backed securities.

One more recent investment provides exposure to a hidden asset that many may not have contemplated before - volatility. Its adjective is often used to describe markets, particularly during periods of market stress and equity market declines, but seldom do people realise that it is also an investible asset class in itself.

Many investors have probably read or heard about the VIX, often referred to as the 'Fear Gauge'. VIX is effectively a measure of how volatile traders expect the S&P 500 to be over the next 30 days. The figure is actually reverse engineered from quoted option prices on the S&P 500.

Futures contracts are tradable on the VIX enabling investors to gain direct exposure to volatility. The beauty of having exposure to VIX is that it typically does the opposite to equity markets i.e. when equity markets fall, VIX usually rises and often spikes. Its inverse correlation to equity markets is what makes it a useful diversifier in multi-asset portfolios.

The problem with using VIX futures, however, is that there is a significant cost to holding the position. This is because VIX futures typically trade at a premium to VIX itself. VIX today trades at 13.2, whilst the futures contract expiring 18 June trades at 14.7 i.e. an 11% premium. [2]If VIX doesn't move between now and when the June contract expires on the 18th, then the futures contract will expire at 13.2 i.e. 10% below the level paid for it (14.7). That's a heavy loss to incur in just a little over five weeks and an expensive "cost of carry" which requires very good timing to ever make money!

We have found a strategy that has the benefit of providing exposure to volatility but without suffering an expensive cost of carry. The Alpha Volatility strategy is run by German-based Assenagon Asset Management S.A. and is essentially a dispersion strategy. What is dispersion when it comes to the stock market, I hear you ask. Dispersion is the average absolute difference between the return of each individual stock in a basket of stocks and the return of that basket of stocks as a whole.

Imagine a basket of 10 equally weighted stocks. If all 10 stocks are up 10% in one month's time, then the overall basket will have returned 10%, however, the dispersion of returns will be 0%. This is because each individual stock has returned the same as the overall basket – 10%. However, now imagine that 5 of those stocks rallied 10% and 5 fell 10%. In this instance, the overall basket has returned nothing, however, the dispersion of returns is 10%. This is because the absolute difference between each individual stock's return and the return of the overall basket is 10%.

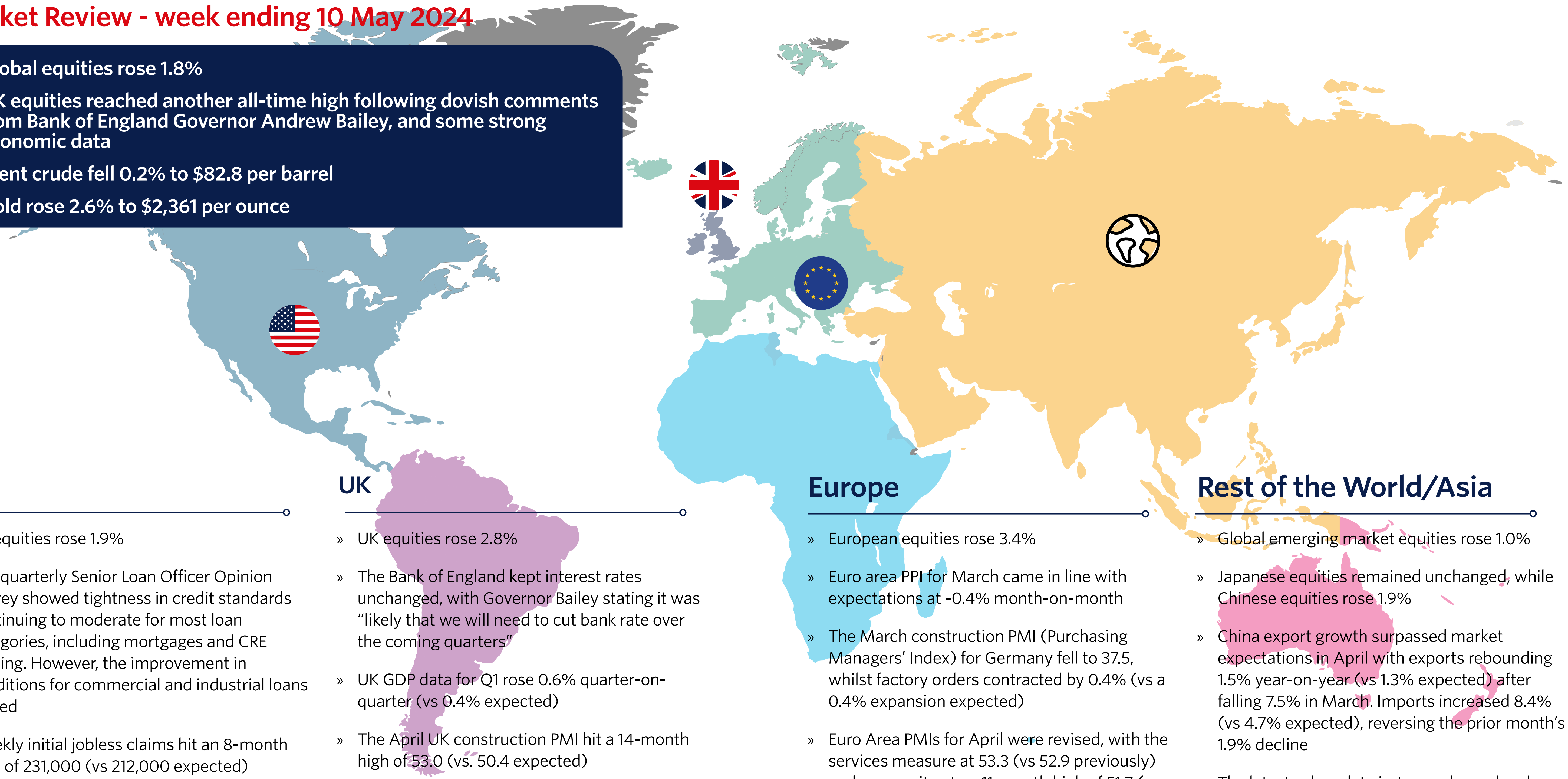
Now imagine that 5 of the stocks fell 10% and 5 of the stocks fell 30%. The overall basket will have fallen 20% but the dispersion of returns will still have been 10%. This is because the absolute difference between each individual stock return and the basket return is 10%. Some stocks fell 10% and some fell 30% but, in both cases, the absolute difference between the negative return of the stock and the basket's return of -20% is 10%.

So, what we have observed is that the dispersion of returns can actually be positive when markets fall (when the basket fell 20%, the dispersion of returns was +10%) making it a great diversifier. The strategy employed by Assenagon has been actively managed since 2011 using a proprietary database and trading platform. It essentially takes positions in individual stocks that enable it to benefit when the dispersion of returns between those stocks is greater than what the market was expecting.

Whilst we do not wish investors to suffer volatile markets, it's useful to know that there are strategies out there that typically benefit from

Sources: [1]Momentum Global Investment Management, 60% MSCI World, 40% US Treasuries, USD TR, 1977-2022 , [2]Bloomberg Finance L.P, 9 May 2024.

Market Review - week ending 10 May 2024



- Global equities rose 1.8%
- UK equities reached another all-time high following dovish comments from Bank of England Governor Andrew Bailey, and some strong economic data
- Brent crude fell 0.2% to $82.8 per barrel
- Gold rose 2.6% to $2,361 per ounce

US

- US equities rose 1.9%
- The quarterly Senior Loan Officer Opinion Survey showed tightness in credit standards continuing to moderate for most loan categories, including mortgages and CRE lending. However, the improvement in conditions for commercial and industrial loans stalled
- Weekly initial jobless claims hit an 8-month high of 231,000 (vs 212,000 expected)
- The University of Michigan's preliminary consumer sentiment index showed the headline sentiment index dropping well below expectations, falling from 77.2 to 67.4 (vs 76.2 expected)

UK

- UK equities rose 2.8%
- The Bank of England kept interest rates unchanged, with Governor Bailey stating it was "likely that we will need to cut bank rate over the coming quarters"
- UK GDP data for Q1 rose 0.6% quarter-on-quarter (vs 0.4% expected)
- The April UK construction PMI hit a 14-month high of 53.0 (vs. 50.4 expected)

Europe

- European equities rose 3.4%
- Euro area PPI for March came in line with expectations at -0.4% month-on-month
- The March construction PMI (Purchasing Managers' Index) for Germany fell to 37.5, whilst factory orders contracted by 0.4% (vs a 0.4% expansion expected)
- Euro Area PMIs for April were revised, with the services measure at 53.3 (vs 52.9 previously) and composite at an 11-month high of 51.7 (vs 51.4 previously)
- Euro Area retail sales rose 0.8% in March (vs 0.7% expected)
- The Swedish Riksbank became the second central bank with a G10 currency to cut rates in this cycle

Rest of the World/Asia

- Global emerging market equities rose 1.0%
- Japanese equities remained unchanged, while Chinese equities rose 1.9%
- China export growth surpassed market expectations in April with exports rebounding 1.5% year-on-year (vs 1.3% expected) after falling 7.5% in March. Imports increased 8.4% (vs 4.7% expected), reversing the prior month's 1.9% decline
- The latest salary data in Japan showed real wages falling 2.5% year-on-year in March (vs -1.4% expected), notching the sharpest drop in four months and extending the streak of declines to 24 months
- Chinese consumer inflation rose 0.3% year-on-year in April (vs 0.2% expected), however PPI fell 2.5% (vs -2.3% expected)

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Market Performance - week ending 10 May 2024

Asset Class / Region	Currency	Week ending 10 May	Month to date	YTD 2024	12 months
		Cumulative returns			
Developed Markets Equities					
United States	USD	1.9%	3.7%	9.9%	27.6%
United Kingdom	GBP	2.8%	3.7%	11.0%	13.5%
Continental Europe	EUR	3.4%	3.6%	9.9%	15.3%
Japan	JPY	0.0%	-0.5%	16.4%	33.8%
Asia Pacific (ex Japan)	USD	1.2%	2.9%	5.5%	10.3%
Australia	AUD	1.8%	1.3%	3.6%	11.2%
Global	USD	1.8%	3.6%	8.6%	23.1%
Emerging Markets Equities					
Emerging Europe	USD	1.8%	2.8%	14.5%	36.5%
Emerging Asia	USD	1.1%	2.7%	7.1%	12.6%
Emerging Latin America	USD	0.1%	2.9%	-4.6%	14.7%
BRICs	USD	0.3%	3.0%	6.9%	10.0%
China	USD	1.9%	6.4%	10.9%	0.1%
MENA countries	USD	-0.1%	-0.7%	-1.1%	2.5%
South Africa	USD	3.2%	5.5%	1.1%	8.0%
India	USD	-1.9%	-2.4%	1.4%	19.6%
Global emerging markets	USD	1.0%	2.6%	5.5%	12.3%
Bonds					
US Treasuries	USD	0.1%	1.2%	-2.1%	-1.9%
US Treasuries (inflation protected)	USD	0.1%	1.1%	-0.7%	-0.4%
US Corporate (investment grade)	USD	0.1%	1.3%	-1.1%	3.3%
US High Yield	USD	0.0%	1.0%	1.5%	10.3%
UK Gilts	GBP	0.7%	1.6%	-3.1%	0.7%
UK Corporate (investment grade)	GBP	0.8%	1.6%	-0.3%	7.1%
Euro Government Bonds	EUR	-0.1%	0.4%	-1.6%	2.8%
Euro Corporate (investment grade)	EUR	0.1%	0.5%	0.1%	5.5%
Euro High Yield	EUR	0.4%	0.5%	2.2%	10.8%
Global Government Bonds	USD	-0.2%	1.1%	-4.2%	-3.5%
Global Bonds	USD	0.0%	1.2%	-3.2%	-0.9%
*Global Convertible Bonds	USD	0.9%	0.9%	-1.6%	4.6%
Emerging Market Bonds	USD	0.5%	1.5%	0.5%	8.2%

Asset Class / Region	Currency	Week ending 10 May	Month to date	YTD 2024	12 months
		Cumulative returns			
Property					
US Property Securities	USD	1.9%	4.0%	-4.0%	4.2%
Australian Property Securities	AUD	2.4%	3.1%	10.3%	17.7%
Asia Property Securities	USD	-0.2%	2.3%	-2.7%	-4.9%
Global Property Securities	USD	1.0%	3.3%	-2.4%	5.6%
Currencies					
Euro	USD	0.1%	0.9%	-2.6%	-1.8%
UK Pound Sterling	USD	-0.1%	0.2%	-1.8%	-0.7%
Japanese Yen	USD	-1.9%	1.0%	-9.6%	-13.8%
Australian Dollar	USD	-0.1%	1.8%	-3.3%	-2.3%
South African Rand	USD	0.5%	2.1%	-0.9%	2.6%
Swiss Franc	USD	0.0%	1.3%	-7.4%	-1.7%
**Chinese Yuan	USD	0.2%	0.2%	-1.7%	-4.1%
Commodities & Alternatives					
Commodities	USD	1.4%	0.5%	7.9%	10.7%
Agricultural Commodities	USD	1.8%	2.7%	6.1%	8.7%
Oil	USD	-0.2%	-5.8%	7.5%	8.3%
Gold	USD	2.6%	2.9%	14.4%	16.4%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.
*Data as at 29 April 2024 **Data as at 30 April 2024

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