Origin

Asset Management

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## Q4 2018

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What a difference a year makes.

This time last year I was writing about the remarkably benign and rational market environment that we had witnessed over the prior 12 months, with equity markets universally positive and Emerging Markets leading the way. Fast forward twelve months, and the market environment could not be more different, as equity markets across all regions and sectors had a very difficult fourth quarter of 2018, concluding what was, for the most part, a turbulent year.

October saw markets around the world taking a hit, a marginal consolidation in November, and then a reprisal of October in December, but on the back of rising volatility. Against this backdrop the MSCI World Index concluded the quarter down -13.3%*. Meanwhile, bucking the trend of the prior three quarters, Emerging Markets enjoyed a period of relative outperformance, although in a very different manner to the strongly positive performance delivered in 2017, down a relatively benign -7.4%* over the period. Nevertheless, this leaves Emerging markets the laggards over the year, down -14.0%* over 12 months. One dynamic that didn't change in the fourth quarter was the market's preference for larger capitalized companies, with MSCI World Small Cap delivering -16.7%* for the period.

Throughout the majority of the year we saw an increasing desynchronization between regions, and divergence of relative performance, with the US enjoying an extended period of strong equity market dominance, Emerging Markets demonstrating relative weakness, while the rest of the developed world occupied somewhere in the middle ground. To a certain extent, this divergence in macroeconomic performance could be easily explained: corporate strength in the US appeared in some respects justified, while elsewhere slightly weaker corporate results combined with rising rates combined with tensions surrounding the threat of a global trade war, drove the relative weakness in other regions.

However, it felt as though the fourth quarter saw markets catching up with the events and macroeconomic environment that had been prevalent during most of the rest of the year. Throughout the year the headlines were plagued by negativity, with the escalating tensions of a trade war between the US and the rest of the world dominating the press, with China bearing the brunt of the proposed tariffs, and Europe occasionally joining the fray. Geopolitical tensions continued throughout the year, as the war in Syria has continued unabated with the complexities of the political undercurrents suggesting a resolution any time in the near future looking unlikely. Meanwhile, the difficulties in Europe continue, as the stalemate between the UK and mainland Europe remains unresolved even now, with the spectre of an unmediated Brexit looming ever larger. Mainland Europe also has other problems to contend with, as a rising interest rate environment pushes debt-heavy economies such as Italy closer to the edge.

Of course, as you may well be aware, while these events all provide an attractive and perhaps credible explanation of market behaviour, it is all an attempt to apply a rational framework and some sort of logic to explain market behaviour ex-post. As an exercise this has marginally more efficacy than attempting to forecast market behaviour ex-ante, but only marginally. Those of you familiar with our philosophy at Origin will be aware that we do not believe it is possible to predict the future of financial markets with any consistent accuracy and attempting to explain them ex-post is virtually as limited in benefit as ex-ante. To quote the Hollywood scriptwriter, the late William Goldman: "Nobody knows anything - not one person in the entire motion picture field knows for a certainty what's going to work. Every time out it's a guess and, if you're lucky, an educated one." Goldman expressed this view in reference to the film industry, nevertheless its application is virtually universal, and we would certainly view it as eminently relevant to financial markets.

Thus, at Origin, we reject the concept of economic forecasting, instead focusing solely on examining the evidence and making "educated guesses": searching for companies that exhibit those characteristics that we believe – and which history demonstrates – are the persistent drivers of long-term relative out-performance.

These are companies that are well-managed, attractively valued on a relative basis, receiving broad based support from the analyst community and are in relative uptrend.

In 2017 the market went through a period of being extremely benign, with low volatility combined with high rationality whereby all of the characteristics that we value being rewarded by the market. 2018, and in particular the final quarter, embodied an inversion of that rationality. Against a backdrop of heightened volatility, markets were not only not rewarding those characteristics that we value, but they were actively punishing them. We have seen periods like this in the past, and they are typically short lived. While it is unusual to see consecutive periods of such strong market support either for or against those characteristics, it is not outside the realms of statistical probability. Similarly, for the strength and consistency of this support or rejection to fall so clearly within specific calendar years might be considered unusual, but not indicative of anything more profound than a statistical anomaly.

Against the backdrop of broader market irrationality and drilling down into the performance of our target characteristics, it will perhaps be unsurprising to note that none of the characteristics were supported by the market, and earnings revisions and technical were most rejected. What is interesting and somewhat unusual is that those companies which exhibited the most positive balance of characteristics performed worse than those companies that looked strongest on each individual characteristic. This is statistically unusual, and we have only seen this in two other years in our history. Inevitably this presents a short-term period of difficulty, an environment in which it will be difficult if not impossible for our strategy to outperform.

Taking a moment to examine performance through a more traditional lens it will come as no surprise that in our global portfolios the overweight position in Emerging Markets that we held coming into 2018 and throughout much of the year was a drag on relative performance, but as we entered the fourth quarter having trimmed our positions in the region the reversal did not benefit the strategies. Examining the strategies at a sector level, Health Care, Consumer Discretionary and Financials all provided the biggest drag on relative performance, marginally offset by Energy and Information Technology positions. All regions proved a drag on performance, but positions in North America weighed the heaviest.

Even when one has a clearly articulated and robust investment process as we do, this type of difficult relative performance presents a challenge. However, it is worth noting that whenever we have experienced this type of shorter-term relative performance weakness in the past against this type of factor backdrop, the ensuing longer term performance has always been extremely positive. Naturally it is always a happier proposition to write about periods of positive relative performance, and from a personal perspective we would remind you that we have our own assets invested in the strategies, but if there is a happy note to which we would draw your attention as we move into the new year it is that the current point in the relative performance cycle represents what we would view as being a particularly strong opportunity to access the Origin strategies. I very much look forward to writing about that strong performance in future notes, in the meantime thank you for your continued confidence.

Paul Broxup – Head of Investment Solutions

As at December 31, 2018, Origin managed USD 2.9bn on behalf of 34 institutional clients around the world.

Further information regarding Origin's strategies can be found at www.originam.com

Data sources: Origin, FactSet, MSCI. The benchmark is shown for comparative purposes only and it is not possible to invest directly in an index.

* USD terms

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