Elgin asset management

investment commentary monthly

Monthly Commentary 4th May 2016

April was a month with flat or slightly positive returns in equities and bonds, while commodities surged 9%. This helped material and energy stocks that rose substantially, albeit from very low levels. Technology was hit hard as earnings from Google, Apple and Microsoft disappointed. Hedge funds had another difficult month as market leadership changed.

On Currency Forecasts and Portfolio Allocations

The USD fell hard in April, a trend that is continuing into May. This has once again confounded almost every forecaster. While we are not surprised that collectively, so many analysts have been wrong, it is worth mentioning portfolio implications.

Below is a table that shows the EURUSD forecasts from the end of 2015.

Region G10 | Currency Euro | As of 12/31/15

EURUSD			Q1 16	Q2 16	Q3 16	Q4 16	2017	2018	2019	2020
Spot	1.09	Median	1.05	1.04	1.05	1.06	1.10	1.18	1.21	1.24
Q3 15	Actual	Mean	1.06	1.05	1.05	1.06	1.12	1.15	1.19	1.24
	1.12	High	1.15	1.19	1.18	1.20	1.30	1.25	1.32	1.30
Q3 15	Forecast	Low	.99	.95	.95	.90	.95	.94	.90	1.20
	1.08	Forward	1.09	1.09	1.10	1.10	1.12	1.15	1.17	1.19

Contributors (98)	As of↑	Q1 16	Q2 16	Q3 16	Q4 16	2017	2018	2019	2020
1) Prestige Economics	12/31/15	1.11	1.13	1.16	1.20	1.30			
2) Kshitij Consultancy	12/30/15	1.15	1.19	1.16	1.17				
3) Lloyds Bank Comme	12/30/15	1.04	1.02	1.06	1.10	1.25			
4) RBC Capital Markets	12/28/15	1.03	1.00	1.00	1.02	1.06			
5) Swissquote Bank	12/24/15	1.08	1.06	1.06	1.10				
6) Hamilton Court FX LL	12/23/15	1.06	1.05	1.05	1.06	1.07			
7) Rabobank	12/23/15	1.05	1.05	1.04	1.04	1.11	1.13	1.15	
8) Alpha Bank	12/22/15	1.05	1.03	1.04	1.04				
9) CIB Bank	12/22/15	1.06	1.09	1.11	1.14	1.21	1.25		
10) Citigroup	12/22/15	1.09	1.06	1.03	1.03	1.05			
11) Day By Day	12/22/15	1.07	1.04	1.00	1.00	.97	.94	.90	
12) Danske Bank	12/22/15	1.06	1.10	1.13					
13) Handelsbanken	12/22/15	1.03	1.00	.95	.90	.95	1.00		
14) Standard Chartered	12/22/15	1.00	1.03	1.08	1.05	1.15	1.20	1.25	1.30

The average forecast for now was for EURUSD to be at 1.05-1.06. Only 2 of the 98 analysts predicted that the Euro would be at 1.15, where it is today.

So one may argue that while all fundamentals point to a weakening Euro and strengthening USD, the opposite has happened, as the Euro has risen more than 6% so far this year. Even more lopsided was the 13% rise in the Japanese Yen vs the USD.

Have Quantitative Easing and interest rate differentials been completely forgotten by the markets?

Portfolio implications could be severe if one has invested a large percentage of their assets in a currency that is not their home currency. So while the US equity market is the only major developed market that is slightly up this year, for a European investing in the US, the returns would be closer to -4%. For a Japanese investor, it would be even worse, as losses would be almost 10%.

One can argue that equities are volatile and an investor is rewarded for taking some currency risk. How about those more conservative investors that are yield-starved and were attracted to the much better yield of investment grade US corporate bonds, that were yielding about 4% at the beginning of the year? They too would have faced losses on fixed income.

Of course forex can also work in your favour if you were buying European or Japanese bonds as an American investor. The yields might be well below 1% in local currencies, but in USD the gains wold have been substantial so far this year.

So is it worth trying to time the markets and be "nimble" when it comes to buying assets in another currency? Not likely. Those that try and trade in and out of currencies to anticipate price movements almost always get burnt.

Is it worth taking the risk? After all, diversification is the cornerstone of prudent investing. We believe it is only warranted if only a small portion of one's portfolio is allocated to foreign-currency assets, thus mitigating the overall risk. Otherwise currency hedging would be your safer option.

The Elgin Analyst Team