# INTEREST

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## For a few dollars more

**“From now on, depressions will be scientifically created”**

**Congressman Charles A. Lindbergh Sr.**

**The Fed’s blown it** – since its May meeting the US Federal Reserve has gone public in preparing the financial markets for a reduction in the $85bn bond buying per month of monetary stimulus it has been engaged in via its treasury operations.

The fear in the markets was that this reduction, in a process known as “tapering”, would halt the money going into bond and equity markets over the last 12 months as financial markets adjusted to a world of slowly rising interest rates. But the Fed had other ideas.

In its meeting September 18 it decided to continue with the same amount ($85bn) of bond buying as before until the US economy showed signs of more lasting improvement and unemployment had dropped to 6.5% (current 7.7%).

The Fed is probably also concerned, perhaps justifiably, that the bickering among US politicians on Capitol Hill over the US budget may slow the economy in the fourth quarter of the year.

The conclusion will be drawn that the Americans are determined to have the economic recovery embedded more deeply before taking risks with it. As a result economists will almost certainly move to adjust their growth forecasts for 2014 and revise down their outlook for the US dollar.



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Hume Capital

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# Fund Reporting

**"An ounce of performance is worth pounds of promises"**

**Mae West**

**When Hume took stewardship** of their Funds each reported a benchmark based on indices. As with other funds these served as a comparison point for investors. Broadly, funds use two types of benchmarks; peer group benchmarks and index benchmarks. For instance a European equity fund might use the Lipper / Investment Management Association (IMA) average fund return or the FTSE Europe / MSCI Europe index.

Using indices has recently become very expensive. Hume has reported the index benchmarks which are obtained via third party services such as Lipper and Bloomberg. Recently FTSE have been advising managers that to use their indices will incur a notable additional fee. We do not feel that the cost is justifiable to investors. We recognise that alongside the performance aims set for each fund, investors require a comparator with what the market achieved or other similar funds returned. For now we have removed indices from our reports but plan to identify the appropriate IMA sector and use its return in their place.

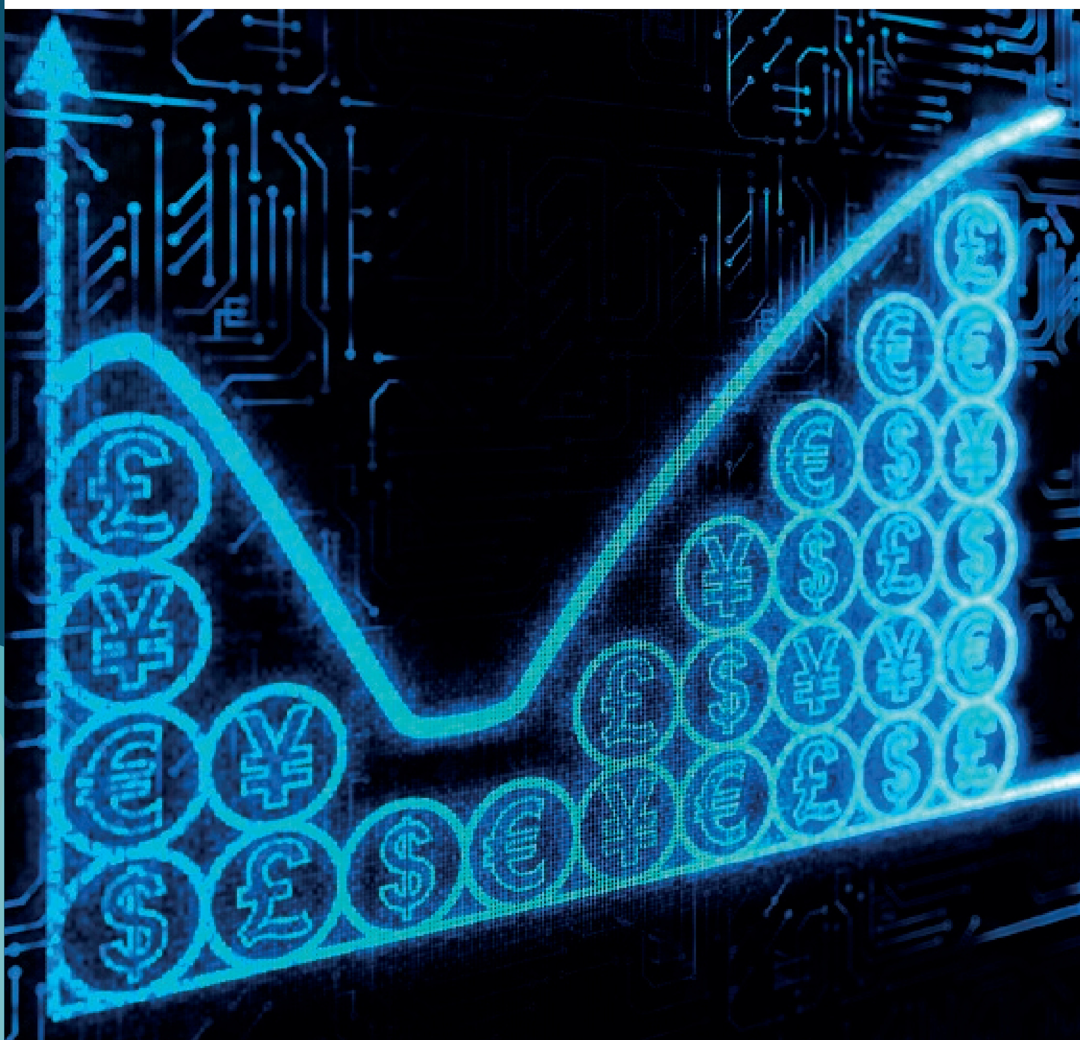
# China's Conversion

**"The best way to destroy the capitalist system is to debauch the currency"**

**Lenin**

**Are the Chinese about to convert?**
2013 has seen a big depreciation of the Japanese yen which ended the summer touching JPY100 to the US$ and down 20% since November 2012. This has had an impact across Asia as the US currency has been pulled higher against most other Asian currencies and ASEAN and Indian countries being forced to engage in a round of interest rate rises ultimately to protect their currencies amidst capital flight.

These moves themselves would be noteworthy enough but they are being joined by increasing speculation that even the mighty Chinese polity would look to adjust its long standing Yuan peg to the US dollar and make the currency at least partly convertible. The establishment of a new Shanghai Free Trade zone this September is the latest move which has furthered speculation about currency convertibility. Such a move would have potentially major implications with Chinese companies and households able to invest more freely outside China. Knock-on effects across the globe may also impact European currencies, with sterling and euro's strength against Asian currencies unhelpful for Europe's efforts to restore its own competitiveness. For the US, with its rapidly improving competitive position courtesy of low comparative energy costs, the impact will not be as harsh but it will be important to watch these moves carefully in coming months nevertheless.

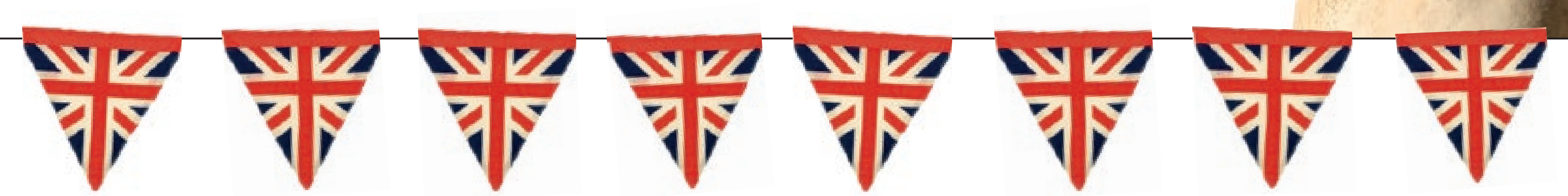


# Italian Reform

> **"Reform is not pleasant, but grievous; no person can reform themselves without suffering and hard work, how much less a nation"**
>
> **Thomas Carlyle**

**The Italian Job – is Italian economic reform about to get serious?**
In Troy Martin's 1969 caper, the gang is left hanging for dear life on the edge of an Alpine ravine with the sound of Quincy Jones's Self Preservation Society ringing in their ears. Many would argue the scene sums up today's modern Italy, but a recent visit by the Hume team to see a number of quoted Italian companies is more reassuring. Amongst the companies we saw were eyeware company Luxottica, fund manager Banca Generali and utility company Sias, which runs the northern Italian motorway toll roads.

Italian companies have franchises to rival many European, and even global competitors. While the task ahead for new Prime Minister Enrico Letta is a huge one, recent local elections have pushed back the possibility of a serious challenge to his government from Pepe Grillo's Five Star alliance or Berlusconi's Freedom Party. British, German and Swiss markets have hit a succession of highs in 2013, but the Italian stock market is down at mid-1990's levels and is attractively valued trading below book value and a dividend yield of 3.5%. Companies like Chrysler, Ferrari, Ferrogama, Prada, and Case New Holland are all Italian owned and many are quoted, allowing investors access to some very attractive names.



# Good News Britain

> **"It is well enough that people of the nation do not understand our banking and money system, for if they did, I believe there would be a revolution before tomorrow morning"**
>
> **Henry Ford**

**Lehmans 5 years on – the rise of new entrants.**
Superficially it is remarkable how little has changed since the downfall of Lehmans brought the banking system to the edge of collapse and making banking a dirty word in the English vocabulary. Big banks remain structured as they were before and houses like HSBC, JP Morgan and UBS continue to commit to investment banking as fierce competition for dealflow from Asian peers leaves them forced to deploy capital to compete.

Scratch beneath the surface though and changes are afoot. In much of the US and the UK there is little market for traditional loans, particularly for smaller companies that make up the backbone of their respective economies. The banks have withdrawn, preferring to rely on the addictive round trip of the yield curve, and eschewing traditional lending. This caution is spawning a boom in alternative lending as private equity, mezzanine finance and start-ups like Wonga.com seize the moment, a growth we expect to continue as banking fundamentally changes on both sides of the Atlantic.

**+ Car sales were up 10.9% in August 2013 compared to August 2012.**
Source: The Society of Motor Manufacturers and Trades (SMMT).

**+ UK manufacturing recorded its strongest quarterly performance for two and a half years.**
Source: Markit/CIPS Purchasing Managers.

**+ Mortgage approvals in August were at a five year high.**
Source: Bank of England.

## Hume Guernsey Funds

The key objectives we aimed for when Hume took over the Zenith International Funds have largely been met. All the funds are now under a single umbrella; Hume Global Investors. As a result the funds are expected to see the benefits of reduced costs feeding through over time.

The Zenith name is no longer used. Hume now has a focused range of funds at different points of the risk spectrum. For advisers this provides a number of ways to use the funds, including using the full range as part of a wealth management solution for clients or to complement a portfolio including other funds or investments. To find out more visit humefunds.com

Hume Global Investors

# Telecoms Frenzy

**"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change"**

**Charles Darwin**

**The European telecoms sector is set alight by merger activity.**

We have invested heavily in the telecoms sector during 2013 and the third quarter has seen this strategy pay off handsomely with Spanish telecoms giant Telefonica offering €8.1bn for E Plus, KPN's German business, and prompting KPN's largest shareholder Carlos Slim's América Móvil to make a bid for the whole group. This, along with confirmation of Vodafone's €7.7bn bid for German cable operator Kabel Deutschland, is kicking off the long awaited consolidation in the European telecoms industry.

The offer by leading US telecoms operator Verizon to buy back the 45% of its mobile division Verizon Wireless from Vodafone has added fuel to the fire, with the prospect of US$130bn coming back into the sector either via returns to shareholders or investment in other companies. It also demonstrates how European companies like Telefonica and Vodafone are looking at more ways of integrating their offerings and taking advantage of the move to 4G services where content will be more and more important. We remain significantly invested in media for this reason in addition to our overweight position in telecoms.

# New Fund Launch

Hume Capital was founded on the principles of accurately understanding company valuations and extracting value by trading relative valuation differences of similar businesses. The aim is to isolate market risk (Beta) and produce positive absolute returns (Alpha).

Quantitative easing has provided a safety net for the financial markets. Going forward, as the liquidity taps turn off, it is going to be difficult to see which asset classes will be able to maintain momentum. Will those liquidity injections ultimately find their way through to company earnings and sustain the equity market rally? Will the bond markets, so long supported with buybacks avoid significant capital losses from lesser support, new issuance and inevitable rate rises?

At this difficult time in the investment cycle Hume is to re-launch its Absolute Return Fund to offer a useful alternative to investors. Unfortunately many absolute return or market neutral fund investors have suffered badly in volatile markets. Excuses are given, crowded trades, portfolio commonality, liquidity withdrawal and redemptions to name a few.

We believe that our approach of analysing and factoring in the leverage of company balance sheets identifies more meaningful valuation discounts and far more robust hedging ratios.

We also believe analysis indicates how the more mainstream conventional valuation techniques, using measures such as Price to Book and Net Asset Value, generate a bias to owning more leveraged companies. These tend to be under hedged fundamentally thereby concealing a long portfolio exposure that will suffer more than expected in market drawdowns and confuse where returns are actually being generated, something the new fund particularly seeks to avoid.

The new fund will be lunch in the first quarter of 2014 and can be held in an ISA. Advisers – to find out more about the launch of this product contact adviser@humecapital.co.uk