MitonOptimal

Surviving a rip current

Managing Director in the UK and Fund Manager, James Sullivan, looks at the macro environment and, amidst all the uncertainty, reminds us not to panic. Whilst his views are specific to the UK multi-asset portfolios his overarching message applies to us all.

It's my turn to write a note that goes out to our supporters offshore. I enjoy writing when I have something to say, and yet find it hard when presented with a deadline to produce 500 words.

One may think that the events of the past few days would have provided plenty of material, and they'd be right of course. I agree that the escalation of trade wars spilling over into the currency markets isn't ideal, whilst the gravity of global and local political polarisation doesn't offer much hope for compromise. Negative rates on more than $13 trillion worth of bonds doesn't bode well and blurs the lens through which one values equities.

However, there is nothing original that I can write on such herculean subjects that hasn't already been said and digested several times over in recent days.

What I can say with honesty, however, is that we will get pushed around by these markets like a lot of other market participants. We will undoubtedly feel bruised as our prices get caught up in the market maelstrom. Cheap markets will be impacted negatively by current events. Good quality companies and sectors will suffer. The market will show little consideration for fundamentals. Short term equity momentum is often powerful, displaying the characteristics of a rip current. One is best not to try and swim against it in fear of exhaustion and death.

Someone somewhere once spoke of 'known knowns'. Well, nothing that has triggered the events of the past few days was new material. It has been hiding in plain sight. There is always a danger that when significant market moves come in to play, emotion takes over and one's fears are heightened, further accelerating the issue. Selling into a correction is unlikely to trigger exhaustion or death, but it can be a rather painful experience to chase the market down.

We're not sure the facts have changed enough for us to change direction. We were comfortable with our portfolio last week, and remain even more comfortable with it today with markets 6% cheaper. Our only regret, perhaps, is having duration of 2 years, and not 10 on our fixed income book.

Continued overleaf

The solace we have is that our investment process is robust. It is more robust and tangible than it ever has been. Our investment process performs the role of a lighthouse; it doesn't dictate our direction of travel, but it does guide us, and help us from straying too close to the rocks.

We believe our multi-asset portfolios to be well balanced, with a bias towards markets that are trading below their historical average, in markets where the currencies offer value on a purchasing power parity basis. Frustratingly for us, perhaps, the US equity market has led the way for several years, yet it's a market we remain concerned by and subsequently underweight. The vast majority of appreciation in the various US indices has come from multiple expansion, whilst the currency looks to be rich in valuation versus most others. We have chosen to deploy our risk budget into regions and markets that suggest the upside potential is yet to be realised, paired with downside risks mitigated by below average starting valuations and pay-out ratios.

Rip currents tend to die out just beyond the last breaking waves, which feels pertinent. It is over shortly after what feels like the most extreme point, the point when doubt and fatigue begins to creep in.

We're not sure if we've seen the last set of waves just yet, but recognise the last thing we need to be doing right now is panicking.

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James Sullivan
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