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Weekly

momentum
global investment management

Momentum Investing at Momentum

Identifying trends and catalysts in stocks requires skill and experience...

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Last week my colleague Gary Moglione shared his thoughts on the advantages of adopting a contrarian stance or going against the crowd when it comes to investing, which can be very rewarding if investors can exercise patience and take a long-term perspective. This approach is commonly referred to as value investing, where the underlying concept involves seeking undervalued assets. However, there are other approaches to investing which can also generate strong returns if you have the required skill set and mentality. Simply put, the converse of the contrarian approach is known as momentum or growth investing. Both investment styles aim to harvest factor risk premia, whether it be value or momentum. Over the long-term, both approaches have generated above market returns but they are cyclical in nature. For instance, in 2021 and 2022 we saw value outperform its growth counterpart, while in 2020 and for most of the previous decade we witnessed phenomenal performance of momentum and growth stocks. So, which approach should investors adopt?

As with all equity styles or factors there are multiple approaches to momentum investing. The most basic is price momentum. Price momentum involves buying stocks that have already experienced price increases based on the belief that stocks which have performed well in the past will likely continue to perform well and vice-versa for underperforming stocks. This strategy is effectively buying past winners and selling past losers – fairly straightforward.

The other common approach to momentum investing is to focus on company fundamentals, such as earnings growth. The emphasis on growth is the reason momentum investing is often used interchangeably with growth investing. Typically, these strategies look to identify companies with sustainably high earnings that are also growing at an accelerated rate. These companies would also tend to exhibit positive earnings surprises or revisions.

The momentum risk premium or the momentum effect is well documented and has been around for decades. Momentum investing challenges the conventional wisdom of the Efficient Market Hypothesis (EMH), which broadly states that stock prices at any given time should reflect all publicly available information and assumes that all investors are rational, meaning that garnering additional returns is nigh on impossible. However, this belief in efficient markets doesn't hold, as this type of strategy has proven to reward investors with above market returns consistently over the long-term.

Why does it work? Many explanations are offered for why this phenomenon exists; however, most can be explained by behavioural biases. Investors either overreact or underreact to information in a way that is remarkably consistent through time. The underreaction effect causes information to take longer to be fully priced in, as analysts fail to revise earnings forecasts sufficiently in response to new information. Overreactions to market events can result in excessive declines in prices following bad news, while underreactions lead to miserly increases following positive news.

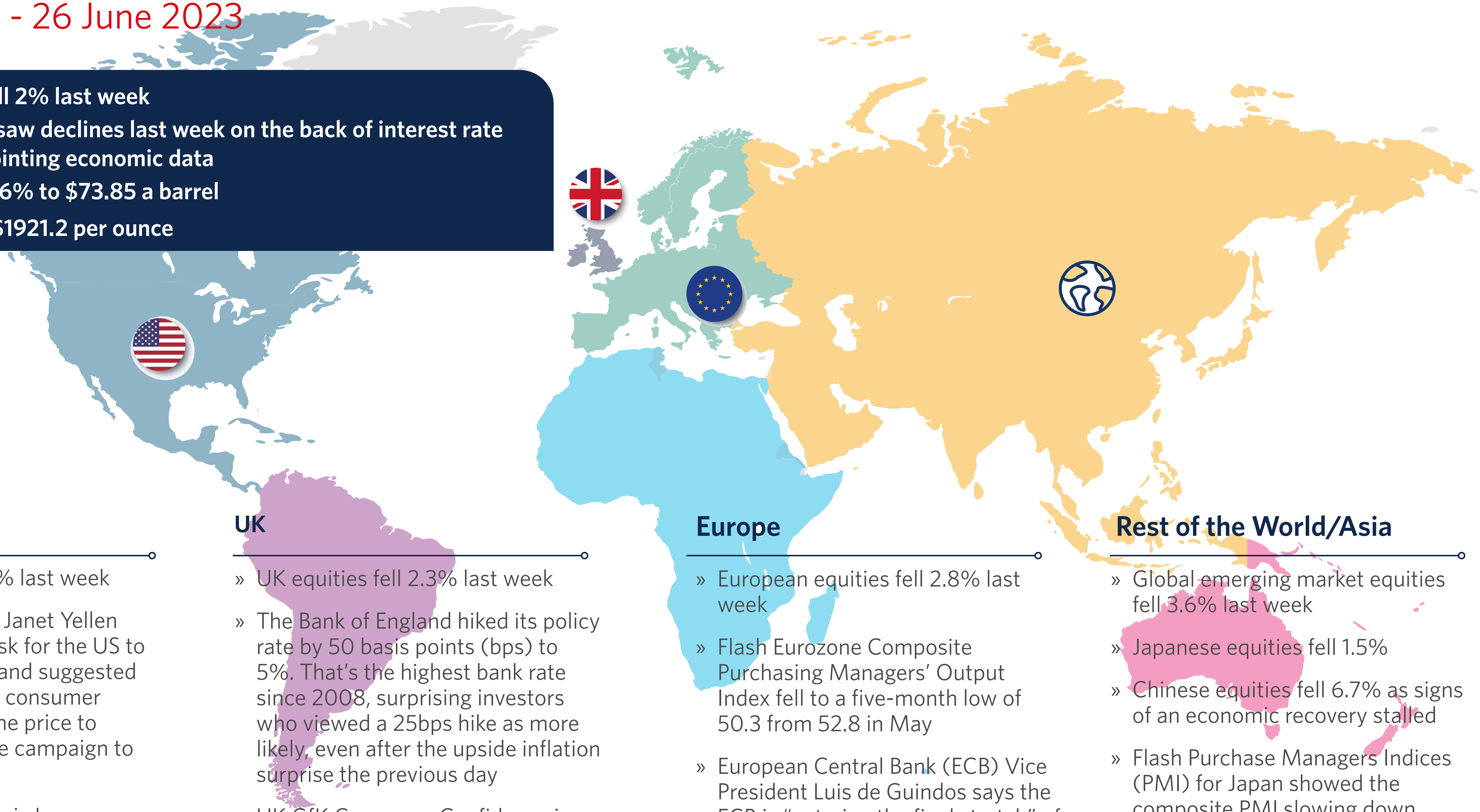
The so-called disposition effect is another popular theory – it says that investors' fear of potential losses causes them to sell winners too early whilst holding onto losers longer in the hope of an eventual recovery – this relates closely to the concept of loss aversion. Lastly, herd mentality or fear of missing out (FOMO) is another phenomenon which can spur stock prices to gather momentum, as investors jump on a rapidly rising trend, something we've seen recently with AI-related stocks.

Momentum investing often sounds simple to exploit, but in reality, it is a highly nuanced strategy with a high propensity for crashes. This added risk is another reason cited for momentum investing's success: it is a reward for accepting higher levels of risk. Identifying trends and catalysts in stocks requires skill and experience – but it is equally important to recognise when the momentum or trend has waned, as knowing when to exit positions is crucial to capturing the full momentum effect. It is therefore operationally challenging due to its inherently high turnover nature, hence not one for the novice investor. We advocate gaining exposure through third-party specialists and we have invested with some of the best momentum and growth managers for many years.

As with any equity style or factor, there are better and worse times to adopt a momentum strategy, but, in our view the best way to ensure a smoother investment journey is to hold a blend of different styles through the cycle.

Market Focus - 26 June 2023

- **Global equities fell 2% last week**
- **All major indices saw declines last week on the back of interest rate hikes and disappointing economic data**
- **Brent crude fell 3.6% to $73.85 a barrel**
- **Gold fell 1.9% to $1921.2 per ounce**



US

- US equities fell 1.4% last week
- Treasury Secretary Janet Yellen sees diminishing risk for the US to fall into recession, and suggested that a slowdown in consumer spending may be the price to pay for finishing the campaign to contain inflation
- Federal Reserve Chair Jerome Powell continues to say returning US inflation to 2% is crucial to support the long-term health of the US economy, and that more interest-rate increases may be needed this year
- US weekly jobless claims came in at 264k (vs. 259k expected) over the week ending June 17 2023

UK

- UK equities fell 2.3% last week
- The Bank of England hiked its policy rate by 50 basis points (bps) to 5%. That's the highest bank rate since 2008, surprising investors who viewed a 25bps hike as more likely, even after the upside inflation surprise the previous day
- UK GfK Consumer Confidence in June was -24, versus an estimated -26, improving more than expected, and reaching its strongest level in 17 months despite elevated inflation and soaring interest rates

Europe

- European equities fell 2.8% last week
- Flash Eurozone Composite Purchasing Managers' Output Index fell to a five-month low of 50.3 from 52.8 in May
- European Central Bank (ECB) Vice President Luis de Guindos says the ECB is "entering the final stretch" of its tightening cycle

Rest of the World/Asia

- Global emerging market equities fell 3.6% last week
- Japanese equities fell 1.5%
- Chinese equities fell 6.7% as signs of an economic recovery stalled
- Flash Purchase Managers Indices (PMI) for Japan showed the composite PMI slowing down relative to May to 52.3. Meanwhile, Australia's flash reading came in at 50.5
- An adviser to Ukrainian President Volodymyr Zelenskiy said there have been no indications the Wagner mercenary group is retreating from conflict areas in the country after its leader Yevgeny Prigozhin agreed to go into exile

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

Market Summary

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 23 June**	**Month to date**	**YTD 2023**	**12 months**
Developed Markets Equities					
United States	USD	-1.4%	4.1%	13.9%	15.9%
United Kingdom	GBP	-2.3%	0.4%	1.7%	9.6%
Continental Europe	EUR	-2.8%	0.4%	10.1%	18.1%
Japan	JPY	-1.5%	6.3%	21.3%	25.7%
Asia Pacific (ex Japan)	USD	-4.1%	2.9%	2.8%	1.5%
Australia	AUD	-2.1%	0.1%	2.8%	13.8%
Global	USD	-2.0%	3.7%	12.6%	15.8%
Emerging Markets Equities					
Emerging Europe	USD	-2.6%	6.6%	12.6%	39.7%
Emerging Asia	USD	-4.1%	2.8%	4.0%	0.1%
Emerging Latin America	USD	-0.6%	12.6%	19.2%	30.7%
BRICs	USD	-4.4%	4.8%	-0.9%	-4.2%
China	USD	-6.7%	4.0%	-5.5%	-14.8%
MENA countries	USD	-0.4%	3.2%	3.1%	-2.6%
South Africa	USD	-8.1%	7.9%	-6.9%	-5.2%
India	USD	-0.3%	2.4%	5.2%	16.4%
Global emerging markets	USD	-3.6%	3.8%	4.9%	2.6%
Bonds					
US Treasuries	USD	0.2%	-0.3%	2.2%	-1.1%
US Treasuries (inflation protected)	USD	0.2%	0.1%	2.3%	-2.3%
US Corporate (investment grade)	USD	0.2%	0.3%	3.2%	1.6%
US High Yield	USD	-0.8%	0.8%	4.6%	6.6%
UK Gilts	GBP	0.6%	-0.3%	-3.5%	-15.1%
UK Corporate (investment grade)	GBP	0.2%	-0.7%	-0.5%	-7.1%
Euro Government Bonds	EUR	0.6%	0.1%	3.0%	-4.2%
Euro Corporate (investment grade)	EUR	0.3%	-0.2%	2.3%	-0.1%
Euro High Yield	EUR	-0.5%	0.6%	4.4%	6.5%
Japanese Government	JPY	0.2%	0.5%	3.1%	0.3%
Australian Government	AUD	0.3%	-2.1%	1.4%	2.2%
Global Government Bonds	USD	-0.2%	0.1%	1.3%	-2.6%
Global Bonds	USD	0.0%	0.5%	2.5%	-0.9%
Global Convertible Bonds	USD	-1.5%	2.7%	4.1%	5.7%
Emerging Market Bonds	USD	0.5%	2.2%	3.3%	4.4%

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 23 June**	**Month to date**	**YTD 2023**	**12 months**
Property					
US Property Securities	USD	-4.8%	-0.4%	-0.4%	-6.1%
Australian Property Securities	AUD	-3.2%	-4.2%	-1.0%	-1.8%
Asia Property Securities	USD	-4.3%	1.4%	-7.4%	-10.1%
Global Property Securities	USD	-4.7%	0.0%	-2.3%	-7.2%
Currencies					
Euro	USD	-0.4%	2.3%	1.6%	3.6%
UK Pound Sterling	USD	-1.0%	2.5%	5.0%	3.9%
Japanese Yen	USD	-1.4%	-2.9%	-8.9%	-6.3%
Australian Dollar	USD	-2.7%	3.4%	-2.0%	-2.9%
South African Rand	USD	-3.1%	5.3%	-9.2%	-14.8%
Swiss Franc	USD	-0.5%	1.8%	2.6%	7.0%
Chinese Yuan*	USD	-0.7%	-0.9%	-3.9%	-6.7%
Commodities & Alternatives					
Commodities	USD	-2.3%	5.3%	-6.4%	-10.6%
Agricultural Commodities	USD	-0.9%	9.6%	4.2%	2.0%
Oil	USD	-3.6%	1.6%	-14.0%	-32.9%
Gold	USD	-1.9%	-2.2%	5.3%	5.0%
Hedge funds	USD	-0.2%	0.6%	0.5%	1.1%

*Chinese Yuan as at 21/06/2023

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

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