Is active management dead?

Global Matters Weekly

6 March 2023

– Gabby Byron — *Investment Services Executive*

Investment bubbles have occurred throughout history when the prices of certain assets rise to extremely high and unsustainable levels driven by a variety of reasons, including raw speculation. Eventually, these bubbles "pop" causing prices to plummet, and investors are left with significant losses. Echo bubbles (often referred to as a dead cat bounce) are post-bubble rallies which can occur for a similar variety of reasons, including investors' failure to learn from past mistakes or a view that the market has corrected itself and is now undervalued.

Investment bubbles are often driven by speculation; when investors are confident that an asset is going to increase in value, they start piling in, pushing prices higher and ultimately to further and further beyond the intrinsic value. This pattern can continue until something causes the bubble to burst. The cryptocurrency market is a recent example and has experienced several bubbles, with prices rising and falling dramatically. In late 2021, the price of Bitcoin surpassed $60,000 per token, driven by speculation and hype. However, the bubble eventually burst falling over 70% from its peak in November 2021 to end 2022 at around $16,500.

Additionally, investor psychology also plays a huge role in the forming of investment bubbles. When people see others benefitting from a rapid increase in an asset's price, they can get 'FOMO' (fear of missing out), creating a herd mentality or self-perpetuating cycle, where one invests in an asset simply because others are doing it, which then pushes prices even higher.

Some bubbles have a recognisable 'pin' that bursts the bubble, forcing investors to reconsider the value of the asset. For example, many technology and consumer discretionary stocks benefitted enormously during the pandemic following the stay-at-home trend and valuations of these stocks reached extreme highs. As economies returned to normality, and central banks began addressing more persistent inflation by raising interest rates, investors became spooked by the much more aggressive monetary and fiscal tightening paths (growth stocks are more sensitive to interest rate rises as investors expect higher earnings further out in the future, so the higher the interest rates used to discount their future earnings are, the more the present value of those earnings then decreases). We saw a sharp sell-off in this cohort of stocks in 2022 with the NYSE FANG+ index falling -40% and MSCI World Growth down -29% in US dollar terms.

As the saying goes, "You never know you're in a bubble until it bursts"

There was a sharp rebound across most riskier assets in January 2023 with investors seemingly taking a more bullish view, particularly on the path of interest rates. Markets were boosted by growing confidence that we were past peak inflation in the US and Europe, leading investors to moderate their rate hike expectations. Growth stocks outperformed value stocks and the technology sector started bouncing back with the NYSE FANG+ index up more than 20% over the three months to the end of January. However, recent data released in the US has shown that economic activity remains robust, with ongoing tightness in the labour market meaning that inflation is proving more resilient than expected. This raises the probability of higher-for-longer policy rates which potentially forced investors to reappraise their positioning and as a result investors have experienced a bumpier ride throughout February.

So, how can investors avoid getting caught up in the effects of an investment bubble? As the saying goes, "You never know you're in a bubble until it bursts", so it is best to remain prudent and having a strong valuation-based approach will alleviate some of that risk. At Momentum, we take a disciplined valuation approach when it comes to appraising investments – with decisions underpinned by estimates of the intrinsic/fair value of any given investment opportunity in order to focus on those with underappreciated return potential and avoid those where their current market price suggests expectations are too ambitious. This helps us make informed, disciplined decisions about whether to

Sources: Momentum Global Investment Management, Bloomberg Finance L.P.

buy, hold or sell an investment based on its future expected return potential. It also helps us avoid making emotional and impulsive investment decisions based on short-term market fluctuations and trends.

We continue to see a lot of opportunities in value stocks and the current environment of high inflation and higher rates should be supportive for many of the constituents.

Diversification is critical to help manage risk – by investing in a variety of asset classes and investment styles at attractive valuations, investors can spread their risk and reduce volatility whilst minimising drawdowns. Building in additional diversification levers to further smooth the investment journey is an approach that we have always adhered to and have implemented successfully over the decades.

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The **Marketplace**

- Global equities returned 1.9% last week
- All major indices saw positive returns in the week
- Brent crude rose 3.2% to $85.83 per barrel
- Gold returned 2.5% to $1856.48 per ounce

Market **Focus**

US

- US equities returned 1.9% last week, with metal, mining and social media outperforming, while banking and utilities underperformed
- Two Fed officials said recent robust economic data could push them to hike interest rates by more than previously expected. Christopher Waller's commented that "if wage and inflation figures cool, a peak rate between 5.1% and 5.4% makes sense"
- US pending home sales month-on-month for January was 8.1% (vs 1% forecast)
- US ISM manufacturing Purchasing Managers' Index (PMI) for February was 47.7 (vs 48% expected), and Non-manufacturing was 55.1 (vs 54.5 expected)

Europe

- European equities returned 1.7% last week, with auto, parts, and basic resources outperforming while oil, gas and media underperformed
- European Central Bank's Pierre Wunsch said, "If we don't get clear signals that core inflation is going down we will have to do more, looking at rates of 4% would not be excluded"
- European Consumer Price Index year-on-year for February was 8.5% (vs 8.2% expected)
- Germany's manufacturing PMI for February was 46.3 (vs 46.5 expected)

UK

- UK equities returned 0.9% last week
- UK manufacturing PMI for February was 49.3 (vs 49.2 expected)
- Prices in UK stores rose last month at the fastest rate since at least 2005, as the cost-of-living crisis showed little sign of abating. The British Retail Consortium said shop price inflation accelerated to 8.4%, with food prices rising to 14.5%

Asia/Rest of The World

- Global emerging markets returned 1.7% last week
- Japanese equities returned 1.6% last week
- Chinese equities returned 3.7% last week, aided by manufacturing PMI for February at 52.6 (vs 50.5 expected)
- China expects GDP to grow "around 5%" this year, a goal that many economists considered reasonably modest. The National People's Congress will increase defence spending by 7.2% this year due to "complex security challenges"

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Asset Class/Region	Currency	Currency returns			
		Week ending 3 Mar. 2023	Month to date	YTD 2023	12 months
Developed Market Equities					
United States	USD	1.9%	1.9%	5.6%	-6.2%
United Kingdom	GBP	0.9%	1.0%	7.2%	14.9%
Continental Europe	EUR	1.7%	1.0%	10.2%	9.8%
Japan	JPY	1.6%	1.3%	6.8%	10.2%
Asia Pacific (ex Japan)	USD	1.5%	2.4%	3.7%	-9.6%
Australia	AUD	0.0%	0.5%	4.2%	6.0%
Global	USD	1.9%	1.6%	6.2%	-4.7%
Emerging markets equities					
Emerging Europe	USD	2.7%	-0.4%	5.5%	-45.6%
Emerging Asia	USD	1.8%	2.9%	4.1%	-12.4%
Emerging Latin America	USD	1.0%	1.4%	4.5%	-1.8%
BRICs	USD	2.6%	3.8%	1.5%	-12.1%
China	USD	3.7%	5.0%	5.2%	-10.5%
MENA countries	USD	1.0%	1.0%	-1.5%	-19.1%
South Africa	USD	2.9%	1.5%	-2.3%	-19.4%
India	USD	2.3%	2.9%	-1.5%	0.3%
Global emerging markets	USD	1.7%	2.5%	3.4%	-13.3%
Bonds					
US Treasuries	USD	0.1%	-0.1%	0.2%	-9.6%
US Treasuries (inflation protected)	USD	1.3%	0.8%	1.3%	-10.2%
US Corporate (investment grade)	USD	0.3%	0.1%	1.0%	-9.5%
US High Yield	USD	0.8%	0.3%	2.9%	-5.3%
UK Gilts	GBP	-1.1%	-0.6%	-1.4%	-22.1%
UK Corporate (investment grade)	GBP	-0.7%	-0.4%	1.1%	-14.1%
Euro Government Bonds	EUR	-1.2%	-0.5%	-0.4%	-17.3%
Euro Corporate (investment grade)	EUR	-0.9%	-0.5%	0.1%	-10.9%
Euro High Yield	EUR	-0.3%	-0.1%	2.9%	-4.3%
Japanese Government	JPY	0.3%	-0.2%	0.7%	-3.9%
Australian Government	AUD	-0.3%	-0.2%	1.2%	-7.2%
Global Government Bonds	USD	0.0%	-0.3%	-0.7%	-15.3%
Global Bonds	USD	-0.1%	-0.3%	-0.3%	-14.0%
Global Convertible Bonds	USD	0.9%	0.8%	2.8%	-10.0%
Emerging Market Bonds	USD	-0.4%	-0.2%	-0.1%	-11.6%

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

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Asset Class/Region	Currency	Currency returns			
		Week ending 3 Mar. 2023	Month to date	YTD 2023	12 months
Property					
US Property Securities	USD	1.2%	1.4%	6.8%	-13.3%
Australian Property Securities	AUD	-3.4%	-2.6%	4.5%	-11.4%
Asia Property Securities	USD	0.3%	0.8%	-2.4%	-10.5%
Global Property Securities	USD	0.7%	0.5%	3.8%	-14.8%
Currencies					
Euro	USD	0.7%	0.2%	-0.8%	-3.9%
UK Pound Sterling	USD	0.5%	-0.7%	-0.7%	-9.9%
Japanese Yen	USD	0.3%	-0.2%	-3.7%	-15.1%
Australian Dollar	USD	0.5%	0.1%	-0.9%	-7.6%
South African Rand	USD	1.4%	0.9%	-6.2%	-16.3%
Swiss Franc	USD	0.3%	0.0%	-1.7%	-1.9%
Chinese Yuan	USD	0.8%	0.4%	-0.1%	-8.5%
Commodities & Alternatives					
Commodities	USD	3.1%	2.2%	-1.8%	-7.2%
Agricultural Commodities	USD	-0.4%	0.7%	-0.6%	-8.0%
Oil	USD	3.2%	2.3%	-0.1%	-22.3%
Gold	USD	2.5%	1.5%	1.8%	-3.9%
Hedge funds	USD	0.2%	0.2%	1.4%	-1.2%

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

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