PRIVATE CLIENT INDICES

Avoiding A Perfect Storm

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"Sell everything except high quality bonds. This is about return of capital, not return on capital. In a crowded hall the exit doors are small"
Andrew Roberts, RBS Head of Credit, 11th January 2016

"I cannot imagine any condition which would cause a ship to founder. I cannot conceive of any vital disaster happening to this vessel. Modern shipbuilding has gone beyond that."
Captain of the Titanic, Edward Smith

Review of 2016

At the start of 2016 the prevailing market sentiment was one of nervousness that both equity and bond prices were going to struggle as global debt ratios were predicted to reach new highs, world economic growth stagnate; commodity prices collapse; and currencies face turmoil as the debt-driven Chinese economic expansion abruptly ended. Whilst at the extreme end of the scale, the views of Andrew Roberts were not as outlandish as they might appear to investors looking back on a year of solid if not spectacular investment returns.

Of course there were dissenters to the doomsday scenario set forth by RBS and the economist Stephen Koukoulas challenged Andrew Roberts to back his prediction with an Australian Dollar 10,000 wager. If six or more of the eleven metrics chosen by Mr Koukoulas were lower on December 31st 2016, Mr Roberts would win. The metrics were: US equities; Brazil equities; Chinese equities; Japanese equities; US house prices; UK house prices; Sydney house prices; iron ore; oil; copper; and the Australian Dollar versus the US Dollar. Such a display of overconfidence in the other direction is reminiscent of the famous statement by the captain of the Titanic that he could not even imagine disaster happening to the vessel given the advances of technology.

Mr Roberts would have lost the wager, although Chinese stocks did struggle during 2016 and the US Dollar was surprisingly buoyant. However, as ever in financial markets, there were times during the year when the pessimists seemed to have it right and times when the optimists appeared in the ascendant. In other words, the path was bumpy not least as there were several political events where voters surprised pundits and pollsters: BREXIT; Trump and Italian reform being the three biggest shocks.

The table below sets out the ARC Private Client Indices ("PCI") final results for 2016 across the four PCI risk categories and across four currencies.

ARC Private Client Indices Performance Table
2016

Private Client Index (PCI)	Risk relative to World Equities	GBP	USD	CHF	EUR
ARC Cautious PCI	0 – 40%	5.5	2.5	1.0	1.6
ARC Balanced Asset PCI	40 – 60%	8.6	2.5	2.4	1.2
ARC Steady Growth PCI	60 – 80%	11.6	2.7	3.7	2.2
ARC Equity Risk PCI	80 – 110%	13.7	2.9	4.8	2.2

At first glance the returns for Sterling investors look very strong. However, with Sterling falling by over 15% on a trade weighted basis during the year, to its lowest level since 1990, most Sterling investors have seen the international buying power of their wealth decline.

The two key performance differentiators for the year were undoubtedly the extent of international currency exposure and exposure to North American equities.

For private client portfolios with a reference currency of US Dollar, Euro or Swiss Franc, the PCI figures generally reveal another year of muted returns in 2016 across all risk categories.

- US Dollar denominated portfolios experienced gains in the 2-5% range;
- Swiss Franc portfolios on average recorded gains in the 1-4% range; and
- Euro denominated portfolios on average saw gains of circa 2-3%.

However, many private client investors in US Dollars, Swiss Francs and Euros will still be nursing losses, with their portfolios at the end of 2016 perhaps 5% or more below the peak valuation level reached in mid-2015.

Looking at a somewhat longer period, the table below sets out the ARC Private Client Indices ("PCI") results for the three years ended December 2016 across the four PCI risk categories and across four currencies.

ARC Private Client Indices Performance Table
Three Years Ended December 2016

Private Client Index (PCI)	Risk relative to World Equities	GBP	USD	CHF	EUR
ARC Cautious PCI	0 – 40%	11.1	3.6	3.4	5.5
ARC Balanced Asset PCI	40 – 60%	15.7	3.6	8.0	8.5
ARC Steady Growth PCI	60 – 80%	19.4	3.9	10.7	13.5
ARC Equity Risk PCI	80 – 110%	20.8	4.1	13.6	16.2

Has my portfolio performed well?

At the end of each calendar year, most private client investors ask themselves this question: is my portfolio performance any good? PCI has been designed to assist private client investors in answering this question. Managers typically present performance versus one or more benchmarks (usually comprising one or more bond and equity market indices). Such comparisons answer the question of how well a portfolio has performed versus the financial markets. But most investors also want to know how well their portfolio has done versus other investors with similar portfolios. So here is a three step guide to assessing portfolio performance versus the ARC Private Client Indices universe of over 100,000 private client portfolios run by over 60 different discretionary investment managers.

Step 1: Select the appropriate PCI universe for comparison purposes

For each reference currency (GBP; USD; EUR; CHF) four indices are compiled based on targeted volatility ranges. The ranges are set out in the table above and are based on the volatility of a portfolio relative to that of world equities. As an example if a portfolio has a volatility of, say, 0.5 times that of world equities then it would be in the ARC Balanced Asset peer group universe. For those portfolios with a relative volatility on or near a boundary, for example 0.6 times world equity volatility, a judgement call will need to be made.

As a rule of thumb, the correct ARC PCI peer group can be guesstimated by taking the percentage allocated to equities as a proxy for the volatility relative to world equities. Thus if a portfolio had 63% allocated to equities and 37% allocated to other asset classes, it would probably be best compared against the ARC Steady Growth peer group universe.

Step 2: Compare portfolio performance versus the selected PCI

Once the peer group universe has been selected, it is relatively straightforward to compare performance of a portfolio versus the relevant PCI. Multiple time periods are recommended and longer time periods are to be preferred when seeking to draw conclusions on whether the manager has delivered an acceptable level of performance.

Step 3: Place portfolio performance into context versus the selected peer group universe

Whilst the relevant PCI will provide information on whether a portfolio has delivered a better return than the average private client portfolio with similar risk characteristics, much more information can be gleaned by examining performance versus the universe as a whole. There are two ways this can be achieved.

The first way is to examine performance versus the table below which is provided each quarter in the ARC PCI Report. This reveals quartile ranges for each of the PCI series. Thus, by way of example, over the last year returns for Sterling portfolios with a volatility profile of between 0.4 and 0.6 times that of world equities (the ARC Balanced Asset PCI universe) ranged from 10.5% for the 25th percentile manager and 7.7% for the 75th percentile manager.

Private Client Index (PCI)		Last Quarter	YTD	1 Year	3 Years	5 Years	10 Years
ARC Sterling Cautious PCI	25th Percentile	1.0	7.5	7.5	13.5	28.4	51.2
	75th Percentile	0.0	5.3	5.3	9.6	22.1	39.8
ARC Sterling Balanced Asset PCI	25th Percentile	2.0	10.5	10.5	18.3	41.3	59.8
	75th Percentile	1.1	7.7	7.7	14.6	33.5	51.4
ARC Sterling Steady Growth PCI	25th Percentile	2.7	12.6	12.6	21.1	50.9	70.9
	75th Percentile	1.9	9.9	9.9	15.9	41.0	53.6
ARC Sterling Equity Risk PCI	25th Percentile	3.7	15.5	15.5	23.5	59.4	81.5
	75th Percentile	2.3	11.3	11.3	18.5	50.0	64.4

The second way is to create a Portfolio Performance Report ("PPR") on www.suggestus.com which allows an investor to examine risk-adjusted performance versus the peer group universe. Every portfolio is given a performance grade based on where it sits versus portfolios with similar volatility characteristics. These peer group performance grades range from A to F and provide a simple way for an investor to assess whether their portfolio is performing well or lagging behind its peer group.

If your portfolio is run by one of the over sixty discretionary managers who contribute data to facilitate the compilation of the PCI, ARC can automatically load your data upon request making the process for an investor as painless as possible.

To find out whether your portfolio has performed well, log onto www.suggestus.com and create your own portfolio performance report. Registration is FREE!

Conclusions

- 2016 was a year when the threatened perfect storm never arrived. However, it was not all blue sky sailing either. After adjusting for the decline in the value of Sterling, most investors experienced very modest returns across the four PCI risk categories and all four PCI reference currencies.
- Trying to avoid overconfidence in either a pessimistic or an optimistic reading of the economic and geo-political tea leaves, evidence suggests that storm clouds continue to gather on the horizon. It will require agility of thinking and flexibility in asset allocation for discretionary managers to pilot a safe course through 2017 and beyond.

For further information:

Graham Harrison, Managing Director, +44 (0) 1481 817777, graham.harrison@assetrisk.com

A full list of Data Contributors to PCI is available at www.suggestus.com