Friday Night ´Lights

12th January 2018

For Professional Investors and Institutional Clients only

Is 2018 likely to be a *Dinomite* year or one that leaves us as *Nervous Rex*?

2018 marks not only the 50th anniversary of the death of Martin Luther King but also the Centenary of the end of the First World War – the causes of which are well ingrained in this writer's memory thanks to a particularly strict A-Level history teacher. Moreover, there are yet more important milestones coming this year; it is 100 years since women first received the right to vote in the UK, 100 years since the Spanish Flu Outbreak, 150 years since the Meiji Restoration in Japan and 250 years since Captain Cook set sail on the HMS Endeavour. Perhaps most importantly however, these are all rather serious topics, so the 2018 Fortem Outlook is going to ignore those and simply make reference to the 25th anniversary of our favourite dinosaur film. I know, I know, but… *Jurassic times call for Jurassic measures*.

So baring historic commemorations, what does 2018 hold? Well, in an economic sense, there is a fairly wide consensus among the various research outlooks for 2018 that the global economy should continue to grow fairly aggressively this year. Despite higher growth and a broadening expansion, there are expectations that global inflation should remain fairly steady and the recommendations mostly lean towards Asia (especially Japan) and Emerging markets for equity upside in 2018. The outlook for more traditional developed equity markets has been more of a "*Bone*" of contention – some research teams are suggesting reducing exposure to the UK and remaining roughly neutral on Europe, with views on the US being the most disparate. Some desks see a correction for North American stocks, while others think that Trump's tax reform and top line growth could see the S&P continue to "*Saur*" higher. One thing that the majority of research departments do seem to agree on is that "*Tail*" risk for equities and other risk assets will increase into 2018.

Here's hoping there are no big surprises in 2018…

With the above in mind then, what might be of interest in our space? In Q4 we saw increasing demand for Autocalls that do not feature the FTSE, launching two products as can be seen in the table on page 2. This trade, with the slightly more bearish outlook for the UK in 2018 looks to satisfy at least some diversification criteria. To allocate towards Japan or Emerging Markets would provide further diversity, though with knock-out runs in 2017, the consensus is seemingly that these markets are unlikely to double in value, even if there is still potentially plenty of upside remaining. The following product on EM is a structure seen before by our client base, and works nicely in granting a degree of security on the downside, while providing leveraged participation on any modest returns in the future. Indicative terms as follows:

- 6yr Tenor issued with 'A' rated Issuer (Fitch)
- USD
- ISHARES MSCI Emerging Market ETF
- ~200% participation in any performance from 100% - 140% of strike
- 60% EKIP (capital is at risk only if the underlying falls by more than 40%, observed at maturity)

For the same structure on Japan, terms can be enhanced by using a daily-hedging mechanism on the currency to remove some of the large…

Markets this week:

Rates (bps)	Current	Change*
GBP 1yr	68.4	3.4
GBP 3yr	96.8	7.4
GBP 5yr	113.8	9.0

Equity Indices (%)	Current	Change*
FTSE 100	7,762.94	0.87%
S&P 500	2,762.48	1.41%
Nikkei 225	23,710.43	0.87%
Eurostoxx 50	3,595.24	0.74%

5yr Credit Spreads (bps)	Current	Change*
Citigroup	40.11	1.14
Credit Suisse	48.65	2.38
Deutsche	69.77	3.01
GS	51.95	1.37
HSBC	20.09	0.89
JPM	38.12	0.59
MS	49.30	0.78
Sant UK	42.67	0.58
Soc Gen	24.67	2.72

Commodities & Currencies (%)	Current	Change*
Gold	1,322.17	-0.06%
Oil (CLA)	64.53	4.06%
GBPUSD	1.3544	-0.05%
GBPEUR	1.1249	0.17%
GBPJPY	150.77	-1.32%

5yr Implied (vol pts)	Current	Change*
FTSE 100	16.09%	-0.07%
S&P 500	18.64%	0.06%
Nikkei 225	18.40%	-0.05%
Eurostoxx 50	17.35%	0.04%

**Source Fortem / Partner Banks*
Weekly changes for Data as at *11th January 18:00*

Contact

General Enquiries T 020 8050 2900 E enquiries@fortemcapital.com
Trading T 020 8050 2901 E trading@fortemcapital.com
Advisory & Analytics T 020 8050 2904 E analytics@fortemcapital.com
Sales T 020 8050 2905 E sales@fortemcapital.com

"We must all suffer one of two things: the pain of discipline or the pain of regret or disappointment"
– Jim Rohn

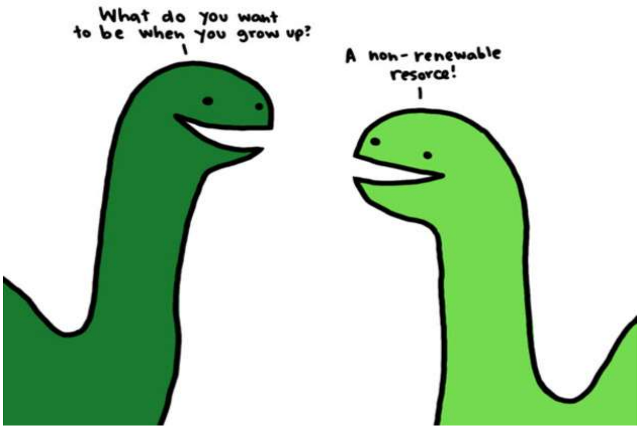
implicit costs in providing a perfect hedge, while still providing a more efficient hedge than the majority of funds in the space operate. We produced the annual performance report for a product traded at the end of 2016. Please click here for further details or speak to us about the launch of a new product.

Moving away from equities, what else is on the horizon? Well, in previous cycles, protection from equity corrections was found in the bond world, however research is suggesting more and more that this may not be the case this time around with correlations between bonds and equities at an all time high with seemingly little upside remaining in the credit space in the next 18 months. Most desks are increasingly concerned over the heavily leveraged balance sheets in the US small-mid cap space and as such remain bearish on US HY vs IG. The most bearish amongst the research teams point to the high levels of company debt and rising rates in 2018 as one of the central reasons for any corrections. For those concerned about a weaker fixed income market in 2018, there are means to address this in our world, either through direct hedging (please speak to us for more on this) or more indirectly, via the fund world. Indeed, the larger investment banks are able to write options on the total return profiles of mutual funds. Due to bond funds having particularly low volatility, this means banks can offer structures with 100% capital protection and also grant an investor leveraged upside to mitigate the perceived weak returns. For clients that likely will still have large weightings to fixed income and who do not wish to spend excess premium on hedging, but are still concerned about short term corrections to their bond holdings, the capital protection makes sense, especially when combined with the leveraged upside. For clients concerned about locking in allocations to a specific fund, actively managed notes can be produced to allow for flexibility of movement between holdings. As a starting point for a product, please see below:

- 6yr Tenor issued with 'A' rated Issuer (Fitch)
- GBP
- Equally weighted basket of 3 well known Fixed Income Funds* (performance of ~4.40% p.a. over the last 5 years)
- ~150% participation in any upside
- 100% capital protected

*Funds used for pricing as at 29/11/2017 with performance figures from September 2012: Pimco GIS-Income Fund, Jupiter JGF – Dynamic, Candrian Bonds – CR Opps

Away from traditional bond and equity markets, Commodities may well be a nice means to diversify in 2018, with most outlooks being moderately bullish for next year. Though prices are up from the 2015 lows, they are well off the highs of 2008 and 2011 and correlation to equities is also lower. It is well noted that gold and oil are purposefully separated from traditional commodities as they have been increasingly linked to equity market shocks and geopolitical tensions respectively. Perhaps then, we should look to benefit from our dinosaur friends?



Well, for those clients looking to continue the capital protected theme and diversify away from traditional asset classes, there are options in this space. One example is a product linked to the performance of oil, that does not suffer the bleed that ETF trackers are prone to:

- 6yr Tenor issued with 'A' rated Issuer (Fitch)
- USD
- WTI Underlying
- ~200% participation in any upside (with final year averaging)
- 100% capital protected

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Or, for a product with less of an asset allocation call, a quirkier absolute return like option might be something similar to a product launched back in August. This product tracks a systematic strategy with a 5yr live track record and historical returns of ~3.65% p.a. (from November 2012 to time of writing). It aims to generate returns by taking advantage of the buying and selling pressures caused by money tracking benchmark commodity indices. It is low volatility, with minimal correlation to both bond and equity markets and is importantly not a directional play on commodities. The note was 100% capital protected with 150% leverage and is performing well. Since launch, at the time of writing the strategy has returned ~1.75% (~4.20% annualised), which including the leverage, would have an intrinsic value of 6.30% for the year. We are launching a different capital protected note with similar characteristics in the new year, i.e. leveraged participation on a strategy with an impressive track record of consistent returns with low correlations to equities and bonds. Hopefully it will prove of interest.

The commodities strategy above is something we recently placed into our fund as part of the diversifiers element. This has helped us to maintain target returns of 6-7% per annum (over the medium to longer term) whilst keeping beta to equity markets at ~50%, and remaining 100% gilt backed. We are likely to be fully invested by month end, and given credit spreads and current market outlooks, do think the fund is worthy of consideration for anyone investing in the defined return space.

Finally, please see below for our most recent launches, including the two Non–FTSE Autocalls:

Description	Barriers	Sedol	Offer Price
Morgan Stanley 7yr FTSE only Autocall EIS – 6.90%	100/100/95/90/85/80/75 60% KI	BZVQY65	102.06%
CIBC 6yr WO S&P/Eurostoxx Auotcall EIS – 5.95%	100/100/90/80/70/60 55% KI	BFB3VQ5	101.16%
Morgan Stanley 6yr WO FTSE/Eurostoxx Autocall EIS – 8.88%	100/95/90/85/80/75 60% KI	BZVQY43	103.09%
Santander UK 6yr WO S&P/Eurostoxx Autocall EIS - 7.80%	100/95/90/85/80/75 65% KI	BD1QTX3	101.09%
Soc Gen 6yr WO FTSE/Eurostoxx Autocall EIS - 8.82%	100/95/90/85/80/75 60% KI	BF6XDV9	102.55%
Citigroup 6yr WO FTSE/Eurostoxx Autocall EIS 8.10%	100/95/90/85/80/65 65% KI	BD97CH3	102.81%

All that's left is to wish our readers a prosperous 2018 and we look forward to working with you in the coming months!

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